Consolidated Financial Statements
2017

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Highlights

BBB+
with a stable outlook

Credit rating
S&P Global Ratings upgraded Landsbankinn's credit rating to BBB+/A-2 with a stable outlook.

Good governance
Landsbankinn was recognised as a model of good corporate governance in 2015, 2016 and 2017.

Nordic Financial CERT

Robust cyber security
Landsbankinn is a member of this Nordic collaboration to boost cyber security.

PRI
Landsbankinn is a member of the United Nation's Principles for Responsible Investment (UNPRI).

PwC's Equal Pay Audit
Landsbankinn was awarded the golden seal of PwC's Equal Pay Audit for the second time in 2017.

Profit

2016	2017
16,643	19,766

Return on equity

2016	2017
6.6%	8.2%

Total capital ratio

2016	2017
30.2%	26.7%

Total liquidity coverage ratio (LCR)

2016	2017
128%	157%

Total assets

2016	2017
1,111,157	1,192,870

Loans and advances to customers

2016	2017
853,417	925,636

Total operating income

2016	2017
48,700	53,512

Cost-income ratio

2016	2017
48.4%	46.1%

All amounts are in ISK million

Report of the Board of Directors and the CEO

Landsbankinn is a leading provider of financial services in Iceland, offering a comprehensive range of financial products and services to individuals, corporates and institutional customers. The Consolidated Financial Statements of Landsbankinn hf. (the “Bank” or “Landsbankinn”) for the financial year 2017 include the Bank and its subsidiaries (collectively referred to as the “Group”).

Operations in 2017

Consolidated profit amounted to ISK 19,766 million for the financial year 2017. The Board of Directors proposes that a dividend of ISK 0.65 per outstanding share, total amount of ISK 15,366 million, be paid before the end of March 2018. Consolidated total equity amounted to ISK 246,057 million and total assets to ISK 1,192,870 million at year-end. The total capital ratio of the Group, calculated according to the Act on Financial Undertakings, was 26.7% at year-end 2017 as compared with 30.2% at year-end 2016 (see Note 47).

Consolidated profit increased from ISK 16,643 million in 2016 to ISK 19,766 million in 2017, a year-on-year increase of ISK 3,123 million. The Bank’s core operations are returning improved revenues and costs remain stable. Net interest income increased by ISK 1,621 million and net fee and commission income rose by ISK 622 million. The average number of full-time equivalent positions during the year 2017 was 1,034, as compared with 1,047 during 2016.

In 2017, the Bank completed refinancing the remaining senior secured bonds issued to LBI ehf. In addition, in the fourth quarter of 2017, the Bank partially refinanced the 2018 maturity of the EUR-denominated senior unsecured bond series with the issuance of new senior unsecured bonds in euros. The Bank’s successful issues of senior unsecured bonds in foreign currencies during the past few years have enabled the Bank to refinance previous issues of bonds on more favourable and longer terms and strengthen the Bank’s liquidity.

The senior unsecured bonds in foreign currencies issued by the Bank to date are all issued under the Bank’s 2,000 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange (see Note 31).

In 2017, the Bank continued to issue indexed and non-indexed ISK covered bond series under the Bank’s ISK 120,000 million Covered Bond Programme and new bank bill series under the Bank’s ISK 50,000 million Debt Issuance Programme. The total year-on-year increase amounts to ISK 27,546 million.

In 2017, the international rating agency S&P Global Ratings upgraded Landsbankinn’s credit rating to BBB+/A-2 with a stable outlook from BBB/A-2 with a positive outlook. The stable outlook reflects S&P’s expectation that domestic economic developments will continue to remain supportive and that Landsbankinn will maintain very strong risk-adjusted capitalisation.

Risk factors

Despite a considerable increase in new lending in 2017, the Bank's credit risk remained fairly stable. Loss given default (LGD) decreased in 2017, inter alia, as a result of rising real estate prices, and probability of default (PD) continued to decrease slightly. Expected credit loss (ECL) has thus declined in 2017 and remains well within the Bank's risk appetite. Despite dwindling credit risk, the growth in new lending resulted in an increased EC for credit risk in 2017.

The Bank's liquidity position was robust in 2017 and the aggregate LCR was 157% at year-end. The Bank continues to seek to diversify its funding, especially in foreign currency, with the issuance of unsecured bonds in euros as well as Swedish and Norwegian krona. FX borrowing in 2017 was on much more favourable terms and longer-term with high demand from a diverse group of investors demonstrating confidence in the Bank. The Bank issued covered bonds and bills in ISK in accordance with its 2017 funding plan.

Market risk remains low and well within the Bank's risk appetite despite a difficult year in the domestic security and FX markets.

Information about the Group's governance as regards risk management and the Bank's risk profile is included in those notes to the Consolidated Financial Statements that discuss risk governance, and in the Bank's Risk and Capital Management – Pillar III Risk Report.

Outlook

Landsbankinn Economic Research forecasts 4.5% economic growth in 2018, 3.6% growth in 2019 and 2.5% in 2020 - an average economic growth of 3.5% for the forecast period. The Central Bank of Iceland forecasts 3.2% growth in 2018 and an average economic growth of 3.0% for the period 2018 to 2020. Investment and private consumption are expected to be the main drivers of economic growth in coming years. The inflation outlook is fairly stable up to the forecast horizon in 2020, with average inflation expected to hold at the Central Bank’s target in 2018, i.e. at 2.5%, and then to increase slightly in coming years to average 2.9% in 2019 and 2020.

Other matters

In accordance with a resolution passed at the Bank's Annual General Meeting on 22 March 2017, the Bank paid dividends and extraordinary dividend to its shareholders for the operating year 2016 on 29 March 2017 and 20 September 2017, respectively. The dividend payments amounted in total to ISK 13,002 million, equivalent to ISK 0.55 per share, and the extraordinary dividend amounted in total to ISK 11,820 million on outstanding shares, or ISK 0.50 per share. Total dividend payments in 2017 for the operating year 2016 amounted to ISK 24,822 million.

In November 2017, the Icelandic Banks' Data Centre (RB) and Landsbankinn deployed a new core system for payments and deposits. The new system replaces many older systems operated by RB and the implementation process has brought on some challenges which the Bank and RB are working to resolve. Implementation of the new system has been a three-year process and has been the most extensive software project undertaken by the Bank to date.

Around year-end 2017, the private limited company JCC ehf. was established around the joint bank-cash centre operated by the Bank, Arion Bank hf. and Íslandsbanki hf. The company operates as a separate legal entity and is managerially and operationally independent from its owners.

Ownership

Shareholders at year-end 2017 numbered 931, down from 1,003 at the beginning of 2017. The ten largest shareholders in the Bank at year-end 2017 were as follows:

Shareholders		Number of shares (in ISK million)	%
Ríkissjóður Íslands	Icelandic State Treasury	23,567.0	98.20%
Tryggingasjóður sparisjóðanna	Insurance fund	10.0	0.04%
Lífeyrissjóður Vestmannaeyja	Pension fund	5.0	0.02%
Vestmannaeyjabær	Local municipality	3.5	0.01%
Vinnslustöðin hf.	Corporate	1.8	0.01%
Helgi T. Helgason	Individual	0.5	0.00%
Hreiðar Bjarnason	Individual	0.5	0.00%
Árni Þ. Þorbjörnsson	Individual	0.5	0.00%
Hrefna Ösp Sigfinnsdóttir	Individual	0.4	0.00%
Steinþór Pálsson	Individual	0.3	0.00%
Top 10 total		**23,589.6**	**98.29%**
Other shareholders		49.9	0.21%
Total shares outstanding		**23,639.5**	**98.50%**
Landsbankinn hf.	Own shares	360.5	1.50%
Total shares issued		**24,000.0**	**100.00%**

Icelandic State Financial Investments (ISFI) manages the State's holding in the Bank on behalf of Ríkissjóður Íslands (the Icelandic State Treasury).

On 24 February 2017, the third repurchase period of the Bank's buy-back programme of own shares expired. During this period, Landsbankinn purchased a total of 8.5 million of own shares at a share price of 10.6226, for the total amount of ISK 90.4 million. Landsbankinn has acquired a total of 142 million of own shares under the buy-back programme, or the equivalent of 0.6% of issued shares in the Bank, for a purchase price of ISK 1,482 million. At the conclusion of the third repurchase period, the Bank holds 360.5 million of own shares, or the equivalent of 1.5% of issued share capital in the Bank.

Governance

Landsbankinn is committed to good corporate governance in accordance with the recommendations of the most recent Corporate Governance Guidelines issued in June 2015 (5th edition) by the Iceland Chamber of Commerce, NASDAQ Iceland and the Confederation of Icelandic Employers. Further details on the Bank's corporate governance in general are provided in the Annual Report of the Group for the year 2017 and on the Bank's website, www.landsbankinn.is. Each year, Landsbankinn reviews compliance with the Guidelines and whether the Bank's governance accords with the Guidelines.

Corporate Social Responsibility

Corporate Social Responsibility (CSR) in promoting economic growth, social well-being and protection of the environment is an integral part of the overall strategy of Landsbankinn. CSR underwrites sustainability through competitiveness, the productive use of resources and good governance, having regard for human rights, anti-fraud and anti-corruption measures. Every year, Landsbankinn publishes a CSR report, disclosing the Bank's progress in terms of social responsibility and social performance indicators. The report is accessible in Icelandic on the Bank's website, www.landsbankinn.is.

Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of Landsbankinn hf. for the year ended 31 December 2017 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union and applicable Icelandic laws and regulations.

In our opinion, the Consolidated Financial Statements of Landsbankinn hf. give a true and fair view of the consolidated financial performance of the Group for the year 2017, its consolidated financial position as at 31 December 2017 and its consolidated cash flows for the year 2017.

Furthermore, in our opinion, the Consolidated Financial Statements of Landsbankinn hf. describe the principal risks and uncertainties faced by the Group.

The Board of Directors of the Bank and Chief Executive Officer hereby endorse the Consolidated Financial Statements of Landsbankinn hf. for the year 2017. The Board of Directors and the CEO recommend that the Consolidated Financial Statements of Landsbankinn hf. for the year 2017 be approved at the Annual General Meeting of Landsbankinn hf.

Reykjavík, 15 February 2018.

Board of Directors

Helga Björk Eiríksdóttir
Chairman

Berglind Svavarsdóttir

Hersir Sigurgeirsson

Jón Guðmann Pétursson

Magnús Pétursson

Samúel Guðmundsson

Sigríður Benediktsdóttir

CEO

Lilja Björk Einarsdóttir

Independent Auditor's Report

To the Board of Directors and Shareholders of Landsbankinn hf.

Opinion

We have audited the accompanying Consolidated Financial Statements of Landsbankinn hf. (hereafter the Group) for the year 2017. The Consolidated Financial Statements comprise the Statement by the Board of Directors and CEO, the Statement of Income, the Statement of Financial Position, the Statement of Cash Flows, the Changes in Equity, a summary of significant accounting policies and other explanatory information.

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the consolidated results of operations of Landsbankinn hf. for the year 2017, its consolidated financial position as at December 31, 2017, and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU and and applicable Icelandic laws and regulations.

In accordance with the provisions of Article 104, paragraph 2 of the Icelandic Financial Statements Act No. 3/2006, we confirm that the Statement by the Board of Directors and CEO accompanying the Consolidated Financial Statements includes at least the information required by the Financial Statements Act if not disclosed elsewhere in the Consolidated Financial Statements.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our Report. We are independent of the Group in accordance with the Code of Ethics for Professional Accountants in Iceland, and we have fulfilled all ethical requirements therein. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Consolidated Financial Statements for the year 2017. These matters were addressed in the context of our audit of the Consolidated Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In our opinion the following matters were key audit matters:

a) Credit risk, impairment of loans and advances to customers:
We refer to the discussion on page 2 (Report of the Board of Directors and CEO), notes 92.6 (e) on page 73 and note 92.6 (g) on page 74 (Significant accounting policies), note 3 (a) on page 14 and note 3 (e) on page 15 (Critical accounting estimates and judgements and notes 54 to 74 on page 46 to 59 (Credit risk).

We have defined impairment of loans and advances to customers as a key audit matter as the assumptions used in the impairment process are subjective and based on the Group´s management´s judgement. As loans and advances to customers are significant in the Consolidated Financial Statements, any change in criteria may have a significant impact on the Group´s results of operations and financial position. Our work covered the impairment of both loans and advances to customers and loans to corporations and institutions.

As part of the audit, we performed tests of key controls related to the impairment of the loan portfolio. The focus of these procedures included the analysis of loss events and assumptions used in the valuation. We examined information in the systems and models used by the Group to estimate impairment. We also assessed the manner in which management evaluated the results of the valuation and responded to deviations if they occurred.

We also performed substantive procedures on loan impairment, including assessing the Group's impairment methodology and whether the methodology is in compliance with International Financial Reporting Standards. We also chose a risk-based sample based on loan and customers' characteristics. Loans with a higher probability of default and loan loss, and that are more likely to go undetected by the Group were examined specifically. Underlying loan agreements were examined, underlying collateral verified and management´s assumptions were assessed.

b) Valuation of level 3 financial assets:
We refer to note 92.6 (f) on page 73 to 74 (Significant accounting policies), note 3 (b) on page 15 (Critical accounting estimates and judgements) and note 17 on page 25 (Fair value hierarchy).

Level 3 financial assets are assets that are measured at fair value using valuation techniques based on significant unobservable inputs. The valuation of level 3 financial assets is a subjective area as the assumptions on which the valuation is based on are not easily observable and subject to management's assessment to a great extent. Any changes made to the evaluation criteria could have a significant impact on the Group's results of operations and financial position.

In our audit, we examined the Group's valuation methodology and its compliance with International Financial Reporting Standards. We examined the Group's process in analysing and evaluating the assumptions used in the valuation process and examined the valuation models used. We selected a sample of financial assets for examination, focusing on the largest and most risk-bearing assets.

Key Audit Matters (continued)

c) Deployment of a new core banking system for deposits and payments:
We refer to the discussion in the Report of the Board of Directors and CEO on page 3

The Bank has implemented and started to use a new core banking system for deposits and payment services late in the year 2017. Due to how extensive the new system is and the large amount of daily transactions, there is a greater risk of errors in the financial statements at the time of the implementation.

As part of our audit, we examined the Bank's implementation process and the transfer of data from the old system into the new. In this examination, we were assisted by the audit team's IT specialist. We performed tests on key controls that relate to completeness of deposits and reviewed reconciliations of the key accounts of system generated.

We also performed substantive procedures to confirm deposits from customers. Among the procedures we performed were to recalculate the interests of a selected sample of deposit accounts existing at the end of the year. We also sent negative confirmation letters to a selected sample of the Bank's customers. For certain types of deposits from customers' positive confirmation letters were sent.

Other Information

The Board of Directors and the CEO are responsible for all information presented by the Group, both the Consolidated Financial Statements as well as other information. The other information comprises the information included in the Annual Report, but does not include the Consolidated Financial Statements and our Auditor's Report thereon. Our opinion on the Consolidated Financial Statements does not cover the information in the Annual Report or other documents issued by the Group, and we do not express any form of assurance on the information in those documents thereon. In connection with our audit of the Consolidated Financial Statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the Consolidated Financial Statements, our knowledge obtained in the audit, or otherwise appears to be materially misstated.

The Board of Directors and CEO's Responsibility for the Consolidated Financial Statements

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

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

The Board of Directors and the Audit Committee are responsible for overseeing the Group's financial reporting process.

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

Our objectives are to obtain reasonable assurance about whether the Consolidated Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Consolidated Financial Statements.

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

- Identify and assess the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group´s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exist related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our Auditor's Report to the related disclosures in the Consolidated Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Auditor's Report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the Consolidated Financial Statements, including the disclosures, and whether the Consolidated Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the Consolidated Financial Statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

Auditor's Responsibility for the Audit of the Consolidated Financial Statements (continued)

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

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

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

For and on behalf of Grant Thornton endurskoðun ehf.
Reykjavík, 15 February 2018

Davíð Arnar Einarsson
State Authorized Public Accountant

J. Sturla Jónsson
State Authorized Public Accountant

Consolidated Income Statement for the Year ended 31 December 2017

Notes		2017	2016
	Interest income	62,556	64,612
	Interest expense	(26,285)	(29,962)
5	**Net interest income**	**36,271**	**34,650**
6	Net valuation adjustments and credit impairment charges	1,785	(318)
	Net interest income after net valuation adjustments and credit impairment charges	**38,056**	**34,332**
	Fee and commission income	11,289	10,290
	Fee and commission expense	(2,858)	(2,481)
7	**Net fee and commission income**	**8,431**	**7,809**
8	Net gain (loss) on financial assets and liabilities	5,802	1,755
9	Net foreign exchange (loss) gain	(1,375)	(179)
10	Other income and (expenses)	2,598	4,983
	Other net operating income	**7,025**	**6,559**
	Total operating income	**53,512**	**48,700**
11	Salaries and related expenses	14,061	14,049
12	Other operating expenses	9,789	9,465
	Total operating expenses	**23,850**	**23,514**
	Profit before tax	**29,662**	**25,186**
13	Income tax	(6,643)	(5,570)
14	Tax on liabilities of financial institutions	(3,253)	(2,973)
	Profit for the year	**19,766**	**16,643**
	Profit for the year attributable to:		
	Owners of the Bank	19,766	16,633
	Non-controlling interests	0	10
	Profit for the year	**19,766**	**16,643**
	Earnings per share:		
36	Basic and diluted earnings per share from operations (ISK)	**0.84**	**0.70**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Financial Position as at 31 December 2017

Notes		2017	2016
	Assets		
18, 79	Cash and balances with Central Bank	55,192	30,662
15, 19, 79	Bonds and debt instruments	117,310	154,892
20	Equities and equity instruments	27,980	26,688
15, 21	Derivative instruments	1,905	278
22, 79	Loans and advances to financial institutions	44,866	20,408
23, 79	Loans and advances to customers	925,636	853,417
24	Investments in equity-accounted associates	1,086	1,184
25	Property and equipment	5,238	5,452
26	Intangible assets	3,044	2,634
27	Other assets	6,965	8,093
28	Assets classified as held for sale	3,648	7,449
	Total assets	**1,192,870**	**1,111,157**
	Liabilities		
29	Due to financial institutions and Central Bank	32,062	20,093
30	Deposits from customers	605,158	589,725
21	Derivative instruments and short positions	1,258	1,729
31, 79	Borrowings	281,874	223,944
32	Deferred tax liabilities	40	85
33	Other liabilities	26,317	22,867
28	Liabilities associated with assets classified as held for sale	27	1,095
34	Subordinated liabilities	77	388
	Total liabilities	**946,813**	**859,926**
35	**Equity**		
	Share capital	23,640	23,648
	Share premium	120,764	120,847
	Reserves	12,902	10,875
	Retained earnings	88,751	95,834
	Total equity attributable to owners of the Bank	**246,057**	**251,204**
	Non-controlling interests	0	27
	Total equity	**246,057**	**251,231**
	Total liabilities and equity	**1,192,870**	**1,111,157**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Changes in Equity for the Year ended 31 December 2017

Notes										
		Attributable to owners of the Bank								
				Reserves						
	Change in equity for the year 2017	**Share capital**	**Share premium**	**Statutory reserve**	**Unrealized gains in subsidiaries and equity-accounted associates reserve**	**Financial assets designated at fair value through profit or loss reserve**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total**
	Balance as at 1 January 2017	23,648	120,847	6,000	4,583	292	95,834	251,204	27	251,231
	Profit for the year						19,766	19,766		19,766
	Transferred to restricted retained earnings				(1,634)	3,661	(2,027)	0		0
	Purchase of own shares	(8)	(83)					(91)		(91)
	Dividends paid						(24,822)	(24,822)		(24,822)
	Disposal of subsidiary							0	(27)	(27)
35	**Balance as at 31 December 2017**	**23,640**	**120,764**	**6,000**	**2,949**	**3,953**	**88,751**	**246,057**	**0**	**246,057**
	Change in equity for the year 2016									
	Balance as at 1 January 2016	23,782	122,105	6,000			112,614	264,501	30	264,531
	Profit for the year						16,633	16,633	10	16,643
	Transferred to restricted retained earnings				4,583	292	(4,875)	0		0
	Purchase of own shares	(134)	(1,258)					(1,392)		(1,392)
	Dividends paid						(28,538)	(28,538)		(28,538)
	Change in non-controlling interest in subsidiary							0	(13)	(13)
35	**Balance as at 31 December 2016**	**23,648**	**120,847**	**6,000**	**4,583**	**292**	**95,834**	**251,204**	**27**	**251,231**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Cash Flows for the Year ended 31 December 2017

Notes		2017	2016
	Operating activities		
	Profit for the year	19,766	16,643
	Adjustments for non-cash items included in profit for the year	(33,829)	(30,144)
	Changes in operating assets and liabilities	(6,835)	(22,939)
	Interest received	60,802	60,308
	Interest paid	(24,338)	(28,747)
8	Dividends received	1,587	1,401
	Income tax and special tax on financial institutions paid	(9,192)	(10,791)
	Net cash from (used in) operating activities	**7,961**	**(14,269)**
	Investing activities		
	Sale and (purchase) of shares in subsidiaries and equity-accounted associates	148	(28)
25	Purchase of property and equipment	(325)	(351)
25	Proceeds from sale of property and equipment	269	186
26	Purchase of intangible assets	(736)	(852)
	Net cash used in investing activities	**(644)**	**(1,045)**
	Financing activities		
31	Proceeds from borrowings	142,509	127,558
35	Purchase of own shares	(91)	(1,392)
	Repayment of borrowings	(92,318)	(86,378)
	Repayment of subordinated liabilities	(294)	(252)
35	Dividends paid	(24,822)	(28,538)
	Net cash from financing activities	**24,984**	**10,998**
	Cash and cash equivalents as at the beginning of the year	21,252	24,257
	Net change in cash and cash equivalents	32,301	(4,316)
	Effect of exchange rate changes on cash and cash equivalents held	(379)	1,311
	Cash and cash equivalents as at 31 December	**53,174**	**21,252**

Cash and cash equivalents is specified as follows:

18	Cash and balances with Central Bank	55,192	30,662
22	Bank accounts with financial institutions	30,219	14,539
18	Mandatory and special restricted balances with Central Bank	(32,237)	(23,949)
	Cash and cash equivalents as at the end of the year	**53,174**	**21,252**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Cash Flows for the Year ended 31 December 2017

Notes		2017	2016
	Adjustments for non-cash items included in profit for the year		
5	Net interest income	(36,271)	(34,650)
6, 69	Net impairment and reversal of guarantees	(565)	(5,117)
6	Reversals of loss from foreign currency linkage of loans and advances to customers	(1,220)	5,435
8	Net gain on financial assets and liabilities	(5,802)	(1,755)
9	Net foreign exchange loss (gain)	1,754	(1,132)
10	Gain on sale of property and equipment	(122)	(10)
10	Net gain on assets classified as held for sale	(2,076)	(1,586)
12	Depreciation and amortisation	718	611
10, 24	Share of profit of equity-accounted associates	(141)	(483)
13	Income tax	6,643	5,570
14	Tax on liabilities of financial institutions	3,253	2,973
		(33,829)	**(30,144)**
	Changes in operating assets and liabilities		
	Change in reserve requirement with Central Bank	(8,289)	(7,946)
	Change in bonds and equities	43,271	44,507
	Change in loans and advances to financial institutions	(8,411)	(4,026)
	Change in loans and advances to customers	(66,837)	(67,471)
	Change in other assets	1,411	361
	Change in assets classified as held for sale	5,427	4,200
	Change in due to financial institutions and Central Bank	11,957	(36,209)
	Change in deposits from customers	15,173	43,843
	Change in tax liability	(45)	81
	Change in other liabilities	453	146
	Change in liabilities associated with assets classified as held for sale	(945)	(425)
		(6,835)	**(22,939)**

Change in liabilities due to financing activities

	As at 1.1.2017	Cash flow	Accrued interest	Foreign exchange	Change in the fair value	As at 31.12.2017
Issued bonds to LBI hf.	50,122	(47,707)	-	(2,415)	-	0
Covered bonds - secured	38,586	30,885	782	-	-	70,253
EMTN issued	118,513	64,827	1,437	7,276	(568)	191,485
Bills issued	11,554	(4,907)	786	-	-	7,433
Other unsecured loans	5,169	7,093	114	327	-	12,703
Subordinated liabilities	388	(294)	(13)	(4)	-	77
Total	**224,332**	**49,897**	**3,106**	**5,184**	**(568)**	**281,951**

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Notes to the Consolidated Financial Statements for the Year 2017

Notes to the Consolidated Financial Statements

General

1. Reporting entity

Landsbankinn hf. (hereinafter referred to as the "Bank" or "Landsbankinn") was founded on 7 October 2008. The Bank is a limited liability company incorporated and domiciled in Iceland. The Bank operates in accordance with Act No. 161/2002 on Financial Undertakings. The Bank is subject to supervision of the Financial Supervisory Authority (FME) in accordance with Act No. 87/1998, on Official Supervision of Financial Activities. The registered address of the Bank's office is Austurstræti 11, 155 Reykjavík.

The Consolidated Financial Statements of the Bank for the year ended 31 December 2017 include the Bank and its subsidiaries (collectively referred to as the "Group" and individually as "Group entities"). The Group's primary lines of business are corporate and personal banking, markets, asset management and other related financial services. The Group operates solely in Iceland.

2. Basis of preparation

These Consolidated Financial Statements for the year ended 31 December 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and applicable Icelandic laws and regulations.

The issue of these Consolidated Financial Statements was authorised by the Board of Directors and the CEO of the Bank on 15 February 2018.

Information regarding significant accounting policies can be found in Note 92.

Going concern

The Bank's management has assessed the Group's ability to continue as a going concern and it has a reasonable expectation that the Group has adequate resources to continue its operations. Accordingly, these Consolidated Financial Statements have been prepared on a going concern basis.

Basis of measurement

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

- Financial assets and liabilities classified as held for trading are measured at fair value;
- Financial assets and liabilities designated at fair value through profit or loss are measured at fair value;
- Non-current assets and disposal groups classified as held for sale are measured at the lower of cost or fair value less costs to sell.

Functional and presentation currency

The functional currency of the Bank and its individual Group entities is Icelandic króna (ISK) and all amounts are presented in ISK, rounded to the nearest million unless otherwise stated.

Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Accounting estimates and underlying assumptions are reviewed on an ongoing basis. Revisions of accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Note 3 discusses estimates and assumptions involving a substantial risk which could result in material adjustments to the carrying amounts of assets and liabilities during the next year.

3. Critical accounting estimates and judgements in applying accounting policies

(a) Impairment losses on loans and advances

To assess impairment, the Group reviews its loan portfolios on at least a quarterly basis. To determine whether an impairment loss should be recognised, the Group evaluates whether there is any observable data indicating a measurable decrease in estimated future cash flows from a portfolio of loans, before any decrease in an individual loan becomes identifiable within that portfolio. The evidence may include either observable data indicating that an adverse change has occurred in the payment status of the borrowers in a group, or national or local economic conditions correlating with defaults on assets in the group. In order to schedule its future cash flows, management uses estimates based on historical loss experience, together with objective evidence of impairment in homogeneous portfolios. The methodology and assumptions for estimating both the amount and timing of future cash flows are reviewed regularly in order to reduce potential discrepancies between loss estimates and actual loss experience.

3. Critical accounting estimates and judgements in applying accounting policies (continued)

(b) Valuation of financial instruments

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where observable market inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair value, they are validated and regularly reviewed by discrete and qualified in-house reviewers. All models are certified before use, and calibrated to ensure that the outputs reflect actual data and comparative market prices. Wherever practical, models are confined to observable data; however, areas such as volatility, correlation and credit risk, whether own or counterparty, require management to make estimates. Changing assumptions on these factors could affect the reported fair value of financial instruments.

(c) Assets classified as held for sale

The Group classifies assets and groups of assets together with related liabilities as held for sale:
• if such assets or disposal groups are immediately available for sale in their present condition, subject to terms that are usual and customary for selling such assets or disposal groups;
• if management is committed to selling such assets and is actively looking for a buyer;
• if the assets are being actively marketed at a reasonable sales price in relation to their fair value;
• if completion of the sale is expected within one year;
• if sale is considered highly probable.
However, events and circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete the sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and the Group remains committed to its plan to sell the asset (or disposal group).

When assets are classified as held for sale, the Group has determined that the classification criteria have been met.

(d) Determination of control over investees

Management applies its judgement to determine whether the control indicators set out in Note 92.1 Consolidation, indicate that the Group controls an investee.

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

For further disclosure in respect of unconsolidated investment funds in which the Group acts as an agent see Note 42 Unconsolidated structured entities.

(e) Foreign currency indexed loans

Since 2011, the Supreme Court has ruled in a number of lawsuits brought against the Bank on recalculation of foreign currency indexed loans. The conclusions of the Supreme Court in some of these disputes were unfavourable for the Bank and, as a result, the Bank recognised the impact of the rulings by recording expenses in the relevant periods in its Consolidated Income Statements. All material cases, reported open in the litigation section of the Bank's Consolidated Financial Statements for the year 2016, have now been closed, as reported in interim financial statements for the first and second quarters of 2017. There are currently no open litigation cases against the Bank relating to adjustments of recalculation of foreign currency indexed loans where the Bank considers the parties to have been in a comparable position.

4. Operating segments

Business segments are presented in accordance with internal reporting to the CEO and the Board of Directors, who are responsible for allocating resources to the reportable segments and assessing their financial performance.

The Group has four main business segments as at the end of the reporting period:

• **Personal Banking** provides financial services through the Bank's branch network to individuals and to small and medium-size businesses outside the capital city region.

• **Corporate Banking** provides financial services to corporate clients and to small and medium-size businesses in the capital city region.

• **Markets** provides brokerage services in securities, foreign currencies and derivatives, securities offerings and advisory services. Markets also handles market making for listed securities and foreign currencies. Markets provides a range of wealth and asset management products and services for individuals, corporations and institutional investors. Landsbréf hf., a subsidiary of the Bank, is included in Markets as an operating segment.

• **Treasury** incorporates the Bank's funding and liquidity management, market making in money markets, and determines the Bank's internal pricing. Treasury also manages the Bank's exchange rate, interest rate and inflation risks, within limits set by the Board of Directors. The Bank allocates capital to the operating segments based on the Bank's target for a total capital ratio.

Support functions are comprised of Finance (excluding Treasury), Risk Management, IT and the CEO's Office. The CEO's Office is comprised of Human Resources, Marketing & Communications and Compliance. The Bank's Internal Audit department is also included in support functions; however, it is independent and reports directly to the Bank's Board of Directors.

Reconciliation consists of eliminations and transactions that cannot be allocated to any one segment.

Administrative expenses of the Group's support functions are allocated to appropriate business segments based on the underlying cost drivers. Expenses are allocated to the business units at market price level. Support functions supply services to business units and transactions are settled at unit prices or on an arm's-length basis, if possible, on the basis of use and activity.

The following table summarises each segment's financial performance as disclosed in the internal management reports on segment profits (loss) before tax. In these reports, all income statement items are reported on a net basis, including the total interest income and expense. Inter-segment pricing is determined on an arm's-length basis.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue during the period from 1 January to 31 December 2017 and 2016.

4. Operating segments (continued)

1 January - 31 December 2017	Personal Banking	Corporate Banking	Markets	Treasury	Support functions	Recon-ciliation	Total
Net interest income	15,665	16,611	398	3,656	40	(99)	**36,271**
Net valuation adjustments and credit impairment charges	1,014	761	-	10	-	-	**1,785**
Net fee and commission income	3,387	966	4,535	(311)	135	(281)	**8,431**
Other net operating income (expenses)	(74)	(1)	(161)	5,027	2,126	108	**7,025**
Total operating income (expense)	**19,992**	**18,337**	**4,772**	**8,382**	**2,301**	**(272)**	**53,512**
Operating expenses	(6,294)	(1,644)	(2,178)	(1,671)	(12,354)	291	**(23,850)**
Profit (loss) before cost allocation and tax	**13,698**	**16,693**	**2,594**	**6,711**	**(10,053)**	**19**	**29,662**
Cost allocated from support functions to business segments	(5,254)	(3,652)	(1,540)	(1,046)	11,492	-	**0**
Profit (loss) before tax	**8,444**	**13,041**	**1,054**	**5,665**	**1,439**	**19**	**29,662**
Net revenue (expenses) from external customers	22,783	26,274	4,459	(1,951)	2,219	-	**53,784**
Net revenue (expenses) from other segments	(2,791)	(7,937)	313	10,333	82	-	**0**
Total operating income	**19,992**	**18,337**	**4,772**	**8,382**	**2,301**	**0**	**53,784**
As at 31 December 2017							
Total assets	436,874	505,912	12,267	453,475	16,051	(231,709)	**1,192,870**
Total liabilities	374,660	382,541	7,316	397,954	16,051	(231,709)	**946,813**
Allocated capital	62,214	123,371	4,951	55,521	-		**246,057**

1 January - 31 December 2016	Personal Banking	Corporate Banking	Markets	Treasury	Support functions	Recon-ciliation	Total
Net interest income	13,838	14,200	357	6,663	10	(418)	**34,650**
Net valuation adjustments and credit impairment charges	3,580	(3,798)	-	(100)	-	-	**(318)**
Net fee and commission income	3,488	818	4,043	(330)	110	(320)	**7,809**
Other net operating income (expenses)	1,414	262	356	2,245	1,902	380	**6,559**
Total operating income (expense)	**22,320**	**11,482**	**4,756**	**8,478**	**2,022**	**(358)**	**48,700**
Operating expenses	(6,331)	(1,568)	(2,097)	(1,586)	(12,274)	342	**(23,514)**
Profit (loss) before cost allocation and tax	**15,989**	**9,914**	**2,659**	**6,892**	**(10,252)**	**(16)**	**25,186**
Cost allocated from support functions to business segments	(4,931)	(3,550)	(1,312)	(1,192)	10,985	-	**0**
Profit (loss) before tax	**11,058**	**6,364**	**1,347**	**5,700**	**733**	**(16)**	**25,186**
Net revenue from external customers	25,592	20,677	4,421	(3,611)	1,979	-	**49,058**
Net revenue (expenses) from other segments	(3,272)	(9,195)	335	12,089	43	-	**0**
Total operating income	**22,320**	**11,482**	**4,756**	**8,478**	**2,022**	**0**	**49,058**
As at 31 December 2016							
Total assets	396,145	481,568	34,904	427,330	14,651	(243,441)	**1,111,157**
Total liabilities	347,267	384,892	29,005	327,552	14,651	(243,441)	**859,926**
Allocated capital	48,878	96,676	5,899	99,778	-		**251,231**

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Notes to the Consolidated Income Statement

5. Net interest income

Interest income	2017	2016
Cash and balances with Central Bank	818	1,193
Bonds and debt instruments classified as loans and receivables	4,331	6,091
Loans and advances to financial institutions	336	225
Loans and advances to customers	57,032	57,078
Other interest income	39	25
Total	**62,556**	**64,612**
Interest expense		
Due to financial institutions and Central Bank	(929)	(1,036)
Deposits from customers	(17,409)	(20,066)
Borrowings	(7,903)	(7,842)
Other interest expense	(27)	(977)
Subordinated liabilities	(17)	(41)
Total	**(26,285)**	**(29,962)**
Net interest income	**36,271**	**34,650**

Interest income and interest expense disclosed above arose on financial assets and financial liabilities that are not carried at fair value through profit or loss.

6. Net valuation adjustments and credit impairment charges

	2017	2016
Net impairment	506	4,798
Reversal of impairment of guarantees	59	319
Reversals of foreign currency linkage loans and advances to customers	1,220	(5,435)
Net valuation adjustments and credit impairment charges	**1,785**	**(318)**
Valuation adjustments and credit impairment charges by customer type		
Individuals	791	2,885
Corporates	994	(3,203)
Net valuation adjustments and credit impairment charges	**1,785**	**(318)**

7. Net fee and commission income

Fee and commission income	2017	2016
Markets	4,644	3,870
Loans and guarantees	1,095	984
Cards	3,624	3,390
Collection and payment services	850	885
Foreign trade	694	755
Other commissions and fees	382	406
Total	**11,289**	**10,290**
Fee and commission expense		
Investment banking and capital markets	(467)	(297)
Cards	(1,259)	(1,199)
Other fees	(1,132)	(985)
Total	**(2,858)**	**(2,481)**
Net fee and commission income	**8,431**	**7,809**

The net fee and commission income above excludes amounts that are otherwise included in determining the effective interest rate for financial assets and liabilities that are not designated at fair value through profit or loss. Moreover, it does not include any net fee and commission income relating to such financial assets and liabilities.

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8. Net gain (loss) on financial assets and liabilities

Net gain (loss) on financial assets designated at fair value through profit or loss	2017	2016
Bonds and debt instruments	1,342	524
Equities and equity instruments	4,712	892
	6,054	**1,416**

Net profit (loss) on fair value hedges		
Change in the fair value of interest rate swaps	(492)	-
Change in the fair value of bonds which are attributable to interest rate	568	-
	76	**0**

Net gain (loss) on financial assets and liabilities held for trading		
Bonds and debt instruments	451	1,016
Equities and equity instruments	(812)	(438)
Derivatives and underlying hedges	33	(239)
	(328)	**339**
Total net gain on financial assets and liabilities	**5,802**	**1,755**

The dividend income below is recognised in the income statement in "Net gain (loss) on financial assets and financial liabilities".

Dividend income	2017	2016
Net gain on financial assets designated at fair value through profit or loss	1,303	1,084
Net gain on financial assets and liabilities held for trading	45	72
Total	**1,348**	**1,156**

9. Net foreign exchange (loss) gain

Assets	2017	2016
Cash and balances with Central Bank	(38)	(265)
Bonds and debt instruments	(1,063)	(6,887)
Equities and equity instruments	12	(74)
Derivative instruments	3,639	511
Loans and advances to financial institutions	1,963	(3,776)
Loans and advances to customers	(61)	(31,006)
Other assets	(263)	(220)
Total	**4,189**	**(41,717)**

Liabilities		
Due to financial institutions and Central Bank	(12)	399
Deposits from customers	(491)	13,144
Borrowings	(5,188)	27,731
Other liabilities	123	255
Subordinated liabilities	4	9
Total	**(5,564)**	**41,538**
Net foreign exchange loss	**(1,375)**	**(179)**

The foreign exchange difference recognised during the year 2017 in the Consolidated Income Statement that arose on financial instruments not measured at fair value through profit or loss, amounted to a gain of ISK 1,601 million for financial assets (2016: loss of ISK 35,267 million) and a loss of ISK 5,564 million for financial liabilities (2016: gain of ISK 41,538 million).

10. Other income and expenses

	Notes	2017	2016
Gain on sale of property and equipment	25	122	10
Gain on repossessed collateral	28	2,076	2,025
Share of profit of equity-accounted associates	24	141	1,129
Other		259	1,819
Total		**2,598**	**4,983**

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11. Salaries and related expenses

	2017	2016
Salaries	10,807	10,761
Contributions to defined pension plans	1,637	1,646
Social security contributions, special financial activities tax on salaries and other expenses	1,617	1,642
Total salaries and related expenses	**14,061**	**14,049**
Number of full-time equivalent positions at year-end	997	1,012
Average number of full-time equivalent positions during the year	1,034	1,047

12. Other operating expenses

	2017	2016
Information technology	2,287	2,104
Real estate and fixtures	843	904
Advertising and marketing	874	836
Operating lease rentals	544	554
FME supervisory expenses	448	359
Contribution to the Debtors' Ombudsman	261	83
Audit and related services	143	151
Other professional services	598	603
Depreciation and amortisation	718	611
Contribution to the Depositors' and Investors' Guarantee Fund	1,277	1,268
Other operating expenses	1,796	1,992
Total	**9,789**	**9,465**

Audit and related services	2017	2016
Audit of financial statement and audit-related service	82	88
Review of interim financial statements and audit-related services	61	63
Total	**143**	**151**

Depreciation and amortisation	2017	2016
Amortisation of property and equipment	392	381
Depreciation of intangible assets	326	230
Total	**718**	**611**

13. Income tax

Income tax is recognised based on the tax rates and tax laws enacted by the end of the year, according to which the domestic corporate income tax rate was 20.0% (2016: 20.0%). An additional special income tax on financial institutions is recognised at a rate of 6% on an income tax base exceeding ISK 1,000 million in accordance with Act No. 165/2011, on Financial Activity Tax.

Income tax recognised in the income statement is specified as follows:

	2017	2016
Current tax expense	(5,429)	(4,755)
Special income tax on financial institutions	(1,438)	(1,209)
Difference of prior year's imposed and calculated income tax	101	48
Origination and reversal of temporary differences due to deferred tax assets/liabilities	123	346
Total	**(6,643)**	**(5,570)**

The tax on Group profit differs to the following extent from the amount that would theoretically arise by the domestic corporate income tax rate:

		2017		2016
Profit before tax		29,662		25,186
Tax on liabilities of financial institutions		(3,253)		(2,973)
Profit before income tax		26,409		22,213
Income tax calculated using the domestic corporate income tax rate	20.0%	(5,282)	20.0%	(4,441)
Special income tax on financial institutions	5.4%	(1,438)	5.4%	(1,209)
Income not subject to tax	(4.2%)	1,121	(2.6%)	587
Non-deductible expenses	4.4%	(1,162)	3.8%	(843)
Other	(0.4%)	118	(1.5%)	336
Effective income tax	**25.2%**	**(6,643)**	**25.1%**	**(5,570)**

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14. Tax on liabilities of financial institutions

On 31 December 2013 the Parliament of Iceland passed an amendment to Act No. 155/2010, on Special Tax on Financial Institutions, according to which financial institutions must pay annually a tax calculated as 0.376% (2016: 0.376%) of the carrying amount of total liabilities at year-end, excluding tax liabilities, in excess of ISK 50,000 million as determined for tax purposes. The special income tax on financial institutions is a non-deductible expense.

	2017	2016
Tax on liabilities of financial institutions	(3,253)	(2,973)

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Notes to the Consolidated Statement of Financial Position

15. Classification of financial assets and liabilities

According to IAS 39, "Financial Instruments: Recognition and Measurement", financial assets and liabilities must be classified into specific categories which affect how they are measured after initial recognition. Each category's basis of subsequent measurement is specified below:
- Loans and receivables, measured at amortised cost;
- Financial assets and liabilities held for trading, measured at fair value;
- Financial assets designated at fair value through profit or loss, measured at fair value;
- Financial liabilities, measured at amortised cost.

Further details on fair value measurement of financial assets and liabilities can be seen in Note 92, Significant accounting policies.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2017:

Financial assets	Notes	Loans and receivables	Held for trading	Designated at fair value	Liabilities at amortised cost	Total carrying amount	Fair value
Cash and balances with Central Bank	18	55,192	-	-	-	55,192	55,192
Bonds and debt instruments	19	49,421	57,176	10,713	-	117,310	117,682
Equities and equity instruments	20	-	9,298	18,682	-	27,980	27,980
Derivative instruments	21	-	1,905	-	-	1,905	1,905
Loans and advances to financial institutions	22	44,866	-	-	-	44,866	44,866
Loans and advances to customers	23	925,636	-	-	-	925,636	930,176
Other financial assets		5,457	-	-	-	5,457	5,457
Total		**1,080,572**	**68,379**	**29,395**	**0**	**1,178,346**	**1,183,258**
Financial liabilities							
Due to financial institutions and Central Bank	29	-	-	-	32,062	32,062	32,062
Deposits from customers	30	-	-	-	605,158	605,158	604,458
Derivative instruments and short positions	21	-	1,258	-	-	1,258	1,258
Borrowings	31	-	-	-	281,874	281,874	283,353
Other financial liabilities		-	-	-	7,815	7,815	7,815
Subordinated liabilities	34	-	-	-	77	77	89
Total		**0**	**1,258**	**0**	**926,986**	**928,244**	**929,035**

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2016:

Financial assets	Notes	Loans and receivables	Held for trading	Designated at fair value	Liabilities at amortised cost	Total carrying amount	Fair value
Cash and balances with Central Bank	18	30,662	-	-	-	30,662	30,662
Bonds and debt instruments	19	110,822	34,006	10,064	-	154,892	155,617
Equities and equity instruments	20	-	9,890	16,798	-	26,688	26,688
Derivative instruments	21	-	278	-	-	278	278
Loans and advances to financial institutions	22	20,408	-	-	-	20,408	20,408
Loans and advances to customers	23	853,417	-	-	-	853,417	858,187
Other financial assets		6,528	-	-	-	6,528	6,528
Total		**1,021,837**	**44,174**	**26,862**	**0**	**1,092,873**	**1,098,368**
Financial liabilities							
Due to financial institutions and Central Bank	29	-	-	-	20,093	20,093	20,093
Deposits from customers	30	-	-	-	589,725	589,725	589,790
Derivative instruments and short positions	21	-	1,729	-	-	1,729	1,729
Borrowings	31	-	-	-	223,944	223,944	225,520
Other financial liabilities		-	-	-	7,206	7,206	7,206
Subordinated liabilities	34	-	-	-	388	388	405
Total		**0**	**1,729**	**0**	**841,356**	**843,085**	**844,743**

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16. Fair value of financial assets and liabilities

Fair value hierarchy

The Group has used a valuation hierarchy for disclosure of inputs used to measure fair value. Fair value measurements of financial instruments are made on the basis of the following hierarchy:

• Level 1: Quoted prices are used for assets and liabilities traded in active markets. Unadjusted quoted prices are used as the measurement of fair value.

• Level 2: Valuation technique based on observable inputs. The most recent transaction prices in combination with generally accepted valuation methods are used to measure fair value of shares. However, the yield of actively traded bonds with the same duration is used as a benchmark for the valuation of bonds.

• Level 3: Valuation technique based on significant non-observable inputs. It covers all instruments for which the valuation technique includes inputs based on unobservable data and the unobservable inputs have significant effect on the instrument's valuation. For unlisted shares and bonds where there is no market data available, various generally accepted valuation techniques are used to measure fair value. Valuation using discounted cash flow or a comparison of peer companies' multiples are the most commonly used methods to calculate fair value of unlisted shares in addition to recent transactions and current market conditions.

Assumptions used in the valuation technique include risk-free and benchmark interest rates for estimating discount rates, credit spreads, bonds and equity prices, foreign currency exchange rates, market multipliers, market conditions for estimating future growth and other market indicators.

Valuation framework

The Bank's Risk & Finance Committee oversees the Group's overall risk and is responsible for fair value measurements of financial assets and liabilities classified as Level 2 and 3 instruments. The Bank's Valuation group reports its valuation results to the Risk & Finance Committee for verification. The Valuation group is comprised of personnel from Risk Management, Treasury and Accounting. The Valuation group holds monthly meetings to determine the value of Level 2 and Level 3 financial assets and liabilities.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the Consolidated Statement of Financial Position, is categorised as at 31 December 2017:

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Bonds and debt instruments	58,726	9,080	83	67,889
Equities and equity instruments	12,321	-	15,659	27,980
Derivative instruments	-	1,905	-	1,905
Total	**71,047**	**10,985**	**15,742**	**97,774**
Financial liabilities				
Derivative instruments	-	941	-	941
Short positions	317	-	-	317
Total	**317**	**941**	**0**	**1,258**

During the year 2017, there were no transfers between Level 1, Level 2 and Level 3.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the Consolidated Statement of Financial Position, are categorised as at 31 December 2016:

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Bonds and debt instruments	35,555	8,337	178	44,070
Equities and equity instruments	10,808	-	15,880	26,688
Derivative instruments	-	278	-	278
Total	**46,363**	**8,615**	**16,058**	**71,036**
Financial liabilities				
Derivative instruments	-	1,183	-	1,183
Short positions	546	-	-	546
Total	**546**	**1,183**	**0**	**1,729**

During the year 2016, there were no transfers between Level 1, Level 2 and Level 3.

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16. Fair value of financial assets and liabilities

Valuation framework (continued)

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, not carried at fair value in the Consolidated Statement of Financial Position, are categorised as at 31 December 2017:

Financial assets	Level 1	Level 2	Level 3	Total
Cash and balances with Central Bank	-	55,192	-	55,192
Bonds and debt instruments	39,635	10,158	-	49,793
Loans and advances to financial institutions	-	44,866	-	44,866
Loans and advances to customers	-	-	930,176	930,176
Other financial assets	-	5,457	-	5,457
Total	**39,635**	**115,673**	**930,176**	**1,085,484**

Financial liabilities				
Due to financial institutions and Central Bank	-	32,062	-	32,062
Deposits from customers	-	604,458	-	604,458
Borrowings	-	283,353	-	283,353
Other financial liabilities	-	7,815	-	7,815
Subordinated liabilities	-	89	-	89
Total	**0**	**927,777**	**0**	**927,777**

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, not carried at fair value in the Consolidated Statement of Financial Position, are categorised as at 31 December 2016:

Financial assets	Level 1	Level 2	Level 3	Total
Cash and balances with Central Bank	-	30,662	-	30,662
Bonds and debt instruments	100,347	11,200	-	111,547
Loans and advances to financial institutions	-	20,408	-	20,408
Loans and advances to customers	-	-	858,187	858,187
Other financial assets	-	6,528	-	6,528
Total	**100,347**	**68,798**	**858,187**	**1,027,332**

Financial liabilities				
Due to financial institutions and Central Bank	-	20,093	-	20,093
Deposits from customers	-	589,790	-	589,790
Borrowings	-	225,520	-	225,520
Other financial liabilities	-	7,206	-	7,206
Subordinated liabilities	-	405	-	405
Total	**0**	**843,014**	**0**	**843,014**

The following tables show the reconciliation of fair value measurement in Level 3 for the year 2017 and 2016:

1 January - 31 December 2017	Bonds and debt instruments	Equities and equity instruments	Total financial assets
Carrying amount as at 1 January 2017	178	15,880	16,058
Net gain on financial assets and liabilities	64	4,702	4,766
Net foreign exchange (loss) gain	(1)	2	1
Purchases	-	606	606
Sales	-	(2,836)	(2,836)
Settlements	(158)	-	(158)
Dividend received	-	(1,255)	(1,255)
Transfers out of Level 3	-	(1,440)	(1,440)
Carrying amount as at 31 December 2017	**83**	**15,659**	**15,742**

1 January - 31 December 2016			
Carrying amount as at 1 January 2016	443	18,123	18,566
Net gain (loss) on financial assets and liabilities	22	732	754
Net foreign exchange loss	(14)	-	(14)
Purchases	11	992	1,003
Sales	(11)	(2,894)	(2,905)
Settlements	(273)	-	(273)
Dividend received	-	(1,073)	(1,073)
Carrying amount as at 31 December 2016	**178**	**15,880**	**16,058**

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16. Fair value of financial assets and liabilities

Valuation framework (continued)

The following table shows the line items in the Consolidated Income Statement where gains (losses) on financial assets and liabilities categorised in Level 3 and held by the Group as at 31 December 2017, were recognised:

1 January - 31 December 2017	Bonds and debt instruments	Equities and equity instruments	Total
Net gain on financial assets and liabilities	35	4,646	4,681
Net foreign exchange loss	1	2	3
Total	**36**	**4,648**	**4,684**
1 January - 31 December 2016			
Net gain on financial assets and liabilities	20	734	754
Net foreign exchange loss	(14)	-	(14)
Total	**6**	**734**	**740**

17. Unobservable inputs in fair value measurement

The following table summarises the unobservable inputs used in measuring fair value of financial assets and liabilities categorised in Level 3 as at 31 December 2017 and 31 December 2016.

					Range of inputs	
As at 31 December 2017	**Assets**	**Liabilities**	**Valuation technique**	**Key unobservable inputs**	**Lower**	**Higher**
Bonds and debt instruments	83	-	See 1) below	See 1) below	n/a	n/a
Equities and equity instruments	15,659	-	See 2) below	See 2) below	n/a	n/a
	15,742	**0**				
As at 31 December 2016						
Bonds and debt instruments	178	-	See 1) below	See 1) below	n/a	n/a
Equities and equity instruments	15,880	-	See 2) below	See 2) below	n/a	n/a
	16,058	**0**				

A further description of the financial instruments categorised in Level 3 are as follows:

1. Fair value of corporate bonds and claims on financial institutions in winding-up proceedings and other insolvent assets is estimated on the basis of an analysis of the estates' financial position and expected recovery. Reference is also made to prices in recent transactions. Given the nature of the valuation method, a range of key unobservable inputs is not available.

2. Equities and equity instruments classified as Level 3 assets, are unlisted and not traded in an active market and therefore subject to unobservable inputs for fair value measurements. Valuation using discounted cash flows, comparison of peer companies' multiples, analysis of financial position and results, outlook and recent transactions are the methods or inputs used to estimate fair value of investments in equities and equity instruments. Given the nature of the valuation method, a range of key unobservable inputs is not available.

The effect of unobservable inputs in fair value measurement

Although the Group believes that its estimates of fair value are appropriate, the use of different valuation methodologies and assumptions could lead to different estimates of fair value. The following tables show how profit (loss) before tax would have been affected if one or more of the inputs for fair value measurements in Level 3 were changed to likely alternatives for the year 2017 and 2016:

	2017		2016	
Effect on profit before tax	**Favourable**	**Unfavourable**	**Favourable**	**Unfavourable**
Bonds and debt instruments	5	(5)	9	(9)
Equities and equity instruments:				
Equities	1,238	(1,244)	465	(603)
Mutual funds	277	(277)	346	(346)
Total equities and equity instruments	1,515	(1,521)	811	(949)
Total	**1,520**	**(1,526)**	**820**	**(958)**

The effect on profit was calculated as the difference between the results of the same valuation methods where key unobservable inputs were changed by +/- 5%.

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18. Cash and balances with Central Bank

	2017	2016
Cash on hand	4,472	3,931
Unrestricted balances with Central Bank	18,483	2,782
Total cash and unrestricted balances with Central Bank	**22,955**	**6,713**
Restricted balances with Central Bank	12,942	11,886
Assets held with Central Bank, subject to special restrictions	19,295	12,063
Total cash and balances with Central Bank	**55,192**	**30,662**

The Bank holds a mandatory reserve deposit account with the Central Bank of Iceland in compliance with the Central Bank's rules on Minimum Reserve Requirements No. 870/2015, with subsequent amendments. The average balance of this account for each reserve term must be equivalent at least to the mandatory reserve deposit requirement which amounted to ISK 12.942 million for December 2017 (December 2016: ISK 11.886 million).

The Bank holds an additional amount as a mandatory reserve with the Central Bank in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions. This reserve is equivalent to at least the amount of the total balance of deposits subject to special restrictions for investment held with the Group and consists of certificates of deposit issued by the Central Bank.

19. Bonds

	2017				2016			
Bonds and debt instruments	**Loans and receivables**	**Held for trading**	**Designated at fair value**	**Total**	**Loans and receivables**	**Held for trading**	**Designated at fair value**	**Total**
Domestic								
Listed	49,421	7,740	9,199	66,360	110,822	9,024	8,681	128,527
Unlisted	-	-	1,514	1,514	-	41	1,383	1,424
	49,421	**7,740**	**10,713**	**67,874**	**110,822**	**9,065**	**10,064**	**129,951**
Foreign								
Listed	-	49,436	-	49,436	-	24,941	-	24,941
	0	**49,436**	**0**	**49,436**	**0**	**24,941**	**0**	**24,941**
Total bonds	**49,421**	**57,176**	**10,713**	**117,310**	**110,822**	**34,006**	**10,064**	**154,892**

Bonds are classified as "domestic" or "foreign" according to issuers' country of incorporation.

Bonds and debt instruments classified as loans and receivables as at 31 December 2017 and 31 December 2016 consist partly of the government bonds which the Bank received in settlement of the capital contribution in 2009. The bonds were listed on the Stock Exchange in Iceland during 2010.

20. Equities

	2017			2016		
Equities and equity instruments	**Held for trading**	**Designated at fair value**	**Total**	**Held for trading**	**Designated at fair value**	**Total**
Domestic						
Listed	9,296	2,663	11,959	9,889	450	10,339
Unlisted	-	15,991	15,991	-	16,229	16,229
	9,296	**18,654**	**27,950**	**9,889**	**16,679**	**26,568**
Foreign						
Listed	2	-	2	1	119	120
Unlisted	-	28	28	-	-	0
	2	**28**	**30**	**1**	**119**	**120**
Total equities	**9,298**	**18,682**	**27,980**	**9,890**	**16,798**	**26,688**

Equities are classified as "domestic" or "foreign" according to issuers' country of incorporation.

At year-end 2017, outstanding commitments of the Group in share subscriptions amounted to ISK 1.546 million (2016: ISK 2.113 million) altogether in seven entities. The entities invested in by the Group are required to redeem its shareholders with proceeds from the sale of assets.

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21. Derivative instruments and short positions

	2017			2016		
	Notional	Fair value		Notional	Fair value	
Foreign exchange derivatives	amount	Assets	Liabilities	amount	Assets	Liabilities
Currency forwards	60,484	542	91	34,674	145	147
Cross-currency interest rate swaps	8,601	1,056	40	13,949	87	982
	69,085	**1,598**	**131**	**48,623**	**232**	**1,129**
Interest rate derivatives						
Interest rate swaps	1,000	35	-	1,250	21	-
Total return swaps	1,428	1	1	462	-	2
	2,428	**36**	**1**	**1,712**	**21**	**2**
Equity derivatives						
Equity forwards	2,645	145	139	-	-	-
Total return swaps	1,703	2	39	5,333	24	45
Equity options	1,501	-	15	312	1	7
	5,849	**147**	**193**	**5,645**	**25**	**52**
Fair value hedging						
Interest rate swaps	78,341	124	616	-	-	-
	78,341	**124**	**616**	**0**	**0**	**0**
Total derivative instruments	**155,703**	**1,905**	**941**	**55,980**	**278**	**1,183**
Short positions						
Listed bonds	450	-	317	457	-	546
	450	**0**	**317**	**457**	**0**	**546**
Total	**156,153**	**1,905**	**1,258**	**56,437**	**278**	**1,729**

The Group uses derivatives both for hedging and trading purposes.

22. Loans and advances to financial institutions

	2017	2016
Bank accounts with financial institutions	30,219	14,539
Money market loans	12,770	2,209
Other loans	1,877	3,660
Total	**44,866**	**20,408**

23. Loans and advances to customers

	2017	2016
Public entities	11,345	10,028
Individuals	359,918	326,844
Corporates	570,563	537,496
Allowance for impairment	(16,190)	(20,951)
Total	**925,636**	**853,417**

During the reporting period, the Group was not permitted to sell or repledge any collateral in absence of default by the owner of the collateral.

Further disclosure on loans and advances to customers is provided in the risk management notes to these Consolidated Financial Statements.

24. Investments in associates

a) Investments in equity-accounted associates	2017	2016
Carrying amount as at the beginning of the year	1,184	909
Acquisition	-	47
Share of profit of equity-accounted associates	141	483
Disposals and dividend received	(239)	(255)
Total	**1,086**	**1,184**

As at 31 December 2017*	Total assets	Total liabilities	Profit (loss)	Ownership interest	Share of profit (loss) of associates	Carrying amount
Reiknistofa bankanna hf.	4,908	3,089	131	39%	28	703
Greiðslumiðlun Íslands ehf.	975	284	691	48%	127	332
Auðkenni ehf.	237	40	197	26%	(14)	51
Total	**6,120**	**3,413**	**1,019**		**141**	**1,086**

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24. Investments in associates (continued)

a) Investments in equity-accounted associates (continued)

As at 31 December 2016*	Total assets	Total liabilities	Profit (loss)	Ownership interest	Share of profit (loss) of associates	Carrying amount
Reiknistofa bankanna hf.	4,292	2,544	163	39%	45	675
Greiðslumiðlun Íslands ehf.	1,150	225	914	48%	515	444
Auðkenni ehf.	292	41	(84)	26%	(77)	65
Total	**5,734**	**2,810**	**993**		**483**	**1,184**

*The amounts for the years 2017 and 2016 in the tables are based on estimates, not actual amounts at the end of the respective years, in instances where actual amounts are not readily available.

None of the above-mentioned associate companies are listed on the market.

b) Investments in associates designated at fair value through profit or loss

One of the investments in associates is accounted for as a financial asset designated at fair value through profit or loss and is recognised in the consolidated statement of financial position in “Equities and equity instruments”. This investment is a 22.0% share in Eyrir Invest hf. and the valuation technique used to measure the investment’s fair value is based on significant non-observable inputs under Level 3 of the fair value hierarchy.

25. Property and equipment

	2017			2016		
	Buildings	Fixtures, equipment and vehicles	Total	Buildings	Fixtures, equipment and vehicles	Total
Carrying amount as at the beginning of the year	3,335	2,117	5,452	3,570	2,088	5,658
Additions during the year	70	255	325	-	351	351
Sold during the year	(139)	(8)	(147)	(171)	(5)	(176)
Depreciation	(62)	(330)	(392)	(64)	(317)	(381)
Carrying amount as at 31 December	**3,204**	**2,034**	**5,238**	**3,335**	**2,117**	**5,452**
Gross carrying amount	3,750	5,475	9,225	3,819	5,228	9,047
Accumulated depreciation	(546)	(3,441)	(3,987)	(484)	(3,111)	(3,595)
Carrying amount as at 31 December	**3,204**	**2,034**	**5,238**	**3,335**	**2,117**	**5,452**
Depreciation rates	2-4%	10-33%		2-4%	10-33%	

Official assessment value of buildings	2017	2016
Official assessment value	4,090	3,795
Replacement value	8,127	8,091

26. Intangible assets

	2017			2016		
	Computer software licenses	Goodwill	Total	Computer software licenses	Goodwill	Total
Carrying amount as at the beginning of the year	2,243	391	2,634	1,621	391	2,012
Additions	736	-	736	852	-	852
Amortisation	(326)	-	(326)	(230)	-	(230)
Carrying amount as at 31 December	**2,653**	**391**	**3,044**	**2,243**	**391**	**2,634**
Gross carrying amount	4,840	391	5,231	4,104	391	4,495
Accumulated amortisation	(2,187)	-	(2,187)	(1,861)	-	(1,861)
Carrying amount as at 31 December	**2,653**	**391**	**3,044**	**2,243**	**391**	**2,634**
Annual amortisation rates	20-33%		20-33%	20-33%		20-33%

27. Other assets

	2017	2016
Unsettled securities trading	1,673	2,301
Other accounts receivable	3,784	4,227
Sundry assets	1,508	1,565
Total	**6,965**	**8,093**

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28. Assets and liabilities classified as held for sale

Assets classified as held for sale

	2017	2016
Repossessed collateral	3,648	6,356
Assets of disposal groups	-	1,093
Total	**3,648**	**7,449**

Repossessed collateral

Repossessed collateral consists mainly of property and equipment resulting from collateral foreclosed by the Group as security for loans and advances. The Group's policy is to pursue timely realisation of the repossessed collateral in an orderly manner. The Group generally does not use the non-cash repossessed collateral for its own operations. Repossessed collateral is recognised as assets of either the Bank or its subsidiary Hömlur ehf.

Repossessed collateral	2017	2016
Real estate	3,632	6,330
Equipment and vehicles	16	26
Total	**3,648**	**6,356**

Repossessed collateral	2017	2016
Carrying amount as at the beginning of the year	6,356	10,095
Repossessed during the year	1,337	3,646
Disposed of during the year	(5,890)	(9,238)
Impairment and gain of sale	1,845	1,853
Carrying amount as at the end of the year	**3,648**	**6,356**

Liabilities associated with assets classified as held for sale

	2017	2016
Liabilities of disposal groups	27	1,095
Total	**27**	**1,095**

29. Due to financial institutions and Central Bank

	2017	2016
Loans and repurchase agreements with Central Bank	66	85
Loans and deposits from financial institutions	25,024	8,599
Deposits subject to special restrictions*	6,972	11,409
Total	**32,062**	**20,093**

*in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions

30. Deposits from customers

	2017	2016
Demand deposits	367,884	367,215
Term deposits	224,951	221,856
Deposits subject to special restrictions*	12,323	654
Total	**605,158**	**589,725**

*in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions

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31. Borrowings

Secured borrowings

As at 31.12.2017	Currency	Final maturity	Outstanding principal	Indexed/ Non-indexed	Contractual interest rate	Carrying amount
LBANK CB 19	ISK	17.09.2019	16,120	Non-indexed	Fixed 6.8%	16,536
LBANK CB 21	ISK	30.11.2021	3,720	Non-indexed	Fixed 5.5%	3,730
LBANK CB 23	ISK	23.11.2023	420	Non-indexed	Fixed 5.0%	417
LBANK CBI 22	ISK	28.04.2022	19,540	CPI-indexed	Fixed 3.0%	20,692
LBANK CBI 24	ISK	15.11.2024	8,640	CPI-indexed	Fixed 3.0%	8,926
LBANK CBI 28	ISK	04.10.2028	19,000	CPI-indexed	Fixed 3.0%	19,952
Total covered bonds						**70,253**
Total secured borrowings						**70,253**

Unsecured borrowings

As at 31.12.2017	Currency	Final maturity	Outstanding principal	Contractual interest rate	Carrying amount
LBANK 3 10/18	EUR	19.10.2018	EUR 150 million	FIXED 3.0%	18,724
LBANK FLOAT 06/19	SEK	10.06.2019	SEK 350 million	STIBOR + 2.6%	4,421
LBANK FLOAT 06/19	NOK	11.06.2019	NOK 500 million	NIBOR + 2.6%	6,329
LBANK 0.75 06/20	SEK	22.06.2020	SEK 300 million	FIXED 0.75%	3,782
LBANK FLOAT 06/20	SEK	22.06.2020	SEK 700 million	STIBOR + 1.0%	8,834
LBANK 1.375 11/20	SEK	24.11.2020	SEK 750 million	FIXED 1.375%	9,442
LBANK FLOAT 11/20	SEK	24.11.2020	SEK 250 million	STIBOR + 1.5%	3,154
LBANK 1.625 03/21	EUR	15.03.2021	EUR 500 million	FIXED 1.625%	62,516
LBANK 1.375 03/22	EUR	14.03.2022	EUR 300 million	FIXED 1.375%	37,370
LBANK 1.000 05/23	EUR	30.05.2023	EUR 300 million	FIXED 1.0%	36,913
Total EMTN issued					**191,485**

As at 31.12.2017	Currency	Final maturity	Outstanding principal	Indexed/ Non-indexed	Carrying amount
LBANK 180110	ISK	10.01.2018	220	Non-indexed	220
LBANK 180212	ISK	12.02.2018	2,720	Non-indexed	2,705
LBANK 180312	ISK	12.03.2018	2,700	Non-indexed	2,674
LBANK 180410	ISK	10.04.2018	1,440	Non-indexed	1,420
LBANK 180510	ISK	10.05.2018	420	Non-indexed	414
Total bills issued					**7,433**

As at 31.12.2017	Carrying amount
Other unsecured loans	12,703
Total other unsecured loans	**12,703**
Total unsecured borrowings	**211,621**
Total borrowings as at 31.12.2017	**281,874**

On 29 November 2017, the Bank completed issuance of EUR 300 million senior unsecured bonds. The bonds mature in May 2023, bear a fixed coupon rate of 1.0% and were priced at terms equivalent to an 85 basis point spread above mid-swaps in euros.

On 28 June 2017, the Nordic Investment Bank (NIB) and Landsbankinn hf. signed a new seven-year loan programme in the amount of USD 75 million.

On 13 June 2017, the Bank completed a bond offering of SEK 1.000 million in senior unsecured bonds. The bonds mature in June 2020 and were issued in two tranches: SEK 700 million at a floating rate of STIBOR, plus a 1.0% margin, and SEK 300 million at a fixed rate of 0.75%.

On 14 March 2017, the Bank completed issuance of EUR 300 million senior unsecured bonds. The bonds mature in March 2022, bear a fixed coupon rate of 1.375% and were priced at terms equivalent to a 130 basis point spread above mid-swaps in euros.

The loan agreement and the bond series issued during the first half of 2017 refinance the remainder of the senior secured Bond D and F series issued by the Bank to LBI hf., in addition to further strengthening the Bank's liquidity. The Bank has thereby paid in full the outstanding amounts of the bonds issued by the Bank to LBI hf. On the other hand, the proceeds of the bonds issued in November were also used, *inter alia*, to refinance partially the EUR 300 million senior unsecured bond series LBANK 3 10/18 maturing in October 2018, following a tender offer by the Bank to the bond holders.

The Bank is obliged to pledge part of its loan portfolio as collateral for the outstanding secured bonds it has issued. A coverage ratio of at least 120% is required on the covered bonds and a coverage ratio of at least 115% was required on the secured bonds issued to LBI hf. For further details on encumbered assets see Note 79.

The senior unsecured bonds in foreign currencies are issued under the Bank's 2,000 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange.

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31. Borrowings (continued)

Each covered bond series in ISK is issued under the Bank's ISK 120,000 million Covered Bond programme. These covered bonds are issued under a licence from the Icelandic FME and with reference to Act No. 11/2008 and FME Rules No. 528/2008. All covered bond series are listed and traded on NASDAQ Iceland.

All the outstanding unsecured non-indexed bank bills issued by the Bank have a maturity of less than one year. These ISK-denominated bills are issued under the Bank's ISK 50,000 million Debt Issuance Programme. All Landsbankinn's bill series are listed and traded on NASDAQ Iceland.

Secured borrowings

As at 31.12.2016	Currency	Final maturity	Outstanding principal	Contractual interest rate (Base rate + Initial margin/ Step-up margin)	Carrying amount
BOND D	USD	09.10.2020	USD 170 million	LIBOR + 2.90% / 3.50%	19,251
BOND F	USD	09.10.2024	USD 271 million	LIBOR + 2.90% / 3.95%	30,871
Total issued bonds to LBI hf.					**50,122**

As at 31.12.2016	Currency	Final maturity	Outstanding principal	Indexed/ Non-indexed	Contractual interest rate	Carrying amount
LBANK CB 17	ISK	23.10.2017	3,160	Non-indexed	Fixed 6.0%	3,189
LBANK CB 19	ISK	17.09.2019	13,540	Non-indexed	Fixed 6.8%	13,873
LBANK CB 21	ISK	30.11.2021	700	Non-indexed	Fixed 5.5%	691
LBANK CBI 22	ISK	28.04.2022	17,780	CPI-indexed	Fixed 3.0%	18,462
LBANK CBI 28	ISK	04.10.2028	2,380	CPI-indexed	Fixed 3.0%	2,371
Total covered bonds						**38,586**
Total secured borrowings						**88,708**

Unsecured borrowings

As at 31.12.2016	Currency	Final maturity	Outstanding principal	Contractual interest rate	Carrying amount
LBANK 3 10/18	EUR	19.10.2018	EUR 300 million	FIXED 3.0%	35,864
LBANK FLOAT 06/19	SEK	10.6.2019	SEK 250 million	STIBOR + 2.6%	4,345
LBANK FLOAT 06/19	NOK	11.6.2019	NOK 500 million	NIBOR + 2.6%	6,564
LBANK 1.375 11/20	SEK	24.11.2020	SEK 750 million	FIXED 1.375%	9,280
LBANK FLOAT 11/20	SEK	24.11.2020	SEK 250 million	STIBOR + 1.5%	3,103
LBANK 1.625 03/21	EUR	15.3.2021	EUR 500 million	FIXED 1.625%	59,357
Total EMTN issued					**118,513**

As at 31.12.2016	Currency	Final maturity	Outstanding principal	Indexed/ Non-indexed	Carrying amount
LBANK 170110	ISK	10.01.2017	2,340	Non-indexed	2,336
LBANK 170210	ISK	10.02.2017	1,020	Non-indexed	1,013
LBANK 170310	ISK	10.03.2017	1,040	Non-indexed	1,029
LBANK 170410	ISK	10.04.2017	2,820	Non-indexed	2,775
LBANK 170510	ISK	10.05.2017	2,780	Non-indexed	2,724
LBANK 170612	ISK	12.06.2017	1,720	Non-indexed	1,677
Total bills issued					**11,554**

As at 31.12.2016	Carrying amount
Other unsecured loans	5,169
Total other unsecured loans	**5,169**
Total unsecured borrowings	**135,236**
Total borrowings as at 31.12.2016	**223,944**

32. Deferred tax liabilities

Recognised deferred tax assets and liabilities are attributable to the following:

	2017			2016		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Property and equipment	-	(210)	(210)	-	(177)	(177)
Intangibles	-	(285)	(285)	-	(181)	(181)
Other assets	-	(6)	(6)	-	(13)	(13)
Deferred foreign exchange differences	174	-	174	32	-	32
Other items	106	-	106	43	-	43
Tax losses carried forward	181	-	181	211	-	211
	461	**(501)**	**(40)**	**286**	**(371)**	**(85)**
Set-off of deferred tax assets together with liabilities of the same taxable entities	(461)	461	-	(286)	286	-
Deferred tax liabilities total	**0**	**(40)**	**(40)**	**0**	**(85)**	**(85)**

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32. Deferred tax liabilities (continued)

The deferred tax assets and liabilities are measured based on the tax rates and tax laws enacted by the end of 2017, according to which the domestic corporate income tax rate was 20% as at 31 December 2017 (2016: 20%).

The movements in temporary differences during the period were as follows:

		Recognised in income statement		
2017	**Balance 1.1**	**Tax (expense) income**	**Changes from prior year**	**Balance 31.12**
Property and equipment	(177)	(33)	-	(210)
Intangibles	(181)	(104)	-	(285)
Other assets	(13)	7	-	(6)
Deferred foreign exchange differences	32	142	-	174
Other items	43	63	-	106
Tax losses carried forward	211	(30)	-	181
Total	**(85)**	**45**	**0**	**(40)**

2016	**Balance 1.1**	**Tax (expense) income**	**Changes from prior year**	**Balance 31.12**
Property and equipment	(239)	62	-	(177)
Intangibles	(132)	(49)	-	(181)
Other assets	(19)	6	-	(13)
Deferred foreign exchange differences	69	(37)	-	32
Other items	(171)	214	-	43
Tax losses carried forward	326	(115)	-	211
Total	**(166)**	**81**	**0**	**(85)**

33. Other liabilities

	2017	**2016**
Unsettled securities trading	6,106	4,779
Withholding tax	2,490	2,873
Accounts payable	641	677
Contribution to the Depositors' and Investors' Guarantee Fund	318	307
Tax on liabilities of financial institutions	3,253	2,973
Current tax liabilities	6,789	5,838
Non-controlling interests - Funds	2,326	883
Sundry liabilities	4,394	4,537
Total	**26,317**	**22,867**

Unsettled securities transactions were settled in less than three days from the reporting date.

Unpaid premiums to the Depositors' and Investors' Guarantee Fund (TIF)

According to Act No. 98/1999, on Deposit Guarantees and Investors' Compensation Scheme, as subsequently amended, the Bank is to pay each quarter a non-refundable general and variable premium to the TIF. The general premium amounts to the equivalent of 0.225% annually of all deposits, as defined by the Act, or equivalent to 0.05625% on each quarterly due date. The variable premium is determined by a risk factor assigned to the Bank by the FME and may at maximum be equal to the general premium.

Acting on a joint proposal from FME and the Central Bank of Iceland, the Fund may collect a supplementary premium if its assets are not sufficient to cover payments when the Fund's obligation to render payment becomes effective. TIF may also collect a supplementary premium to cover costs, instalments and interest payments on its loans. Such a supplementary payment, however, may never exceed 0.6% of the Bank's insured deposits.

The Bank only recognises a liability for premiums to TIF equivalent to the amount the Bank is obliged by law to pay at the end of each accounting period. This is the premium which the Bank is to pay during the current quarter for the preceding quarter. Other premiums to be paid by the Bank to the Fund during later periods are dependent upon the Bank's future activities and therefore are not recognised as a liability on the reporting date.

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34. Subordinated liabilities

As at 31.12.2017	Currency	Final maturity	Remaining principal in currencies	Indexed/ Non-indexed	Contractual interest rate (Base rate + Margin)	Carrying amount
Subordinated loan	JPY	01.12.2023	JPY 47,1 million		LIBOR + 5%	43
Subordinated loan	CHF	01.12.2023	CHF 0,3 million		LIBOR + 5%	34
Total subordinated liabilities						**77**

As at 31.12.2016	Currency	Final maturity	Remaining principal in currencies	Indexed/ Non-indexed	Contractual interest rate (Base rate + Margin)	Carrying amount
Subordinated bonds unlisted	ISK	01.12.2017	25.3		REIBOR + 4%	25
Subordinated loan	JPY	01.12.2023	JPY 49,1 million		LIBOR + 5%	48
Subordinated loan	CHF	01.12.2023	CHF 0,3 million		LIBOR + 5%	37
Subordinated loan	ISK	13.09.2017	59.1	CPI-indexed	Fixed 7,0%	61
Subordinated loan	ISK	18.09.2017	6.4	CPI-indexed	Fixed 7,0%	7
Subordinated loan	ISK	21.09.2017	19.3	CPI-indexed	Fixed 7,0%	20
Subordinated loan	ISK	22.09.2017	52.0	CPI-indexed	Fixed 7,0%	54
Subordinated loan	ISK	01.12.2017	8.2	CPI-indexed	Fixed 7,0%	8
Subordinated bonds unlisted	ISK	22.11.2019	120.5	CPI-indexed	Fixed 5,0%	128
Total subordinated liabilities						**388**

The subordinated liabilities are comprised of liabilities assumed by the Bank in two separate mergers, with savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands on 29 March 2015 and 4 September 2015, respectively. The subordinated liabilities thus assumed share characteristics of equity in that they are subordinated to other Group liabilities and are included in equity in equity ratio calculations, see Note 47, Capital base, risk exposure amount and capital ratios. The outstanding amounts of the subordinated liabilities are subject to regulatory amortisation whereby the amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity.

35. Equity

Share capital

As of 31 December 2017, ordinary shares authorised and issued by the Bank totalled 24 billion while outstanding shares were 23.6 billion. Each share has a par value of ISK 1. Each ordinary share conveys one vote at general meetings of the Bank. All share capital is fully paid up.

On 22 March 2017, shareholders at the Annual General Meeting (AGM) of the Bank for the operating year 2016 approved the Board's recommendation for the Bank to acquire own shares at the maximum of 10% of nominal value of issued share capital in accordance with Article 55 of the Public Limited Companies Act No. 2/1995. The price of each share is to be determined by the internal value of the Bank's shares, according to its most recently published results prior to the timing of the repurchase of the own shares. This authorisation applies until the next AGM in 2018 and the disposal of the own shares under this authorisation is subject to the approval of a shareholders meeting.

Share premium

Share premium represents the difference between the ISK amount received by the Bank when issuing share capital and the nominal amount of the shares issued, less costs directly attributable to issuing the new shares, net of any related tax benefit.

Statutory reserve

The statutory reserve is established in accordance with the Public Limited Companies Act, No. 2/1995, which stipulates that the Bank must allocate profits to the statutory reserve until the reserve is equal to one-quarter of the Bank's share capital.

Retained earnings

In June 2016, the Icelandic parliament passed an amendment to Act No. 3/2006, on Annual Financial Statements. The amendment entered into force immediately and applies to the financial year commencing 1 January 2016. The amendment requires, *inter alia*, the separation of retained earnings into two categories: restricted and unrestricted retained earnings. Unrestricted retained earnings consist of undistributed profits and losses accumulated by the Group since the foundation of the Bank, less transfers to the Bank's statutory reserve and restricted retained earnings. Restricted retained earnings are split into two categories:

Unrealised gains in subsidiaries and equity-accounted associates reserve; if the share of profit from subsidiaries or equity-accounted associates is in excess of dividend received, the Group transfers the difference to a restricted reserve in equity. If the Group's interest in subsidiaries or equity-accounted associates is sold or written off, the applicable amount recognised in the reserve is transferred to retained earnings.

Financial assets designated at fair value through profit or loss reserve. The Group transfers fair value changes arising from financial assets designated at fair value through profit or loss, from retained earnings to a restricted reserve. Amounts recognised in the reserve are transferred back to retained earnings upon sale of the financial asset.

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35. Equity (continued)

Dividend

On 22 March 2017, shareholders at the Annual General Meeting (AGM) of the Bank for the operating year 2016 approved the Board's proposal to pay dividends to shareholders in the total amount of ISK 13,002 million or ISK 0.55 per share. The dividend was paid to shareholders on 29 March 2017. The recommendation of the Board of Directors to pay an extraordinary dividend in the total amount of ISK 11,820 million on outstanding shares, or ISK 0.50 per share, was also approved by the AGM. The extraordinary dividend was paid to shareholders on 20 September 2017. These dividends were payable to shareholders listed on the shareholders' registry of Landsbankinn at end of business on the day of the AGM, 22 March 2017, unless the Bank received notification of assignment of the dividend through the transfer of shares.

Restriction of dividend payments

According to the Public Limited Companies Act, No. 2/1995, it is only permissible to allocate as dividend profit in accordance with approved annual financial statements for the immediate past financial year, profit carried forward from previous years, and free funds after deducting loss which has not been met, and the funds which according to law or Articles of Association must be contributed to a reserve fund or for other use. Furthermore, under the amendment to Act No. 3/2006, on Annual Financial Statements, from June 2016 it is only permissible to allocate as dividend profit from unrestricted retained earnings.

Additionally, according to the Act on Financial Undertakings, No. 161/2002, the Icelandic Financial Supervisory Authority can impose proportionate restrictions on the Bank's dividend payments, if the Bank's capital adequacy ratio falls below the total capital requirement plus capital buffers, see Note 46 Capital requirements.

Other notes

36. Earnings per share

Profit for the year	**2017**	**2016**
Profit for the year attributable to owners of the Bank	19,766	16,633

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

Number of shares	**2017**	**2016**
Number of ordinary shares issued at beginning of year	24,000	24,000
Average number of own shares	(360)	(261)
Weighted average number of shares outstanding	**23,640**	**23,739**
Basic and diluted earnings per share from operations (ISK)	**0.84**	**0.70**

The Bank's basic and diluted earnings per share are equal as the Bank has not issued any options, warrants, convertibles or other potential sources of dilution.

37. Litigation

Material litigation cases against the Bank and its

The Bank and its subsidiaries are from time to time party to litigation cases which arise in the ordinary course of business. Some of these cases are material in the sense that management considers that they may have a significant impact on the amounts disclosed in the Group's financial statements and are not comparable to other, previously closed, cases.

Material litigation cases reported in the Financial

All material cases, reported open in the litigation section of the Group's Consolidated Financial Statements for the year 2016, have now been closed, as reported in the Group´s interim financial statements for the first and second quarters of 2017.

Other cases

In June 2013, a payment card company commenced litigation against the Bank and certain other financial undertakings claiming tort liability in the amount of around ISK 1.2 billion, plus interest. The plaintiff argued that the defendants were liable in tort for alleged violation of competition rules. On 1 June 2017 the Supreme Court confirmed the decision of the District Court to dismiss the case on grounds of insufficient substantiation. In September 2017, the same payment card company commenced litigation against the same defendants as in the previous case claiming tort liability in the amount of ISK 923 million, plus interest. The plaintiff, again, argues that the defendants are liable in tort for alleged violation of competition rules. All defendants have submitted a principal claim for dismissal and a secondary claim for acquittal. The case will be heard by the District Court on 23 February 2018.

In October 2017 the Icelandic Supreme Court rendered a judgment in case no. 623/2016 concluding that a provision in a consumer credit agreement between an individual and a commercial bank, other than Landsbankinn, did not fulfil the requirement stipulated in the Act on Consumer Credit Agreements no 121/1994 to specify the circumstances under which the interest rate may be changed. The Bank has assessed the impact of the case and does not consider that it will have a significant impact on the amounts disclosed in the Group's financial statements.

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37. Litigation (continued)

In December 2014, the Bank sold to Arion Bank hf. all its shares in Valitor Holding hf. (Valitor), the parent company of Valitor hf. The agreement includes an indemnity clause under which the Bank is to proportionally compensate Arion Bank hf. with regards to certain cases concerning Valitor that relate to events that occurred before delivery of the sold shares, inter alia, for potential compensatory damages that Valitor may be obligated to pay for an alleged loss sustained due to Valitor's termination of a vendor agreement. A case on the matter has been filed before the District Court of Reykjavík. The last hearing of the case was on 17 January 2018.

On 16 November 2017 the Supreme Court rendered judgments in cases nos. 770/2016 and 771/2016 acknowledging a claim for recognition of the invalidity of collateral that the Bank had in real estate property owned by a married couple in equal proportions, inter alia, on the grounds that the signature of the spouse of the debtor on a collateral agreement did not indicate that the spouse had agreed to the collateral as regards the part of the property belonging to the spouse, and that other evidence did not indicate that this had been the spouse's intention. On 9 January 2018 the Supreme Court reached a similar conclusion in case no. 736/2017. The Bank is currently assessing the impact of the case.

Proceedings relating to the sale of the Bank´s

In January 2017, Bank commenced proceedings before the Reykjavik District Court against BPS ehf., Eignarhaldsfélagið Borgun slf., Borgun hf. and the then CEO of Borgun hf. In the proceedings, the Bank demands the acknowledgement of the defendants' liability for losses incurred by the Bank because it did not, when the Bank sold its 31.2% shareholding in Borgun hf., have information that the defendants had, but did not disclose to the Bank, on Borgun hf.'s shareholding in Visa Europe Ltd. The defendants demanded the dismissal of the proceedings but those demands were rejected by a ruling of the district court in June 2017. That ruling was not appealable and the defendants have now submitted their written defences responding to the substance of the Bank's pleadings. The proceedings have been delayed while the parties gather evidence.

38. Leasing

Operating lease commitments where the Group is lessee

In cases where the Group is a lessee, the future minimum lease payments under non-cancellable operating leases on 31 December were as follows:

	2017	2016
Less than one year	552	530
Between one and five years	1,797	1,088
More than five years	1,310	1,508
Total	**3,659**	**3,126**

Operating lease commitments where the Group is legal lessor

The Group acts as the legal lessor whereby tools and equipment are purchased and leased to third parties under arrangements that in substance are loans and advances accounted for under IAS 39 in the Consolidated Financial Statements of the Group.

The future minimum lease payments expected to be received under non-cancellable operating leases on 31 December were as follows:

	2017	2016
Less than one year	48	35
Between one and five years	79	152
Total	**127**	**187**

Finance lease commitments where the Group is lessor

The Group acts as lessor whereby items of plant and equipment are leased to third parties under arrangements qualifying as finance leases. Finance lease receivables are included within loans and advances to customers.

The net investment in finance lease receivables was as follows:

At 31 December 2017	Gross investment in finance lease	Future finance income	Present value of minimum lease
Less than one year	4	-	4
Between one and five years	35	(3)	32
Total	**39**	**(3)**	**36**
At 31 December 2016			
Less than one year	72	(5)	67
Between one and five years	42	(3)	39
Total	**114**	**(8)**	**106**

Unguaranteed residual value at year-end 2017 is nil (2016: nil).

39. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the handling, acquisition or disposal of financial instruments. Assets in Bank custody are not reported in the Consolidated Financial Statements, since they are not assets of the Bank. One aspect of these services is that the Group is involved in approving objectives and criteria for investing assets in its custody. As of 31 December 2017, financial assets managed by the Group amounted to ISK 366 billion (2016: ISK 361 billion). Custody accounts amounted to ISK 1.143 billion (2016: ISK 1.025 billion).

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40. Interest in subsidiaries

The main subsidiaries held directly or indirectly by the Group as at 31 December 2017 were as detailed in the table below. This includes those subsidiaries that are most significant in the context of the Group's business. See Note 92.1 (a) for further information on the accounting policies governing the consolidation of subsidiaries.

Main subsidiaries as at 31 December 2017

Company	Ownership interest	Activity
Eignarhaldsfélag Landsbankans ehf. (Iceland)	100%	Holding company
Landsbréf hf. (Iceland)	100%	Management company for mutual funds
Hömlur ehf. (Iceland)*	100%	Holding company

*Hömlur ehf. is a parent of a number of subsidiaries, which are neither individually nor combined significant in the context of the Group's business.

The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities other than those resulting from the supervisory framework. The Group did not have any material non-controlling interests as at 31 December 2017.

41. Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 92.2. Financial investments under control are presented in the following balance sheet lines:

Assets	2017	2016
Bonds and debt instruments	392	342
Equities and equity instruments	2,637	698
Other assets	-	4

Liabilities	2017	2016
Non controlling interests - Funds	2,325	883
Other liabilities	91	6

The Bank holds a majority of the units in the investment funds managed by Landsbréf. These funds are consolidated like subsidiaries in the Bank's Consolidated Financial Statements, with the exception that minority interests are recognised among Other liabilities instead of Equity. The reason for this distinction is that the holders of the units may request redemption of their shareholding and therefore the units do not meet the requirements of the definition of equity.

42. Unconsolidated structured entities

Where the Group acts as an agent for the investor, it does not consolidate the investment funds. When the Group holds investments in unconsolidated investment funds, they are classified as financial investments designated at fair value through profit or loss. The fair value of these investments represents the Group's maximum exposure to loss from its investments into such unconsolidated investment funds.

			Total assets	
Type of structured entity	Nature and purpose	Interest held by the Group	2017	2016
Investment funds	To generate fees from managing assets on behalf of third party investors.	Management fees	97,273	113,417
	These vehicles are financed through the issue of units to investors	Investment in units issued by fund		

The following table shows an analysis of the carrying amounts of interests held by the Group in unconsolidated structured entities. The Group's maximum exposure to loss is the carrying amount of the assets held.

	Carrying amount	
Investment securities	2017	2016
Investment funds	2,159	1,265
Total	**2,159**	**1,265**

43. Guarantees / Off-balance sheet exposures within the Group

These guarantees are provided in the normal course of banking business. The Group's maximum exposures to credit risk as at 31 December 2017 were as follows:

	Carrying amount	
Off-balance sheet exposure 31 December	2017	2016
Financial guarantees	604	442
Undrawn overdraft and credit card facilities	1,307	1,563

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44. Related party transactions

Related parties

The Icelandic State Treasury, on behalf of the Icelandic State, holds 98.2% of shares in the Bank at year-end 2017. Government bodies and public institutions qualifying as related parties are the Ministry of Finance, the ISFI (Icelandic State Financial Investments), and entities and institutions related to them.

Transactions between the Bank and its subsidiaries meet the definition of related party transactions. All transactions with subsidiaries are eliminated on consolidation and are thus not disclosed in the Group's Consolidated Financial Statements. Further details about the main subsidiaries can been seen in Note 40 Interest in subsidiaries.

The key management personnel of the Bank and their close family members meet the definition of related parties and in some cases, the key management personnel of the Bank's subsidiaries. The key management personnel of the Bank are the members of the Board of Directors, the CEO, managing directors and other managers with the authority and responsibility to organise, manage and control the Bank's activities. The Minister for Finance and the Board of Directors of Icelandic State Financial Investments meet the definition of related parties due to the scope of their authority to influence Bank policy.

Transactions with related parties

Transactions with the Icelandic government and government-related entities

The Group's products and services are offered to the Icelandic government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from government-related entities at market price and otherwise under generally accepted commercial terms. The nature of and amounts outstanding with public entities are disclosed in Note 60 under Public entities.

In March 2016, the Icelandic State Treasury took over Íslandsbanki hf. Following the takeover a settlement was reached with the Icelandic Competition Authority to the effect that both banks will continue to operate as independent competitors in the financial market. The takeover qualifies as a merger under Icelandic competition law, as the Icelandic State Treasury has control over the two banks as of the time of the takeover. The Bank has a traditional bank-to-bank relationship with Íslandsbanki under generally accepted commercial terms. The nature of and amounts outstanding with financial institutions, including Íslandsbanki, are disclosed in Note 60, under Financial institutions.

Transactions with other related parties

The following table presents the total amounts of loans to key management personnel and parties related to them and loans to associates of the Group:

	2017		2016	
Loans in ISK million	**Balance as at 31 December**	**Highest amount outstanding**	**Balance as at 31 December**	**Highest amount outstanding**
Key management personnel	227	245	136	142
Parties related to key management personnel	71	182	31	59
Associates	15,382	21,189	14,917	21,192
Other	26	125	123	127
Total	**15,706**	**21,741**	**15,207**	**21,520**

No specific allowance for impairment was recognised in respect of these loans.

No financial pledges or commitments have been given or received in respect of these transactions during the reporting period. However, financial guarantees were given to an associate of the Bank during the period. There are no lease transactions between related parties during the year.

The following table presents the total amounts of deposits received from key management personnel and parties related to them and associates of the Group:

	2017		2016	
Deposits in ISK million	**Balance as at 31 December**	**Highest amount outstanding**	**Balance as at 31 December**	**Highest amount outstanding**
Key management personnel	118	140	105	298
Parties related to key management personnel	30	86	31	227
Associates	3,718	16,885	1,132	15,624
Other	211	3,406	501	7,479
Total	**4,077**	**20,517**	**1,769**	**23,628**

44. Related party transactions (continued)

Transactions with other related parties (continued)

The following table presents the total amount of guarantees to key management personnel and parties related to them and associates of the Group:

Guarantees in ISK million	Balance as at 31 December 2017	Balance as at 31 December 2016
Key management personnel	-	-
Parties related to key management personnel	-	-
Associates	578	-
Total	**578**	**0**

All of the above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

Effect on income statement

The following table presents the total amount of interest income and expense recognised by the Group in relation to key management personnel and parties related to them and associates of the Group:

	2017		2016	
Interest income and expense	**Interest income**	**Interest expense**	**Interest income**	**Interest expense**
Key management personnel	9	10	5	2
Parties related to key management personnel	3	1	1	-
Associates	884	34	783	31
Other	1	11	6	24
Total	**897**	**56**	**795**	**57**

The following table presents the total amount of other income and expense recognised by the Group in relation to key management personnel and parties related to them and associates of the Group:

	2017		2016	
Other income and expense	**Other income**	**Other expense**	**Other income**	**Other expense**
Associates	-	662	-	668
Total	**0**	**662**	**0**	**668**

All of the above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and collaterals, as those prevailing at the time for comparable transactions with third party counterparties.

44. Related party transactions (continued)

The following table presents the total amount of compensation to Directors, CEOs and Managing Directors for the year 2017:

Salary and benefits for the year 2017	Salary and benefits*	Defined contri-butions**	Total
Helga Björk Eiríksdóttir, Chairman of the Board of Directors	10.8	1.2	12.0
Magnús Pétursson, Vice-chairman of the Board of Directors	8.2	0.3	8.5
Berglind Svavarsdóttir, Director	7.1	0.8	7.9
Einar Þór Bjarnason, Director	7.3	0.8	8.1
Hersir Sigurgeirsson, Director	7.3	0.8	8.1
Jón Guðmann Pétursson, Director	7.3	0.8	8.1
Sigríður Benediktsdóttir, Director	5.7	0.6	6.3
Samúel Guðmundsson, Alternate Director	2.3	0.2	2.5
Ásta Dís Óladóttir, Former Director	0.2	0.0	0.2
Danielle Pamela Neben, Former director	1.1	0.1	1.2
Lilja Björk Einarsdóttir, CEO	27.0	5.2	32.2
Hreiðar Bjarnason, CFO***	31.2	6.0	37.2
Five Managing Directors of the Bank's divisions and one former Managing Director of the Bank's divisions****	174.3	33.4	207.7
Total	**289.8**	**50.2**	**340.0**

*Benefits are non-monetary benefits such as the use of cars owned by the Group.

**Includes both private and statutory contributions to independent pension funds without further obligation.

***Interim CEO from 30 November 2016 to 15 March 2017.

****In 2017, a termination of employment agreement was concluded with one Managing Director. All contractual termination payments have been recognised in the income statement for the year 2017.

In 2017 the total monthly average salary and benefits of the current CEO of the Bank amounted to ISK 2.8 million over a nine and a half month period and the average monthly salary and benefits of Managing Directors of the Bank's divisions amounted to ISK 2.6 million. At year-end 2017, the current CEO does not hold any shares in the Bank but six Managing Directors of the Bank's divisions hold a total of 2.4 million shares in the Bank.

The following table presents the total amount of compensation to Directors, CEOs and Managing Directors for the year 2016:

Salary and benefits for the year 2016	Salary and benefits*	Defined contri-butions**	Total
Helga Björk Eiríksdóttir, Chairman of the Board of Directors	8.6	0.9	9.5
Magnús Pétursson, Vice-chairman of the Board of Directors	5.0	0.5	5.5
Berglind Svavarsdóttir, Director	4.4	0.5	4.9
Danielle Pamela Neben, Director	6.6	0.5	7.1
Einar Þór Bjarnason, Director	4.4	0.5	4.9
Hersir Sigurgeirsson, Director	4.4	0.5	4.9
Jón Guðmann Pétursson, Director	4.4	0.5	4.9
Samúel Guðmundsson, Alternate Director	0.9	0.1	1.0
Tryggvi Pálsson, former Chairman of the Board of Directors	3.2	0.3	3.5
Eva Sóley Guðbjörnsdóttir, former Vice-chairman of the Board of Directors	2.5	0.3	2.8
Jóhann Hjartarson, former Director	2.2	0.2	2.4
Jón Sigurðsson, former Director	2.2	0.2	2.4
Kristján Þórarinn Davíðsson, former Director	2.2	0.2	2.4
Ásbjörg Kristinsdóttir, former Alternate Director	0.4	-	0.4
Tinna Laufey Ásgeirsdóttir, former Alternate Director	0.5	-	0.5
Steinþór Pálsson, former CEO***	24.5	7.4	31.9
Hreiðar Bjarnason, interim CEO & CFO	29.8	5.6	35.4
Five Managing Directors of the Bank's divisions	153.8	28.8	182.6
Total	**260.0**	**47.0**	**307.0**

*Benefits are non-monetary benefits such as the use of cars owned by the Group.

**Includes both private and statutory contributions to independent pension funds without further obligation.

***In 2016, an agreement on termination of employment was reached with the former CEO. All estimated contractual termination payments have been recognised as expense in the income statement for the year 2016.

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44. Related party transactions (continued)

In 2016 the total monthly average salary and benefits of the former CEO and current interim CEO of the Bank amounted to ISK 2.3 million and the average monthly salary and benefits of Managing Directors of the Bank's divisions amounted to ISK 2.6 million. At year-end 2016, the former CEO of the Bank holds 0.3 million shares in the Bank, the current interim CEO & CFO holds 0.5 million shares and five Managing Directors of the Bank's divisions hold a total of 1.5 million shares in the Bank.

Transactions with the Minister of Finance and members of the Board of Directors of ISFI

The Minister of Finance and the members of the Board of Directors of ISFI did not receive any salaries or similar payments from the Group during the year 2017. The Group did not enter into any transactions with these persons or close members of their families, other than normal banking transactions which were made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

45. Events after the reporting period

No events have arisen after the reporting period of these financial statements that require amendments or additional disclosures in the Consolidated Financial Statements for the year ended 31 December 2017.

Capital management

46. Capital requirements

The Group's capital management policies and practices aim to ensure that the Group has sufficient capital to cover the risks associated with its activities on a consolidated basis. The capital management framework of the Group comprises four interdependent areas: capital assessment, risk appetite/capital target, capital planning, and reporting/monitoring. The Group regularly monitors and assesses its risk profile in key business areas on a consolidated basis and for the most important risk types. Risk appetite sets out the level of risk the Group is willing to take in pursuit of its business objectives.

The Group's capital requirements are defined in Icelandic law and regulations and by the Icelandic Financial Supervisory Authority (FME). The requirements are based on the European legal framework for capital requirements (CRD IV and CRR), implementing the Basel III capital framework. The regulatory minimum capital requirement under Pillar I is 8% of Risk Exposure Amount (REA) for credit risk, market risk and operational risk. In conformity with Pillar II A requirements, the Bank annually assesses its own capital needs through the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP results are subsequently reviewed by the FME in the Supervisory Review and Evaluation Process (SREP). The Group's minimum capital requirement, as determined by the FME, is the sum of Pillar I and Pillar II A requirements.

In addition to the minimum capital requirement, the Bank is required by law to maintain certain capital buffers determined by the FME, which may, depending on the situation, be based on recommendations from the Icelandic Financial Stability Counsel (FSC). The FSC has defined Landsbankinn as a systematically important financial institution in Iceland.

The Group's most recent capital requirements, as determined by the FME, are as follows (as a percentage of REA):

31.12.2017	CET1	Tier 1	Total
Pillar I	4.5%	6.0%	8.0%
Pillar II A	2.8%	3.7%	4.9%
Minimum requirement under Pillar I and Pillar II A	**7.3%**	**9.7%**	**12.9%**
Systemic risk buffer	2.8%	2.8%	2.8%
Capital buffer for systematically important institutions	2.0%	2.0%	2.0%
Countercyclical capital buffer	1.2%	1.2%	1.2%
Capital conservation buffer	2.5%	2.5%	2.5%
Combined buffer requirement under Pillar II B	**8.5%**	**8.5%**	**8.5%**
Total capital requirement	**15.8%**	**18.2%**	**21.4%**

- The combined buffer requirement (CBR) shall be met in full with Common Equity Tier 1 (CET1) capital.
- Tier 1 capital is the sum of Common Equity Tier 1 (CET1) capital and Additional Tier 1 (AT1) capital.
- Total capital is the sum of Tier 1 capital and Tier 2 capital.

The Bank aims to maintain at all times capital ratios above FME's capital requirements, in addition to a management capital buffer that is defined in the Bank's risk appetite. The Bank also aims to be in the highest category for risk-adjusted capital ratio, as determined and measured by the relevant credit rating agencies.

The Group's capital requirements for the year 2016, as determined by the FME, are as follows (as a percentage of RWA)*:

	SREP based on data from 31.12.2015
Pillar I	8.0%
Pillar II A	6.0%
Minimum capital requirement	**14.0%**
Systemic risk buffer	2.7%
Capital buffer for systematically important institutions	2.0%
Countercyclical capital buffer	0.9%
Capital conservation buffer	2.5%
Combined buffer requirement	**8.1%**
Total capital requirement	**22.1%**

* As a part of the annual SREP, the FME requires the Bank to maintain a capital ratio that reflects the fully phased-in capital buffers.

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47. Capital base, risk exposure amount and capital ratios

The following table shows the Group's capital base, risk exposure amount and capital ratios. The calculations are in accordance with Chapter X of the Act on Financial Undertakings, No. 161/2002. The Group uses the standardised approach to calculate the risk exposure amount for credit risk and market risk, and the basic indicator approach for operational risk.

Capital base	2017	2016
Share capital	23,640	23,648
Share premium	120,764	120,847
Reserves	12,902	10,875
Retained earnings	88,751	95,834
Total equity attributable to owners of the Bank	**246,057**	**251,204**
Intangible assets	(3,044)	(2,634)
Common equity Tier 1 capital (CET1)	**243,013**	**248,570**
Non-controlling interests	-	27
Tier 1 capital	**243,013**	**248,597**
Subordinated liabilities	77	388
Regulatory amortisation	-	(203)
General credit risk adjustment	4,037	4,024
Tier 2 capital	**4,114**	**4,209**
Total capital base	**247,127**	**252,806**
Risk exposure amount (REA)		
Credit risk	809,492	728,428
Market risk	17,664	16,519
Operational risk	96,962	91,811
Total risk exposure amount	**924,118**	**836,758**
CET1 ratio	26.3%	29.7%
Tier 1 capital ratio	26.3%	29.7%
Total capital ratio	26.7%	30.2%

48. Leverage ratio

The following table shows the Group's leverage ratio as at 31 December 2017 and 31 December 2016. The requirements are based on the European legal framework for capital requirements (CRD IV and CRR) implementing the Basel III capital framework. Subject to Article 30(a) of Act No. 161/2002, on Financial Undertakings, a minimum leverage ratio of 3.0% is required.

Leverage ratio	31.12.2017	31.12.2016
- On-balance sheet exposure (excluding derivatives)	1,190,965	1,110,879
- Derivative instrument exposure	1,905	278
- Potential future exposure on derivatives	1,568	835
- Off-balance sheet exposure	141,482	113,267
- Regulatory adjustments to Tier 1 capital	(3,044)	(2,634)
Total leverage exposure	**1,332,876**	**1,222,625**
Tier 1 capital	**243,013**	**248,597**
Leverage ratio	**18.2%**	**20.3%**

Economic capital

49. Economic capital framework

Economic Capital (EC) is a risk measure which is applied to all material risks. It captures unexpected losses and reduction in value or income for which the Group needs to hold capital to avoid insolvency. It arises from the unexpected nature of losses as distinct from expected losses. EC is defined as the difference between unexpected losses and expected losses, where unexpected loss is defined as the 99.9% Value-At-Risk (VaR), with a one year time horizon.

The purpose of the EC framework is to enable the Group to assess the amount of capital it requires to cover the economic effects of risk-taking activities, as well as to compare different risk types using a common "risk currency".

The objective of the EC framework is to measure unexpected losses as well as to decompose EC on various levels to enable capital allocation, limit setting, pricing of products, risk-adjusted performance measurement and value-based management.

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49. Economic capital framework (continued)

The framework covers the following risk types: credit risk, market risk, currency risk, operational risk, concentration risk, interest rate risk and inflation risk in the banking book, business risk and legal and regulatory risk.

The following summarises how the Group calculates its EC for these risks:

Credit risk:
The credit risk EC model is the asymptotic single risk factor (ASRF) model from the Basel II internal rating based (IRB) approach's risk weight formula, i.e. the EC equals the capital requirements of the IRB approach in the capital requirements directive. The main input to the model are the risk parameters probability of default (PD), loss given default (LGD) and exposure at default (EAD).

Market risk:
Economic capital for market risk includes EC for interest rate risk in the trading book and EC for equity price risk in the trading book.

EC for interest rate risk in the trading book and EC for equity price risk in the trading book is calculated according to a Stressed Value at Risk model as specified in the internal models approach in the capital requirements directive (CRR). The model inputs are calibrated to historical data from the previous five years.

EC for credit valuation adjustment equals the capital requirements for credit valuation adjustment.

Currency risk:
EC for foreign exchange risk is calculated according to a modified Stressed Value at Risk model where the model inputs are calibrated to historical data from a period of significant stress relevant to the Groups' net FX position. The time horizon is one year.

Operational risk:
EC for operational risk is calculated using the basic indicator approach, which means that it equals the Group's capital requirement.

Concentration risk:
EC for single name concentration is calculated by adjusting for the granularity and non-homogeneity in the loan portfolio. This is necessary as the credit risk EC model assumes that the portfolio is infinitely large and homogeneous; hence, the single name concentration EC is given as an add-on.

An internal model is used to measure the additional EC for credit risk related to industry concentrations in the loan portfolio, i.e. a concentration add-on. The model calculates the industry concentration risk for the loan portfolio and subtracts the industry concentration risk for Iceland to get the EC add-on for industry concentration.

Interest rate risk and inflation risk in the banking book:
EC for interest rate risk and inflation risk in the banking book is equal to the loss in economic value (EV) for assets and liabilities in all currencies. The loss in EV in ISK is the loss corresponding to the 99.9th percentile of interest rate and inflation risk factor changes estimated by a Monte Carlo simulation model. The loss in EV for other currencies is the loss resulting from a flat 200bp shift (with a zero rate floor) of the corresponding yield curves.

Business risk:
EC for business risk is calculated using an internal model, which is based on the volatility of the Group's income, before profit or loss due to any other material risk.

Legal and regulatory risk:
EC for legal and regulatory risk is calculated by adding the potential loss of on-going disputes. The significance of a dispute is weighted by its status within the legal system.

50. Economic capital by risk type

As the credit quality remained fairly stable during 2017 the increase in economic capital due to credit risk is on account of and in line with increased lending. The Group also updated its industry concentration risk calculations which results in a decrease to the measurement value.

Economic capital calculations for equity price risk in the trading book was also changed at year-end. The EC for equity price risk in the trading book is now calculated as specified in the capital requirements directive (CRR) using a stressed Value at Risk model replacing the previous "Simple risk weight approach". These changes resulted in higher economic capital due to equity price risk.

The Group also adjusted its methodology in estimating interest rate risk in the banking book in foreign currency by introducing a 0% floor for yield curve shifts as specified by regulators. As a result, economic capital for interest rate risk and inflation risk in the banking book was significantly reduced.

Capital requirements for credit valuation adjustment took place in the year 2017. The Group does not assess excess capital due to this risk as it is not considered material.

50. Economic capital by risk type (continued)

Economic capital ISK million	2017	2016
Credit risk - Loans to customers and credit institutions	59,477	53,835
Credit risk - Other assets	7,001	6,769
Market risk	2,717	1,396
Currency risk	948	875
Operational risk	7,757	7,345
Single name concentration risk	5,048	4,784
Industry concentration risk	1,224	2,600
Interest rate risk and inflation risk in the banking book	10,072	15,889
Business risk	3,878	3,672
Legal and regulatory risk	482	1,579
Total	**98,604**	**98,744**
EC/REA	10.7%	11.8%

	Weighted average			
Credit risk as at 31 December 2017	Probability of default (PD)	Loss given default (LGD)	Exposure at default (EAD)	Economic capital (EC)
Financial institutions	0.1%	45.0%	46,818	783
Public entities	0.1%	45.0%	150,347	173
Individuals, small and medium-sized enterprises	2.9%	26.4%	415,860	12,989
Corporates	2.6%	37.3%	608,843	45,532
Total EC	**2.3%**	**34.8%**	**1,221,868**	**59,477**
Credit risk as at 31 December 2016				
Financial institutions	0.2%	45.0%	23,040	584
Public entities	0.2%	45.0%	134,713	135
Individuals, small and medium-sized enterprises	3.5%	26.9%	383,686	12,989
Corporates	2.4%	38.4%	566,046	40,127
Total EC	**2.5%**	**35.4%**	**1,107,485**	**53,835**

Risk management

51. Risk management structure

Risk committees

The Group's risk management governance structure as at year-end 2017 is as follows:

Board of Directors

Supervision by the Board of Directors and its sub-committees:

- Audit Committee
- Remuneration Committee
- Risk Committee
- Strategic Development Committee

Key risk management bodies and committees

Committee	Chair	Other members
Executive Board	CEO	Managing directors
Risk & Finance Committee	CEO	CFO, CRO, Head of Legal Department,
Credit Committee	CEO	CRO, MD of Corporate Banking, MD of Personal Banking
Operational Risk Committee	CRO	MD of Personal Banking, MD of IT, Head of Compliance, Director of Operational Risk

The Board of Directors of the Bank has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite and risk limit setting. The CEO is responsible for the effective implementation of the framework and risk appetite through the corporate governance structure and committees. The CEO has established and is a member of the Executive Board, the Risk & Finance Committee and the Credit Committee.

51. Risk management structure (continued)

Risk committees (continued)

The Credit Committee deals with credit risk – individual credit decisions, credit limits on customers and credit risk policy – while the Risk & Finance Committee covers primarily market risk, liquidity risk and legal risk. The Risk & Finance Committee monitors the Group's overall risk position, is responsible for enforcing the Group's risk appetite and risk limits, and reviews and approves changes to risk models before they are presented to the Board of Directors. The Executive Board serves as a forum for consultation and communication between the CEO and the managing directors, addressing the main current issues in each division and takes decisions on operating matters not being considered in other standing committees. The Operational Risk Committee is a forum for discussions and decisions on operational risk issues and review of the effective implementation of the operational risk framework.

Risk Management Division

The Bank's Risk Management Division is responsible for the Bank's risk management framework. Subsidiaries of the Bank have their own risk management functions and the Risk Management Division receives information on exposures from the subsidiaries and collates them into Group exposures. The Risk Management Division is also responsible for comprehensive risk reporting on risk positions to various internal departments and committees and supervisory authorities.

The Risk Management Division is comprised of four departments.

• The Credit Management Department reviews credit decisions made by the Bank's business units when credit applications exceed the business units limits. The Department has veto rights on those credit applications. Confirmation by Credit Management implies that Credit Management has reviewed the credit application and does not exercise its veto rights. Credit applications exceeding the confirmation limits of the Risk Management Division are referred to the Bank's Credit Committee.

• The Credit Risk & Economic Capital Department is responsible for providing the Group with internal models on credit risk and credit monitoring systems as well as related processes to measure and monitor credit risk and economic capital. The Department also supports the implementation of such models and processes within the Bank. In addition, the Department is responsible for credit risk, economic capital and impairment analysis and reporting within the Bank.

• The Market Risk Department is responsible for measuring, monitoring and reporting on market risk, liquidity risk and interest rate risk in the Group's banking book. The Department develops and maintains the Bank's market risk models and maintains the Group's Market Risk Policy and Liquidity Risk Policy as well as implementing processes to measure and monitor market risk and liquidity risk within the Group. Market Risk is also responsible for monitoring all derivatives trading the Bank enters into, both for hedging and trading purposes, as well as FX balance monitoring for the Group.

• The Operational Risk Department is responsible for ensuring that the Group's operational risks are monitored and that the Bank implements and maintains an effective operational risk management framework. The Department assists the Bank's managers with operational risk assessment incidents related to normal operations and operational loss incidents analysis, and oversees continuity plans. The Department is partly responsible for the security system for the online bank. The Operational Risk Department leads the work on the Bank's certification under the ISO 2701 standard for information security.

The Compliance function monitors, advises and handles instruction on Landsbankinn's actions to combat money laundering and terrorist financing, and specific aspects of the implementation of laws on securities trading, including measures to minimise conflict of interest. Compliance also implements work procedures to control, monitor and assess compliance risk in the Bank's operation. Compliance is one of the Group's support functions and a part of its corporate culture.

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve the Group's operations. The Board has oversight of Internal Audit and appoints the Chief Internal Auditor. It helps the Group to evaluate and improve the effectiveness of its risk management, controls, and governance processes. Internal Audit determines whether the risk management framework, control, and governance processes as designed and represented by management are adequate and functioning, and thus supports the Group in accomplishing its objectives.

52. Risk appetite

The Group's risk appetite has been reviewed, revised and implemented for 2018. The Group's risk policy is as follows:

The Bank provides universal financial services to customers. For this purpose, the Bank has set itself objectives regarding financial position, asset quality, exposures and sustainable long-term profitability. In the pursuit of its goals, the Bank only takes on risks that it understands, is able to evaluate and manage. The Bank aims to be comparable with leading banks in the Nordic countries in similar fields.

The Bank seeks to maintain solid business relationships, having regard for its own position as well as that of customers at each time and with due regard for any internal connections between customers. The Bank pursues long-term business relationships and aims to avoid being linked to transactions that might damage its reputation.

The Bank seeks to ensure diversified and sound financing and a sustainable risk profile in its balance sheet. The Bank has set internal limits that provide for a strong capital and liquidity position which, along with active risk management, ensure long-term profitability and strong standing. In this manner, the Bank aims to minimise fluctuation in its operations and is well positioned to withstand stress scenarios.

52. Risk appetite (continued)

The Bank's corporate culture is characterised by professionalism and processes that support a high level of risk management. Managers are responsible for monitoring and managing risk within their units. Decisions are based on a thorough and professional discussion of major advantages having the long-term interests of Landsbankinn and its customers in mind. Efficient follow-up on decisions and risk monitoring are integral to the Bank's operations.

53. Risk assessment

Risk is inherent in the Group's activities and is managed through a process of on-going identification, measurement, management and monitoring, subject to risk limits and other controls. Risk identification involves finding the origins and structures of possible risk factors in the Group's operations and undertakings. Risk measurement entails measuring the identified risks for management and monitoring purposes. Finally, risk controls and limits ensure compliance with rules and procedures, as well as adherence with the Group's risk appetite.

The objective of the Group's risk policies and procedures is to ensure that the risks in its operations are detected, measured, monitored and effectively managed. Exposure to risks is managed to ensure that it will remain within limits and the risk appetite adopted by the Group will comply with regulatory requirements. In order to ensure that fluctuations which might affect the Group's equity as well as performance are kept limited and manageable, the Group has adopted policies regarding the risk structure of its asset portfolio which are covered in more detail under each risk type.

Risk policy is implemented through the risk appetite, goal setting, business strategy, internal policies and limits that comply with the regulatory framework of the financial markets.

The Group is exposed to the following material risks which arise from financial instruments:

- Credit risk
- Operational risk
- Market risk
  - Currency risk
  - Interest rate risk
  - Other market risk
- Liquidity risk

The table below provides a link between the Group's business units and the principal risks that they are exposed to. The significance of risk is assessed within the context of the Group as a whole and is measured based on allocation of Economic Capital within the Group.

Principal risk	Personal Banking	Corporate Banking	Markets	Treasury
Credit risk	High	High	Low	Low
Operational risk	Medium	Medium	High	Medium
Market risk	Low	Low	Medium	High
Liquidity risk	n/a	n/a	n/a	High

The Group also manages other relevant risks, such as concentration, business, legal and compliance risks.

The above material risks are addressed in the following notes.

Credit risk

54. Credit risk identification

Credit risk is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to fulfil their agreed obligations and the estimated value of pledged collateral does not cover existing claims.

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Credit risk is the greatest single risk faced by the Group and arises principally from loans and advances to customers and from investments in debt securities, but also from commitments, guarantees and documentary credits, counterparty credit risk in derivatives contracts, and the aforementioned settlement risk.

55. Credit risk assessment

Credit risk is measured in three main dimensions: probability of default (PD), loss given default (LGD) and exposure at default (EAD). For the purpose of measuring PD, the Group has developed an internal rating system, including a number of internally developed rating models. The objectives of the rating system are to provide a meaningful assessment of obligor characteristics; a meaningful differentiation of credit quality; and accurate and consistent quantitative estimates of default risk, i.e. probabilities of default (PD). Internal ratings and associated PD are essential in the risk management and decision-making process, and in the credit approval and corporate governance functions.

55. Credit risk assessment (continued)

The rating system has an obligor rating scale which reflects exclusively quantification of the risk of obligor default, or credit quality. The obligor rating scale has 10 rating grades for non-defaulted obligors going from ‘1’ to ‘10’, ‘10’ indicating the highest credit quality, and the grade ‘0’ for defaulted obligors. The rating assignment is supported by rating models, which takes information such as industry classification, financial accounts and payment behaviour into account.

The following table shows the Group's internal mapping from internal rating grade to S&P rating grades:

	S&P	Lower PD	Upper PD
10	AAA/AA+/AA/AA-	0.00%	0.04%
9	A+/A/A-	0.04%	0.10%
8	BBB+	0.10%	0.21%
7	BBB/BBB-	0.21%	0.46%
6	BB+/BB	0.46%	0.99%
5	BB-	0.99%	2.13%
4	B+	2.13%	4.54%
3	B	4.54%	9.39%
2	B-	9.39%	18.42%
1	CCC/C	18.42%	99.99%
0	D	In default	In default

The rating assignment and approval is an integrated part of the credit approval process and assignment shall be updated at least annually or when material information on the obligor or exposure becomes available, whichever is earlier.

LGD is measured using an internal LGD model for the purpose of EC calculations. The internal LGD model takes into account more types of collateral and is more sensitive to the collateralisation level than the Basel model.

Exposure at default is an estimate of the amount outstanding (drawn amounts plus likely future drawdowns of yet undrawn lines) in case the borrower defaults.

56. Credit risk control and monitoring

The Group monitors exposures to identify signs of weakness in customer earnings and liquidity as early as possible.

To monitor customers, the Group uses - supplemental to ratings - an Early Warning System which classifies credit exposures to four credit risk groups. The colour classification is the following:

- Green: the customer are considered as performing without signs of repayment problems;
- Yellow: the customer shows indication of deteriorating financial strength, which could lead to financial difficulties;
- Orange: the customer is or has been in financial difficulties or default;
- Red: the customer is in default and in legal collection and/or restructuring.

The Credit Risk Department within Risk Management, together with the business units, is responsible for the colour classification of customers.

57. Credit risk management and policy

The Group’s credit risk management is based on active monitoring by the Board of Directors, the CEO, the Risk & Finance Committee, the Credit Committee, the credit departments within the Risk Management Division and the business units. The Group manages credit risk according to its risk appetite statement and credit policy approved by the Board of Directors as well as detailed lending rules approved by the CEO. The risk appetite and credit policy include limits on large exposures to individual borrowers or groups of borrowers, concentration of risk and exposures to certain industries. The CEO ensures that the risk policy is reflected in the Group’s internal framework of regulations and guidelines. The Bank’s executives are responsible for the Bank's business units to execute the risk policy appropriately as the CEO is responsible for the oversight of the process as a whole.

Incremental credit authorisation levels are defined based on size of units, types of customers and lending experience of credit officers. The Group has also implemented industry policies to the credit decision process. Credit decisions exceeding authorization levels of business units are subject to confirmation by Credit Management, a department within Risk Management. Credit decisions exceeding the limits of Credit Management are subject to approval by the Group's Credit Committee. Credit decisions exceeding the limits of the Credit Committee are subject to approval by the Board of Directors which holds the highest credit authorisation within the Bank.

58. Credit risk mitigation

Mitigating risk in the credit portfolio is a key element of the Group’s credit policy as well as being an inherent part of the credit-decision process. Securing loans with collateral is the main method of mitigating credit risk whereas for some loan products, collateral is required by legislation, as in the mortgage finance market, or is standard market practice.

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58. Credit risk mitigation (continued)

The most important types of collateral are real estate, vessels and financial assets (shares or bonds).

The amount and type of collateral required depends on an assessment of the credit risk associated with the counterparty. Valuation parameters and the acceptability of different types of collateral are defined in the Group's credit policy. Credit extended by the Group may be secured on residential or commercial properties, land, securities, transport vessels, fishing vessels together with their non-transferable fishing quotas, etc. The Group also secures its loans by means of receivables, inventory and operating assets, such as machinery and equipment. Residential mortgages involve the underlying residential property. Less stringent requirements are set for securing short-term personal loans, such as overdrafts and credit card borrowings.

The Group regularly assesses the market value of collateral received. The Group has developed models to estimate the value of the most frequent types of collateral. For collateral for which no valuation model exists, the Group estimates the value as the market value less a haircut. The haircut represents a conservative estimate of the costs to sell in a forced sale. Costs to sell include maintenance costs in the period over which the asset is up for sale, fees for external advisory services and any loss in value. For listed securities, haircuts are calculated with an internal model based on variables, such as price volatility and marketability.

The Group monitors the market value of mark-to-market collateral and may require additional collateral in accordance with the underlying loan agreements.

In order to limit further the credit risk arising from financial instruments, the Group enters into netting agreements, under which the Group is able to set off all contracts covered by the netting agreement against the debt in cases of default. The arrangements generally include all market transactions between the Group and the client.

Generally, collateral is not held over loans and advances to financial institutions, nor is it usually held against bonds and debt instruments.

The Group includes all collateral to which a value is assigned in accordance with its internal procedures. Guarantees are included if they imply lower risk weights than the original exposure. In addition, collateral is volatility-adjusted (by means of a haircut) in order to take into account price volatility and the expected costs of repossession and sale of the pledge.

Derivative financial instruments

In order to mitigate credit risk arising from derivatives, the Group chooses the counterparties for derivatives trading based on stringent rules, according to which clients must meet certain conditions set by the Group. The Group also enters into standard International Swaps and Derivatives Association (ISDA) master netting agreements and similar general netting agreements with financial counterparties. Commensurate collateral and margin requirements are in place for all derivative contracts the Group enters into. Collateral management and monitoring is performed daily and derivative contracts with clients are usually fully hedged.

The Group's supervision system monitors both derivatives exposure and collateral value and calculates a credit equivalent value for each derivative intraday. It also issues margin calls and manages netting agreements.

Amounts due to and from the Group are offset when the Group has a legally enforceable right to set off a recognised amount and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. External ratings are used where applicable to assist in managing the credit risk exposure of bonds. Otherwise the Group uses fair value estimates based on available information and the Group's own estimates.

59. Impairment process

Group policy requires that individual financial assets above materiality thresholds are reviewed at least quarterly, and more frequently when circumstances require. Impairment allowances on individually assessed accounts are determined on a case-by-case basis by evaluating incurred losses at the reporting date. Collectively assessed impairment allowances are permitted in the following cases: (i) portfolios of homogeneous loans that are individually below materiality thresholds, and (ii) losses that have been incurred but not yet identified, using the available historical experience together with experienced judgement and statistical techniques.

Should the expected cash flows be re-examined and the present value of the cash flows (calculated using the effective interest rate) be revised, the difference is then recognised in profit or loss (as either impairment or net adjustments to loans and advances). Impairment is calculated using the effective interest rate, before any revision of the expected cash flows. Any adjustments to the carrying amount which result from revising the expected cash flows are recognised in profit or loss. The impact of financial restructuring of the Group's customers is reflected in loan impairment, or net adjustments to loans and advances, as the expected cash flow of customers has changed.

60. Maximum exposure to credit risk and concentration by industry sectors

The following tables show the Group's maximum credit risk exposure at 31 December 2017 and 31 December 2016. For on-balance sheet assets, the exposures are based on net carrying amounts as reported in the Consolidated Statement of Financial Position. Off-balance sheet amounts are the maximum amounts the Group might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities.

The Group uses the ISAT 08 industry classification for corporate customers.

				Corporations										
As at 31 December 2017	**Financial institutions**	**Public entities***	**Individuals**	**Fisheries**	**Construction companies**	**Real estate companies**	**Holding companies**	**Retail**	**Services**	**ITC****	**Manu-facturing**	**Agriculture**	**Other**	**Carrying amount**
Cash and balances with Central Bank	-	55,192	-	-	-		-	-	-	-	-	-	-	**55,192**
Bonds and debt instruments	2,149	104,314	-	-	-	9,352	70	-	-	-	-	-	1,425	**117,310**
Derivative instruments	1,744	-	-	-	-	1	145	11	2	-	-	-	2	**1,905**
Loans and advances to financial institutions	44,866	-	-	-	-	-	-	-	-	-	-	-	-	**44,866**
Loans and advances to customers	-	11,243	356,940	114,355	80,067	123,483	25,943	52,363	103,706	31,624	17,185	8,726	1	**925,636**
Other financial assets	2,762	32	80	18	738	4	35	2	1,613	1	168	-	4	**5,457**
Total on-balance sheet exposure	**51,521**	**170,781**	**357,020**	**114,373**	**80,805**	**132,840**	**26,193**	**52,376**	**105,321**	**31,625**	**17,353**	**8,726**	**1,432**	**1,150,366**
Off-balance sheet exposure	**4,913**	**20,539**	**31,821**	**11,123**	**51,826**	**22,690**	**2,609**	**19,999**	**26,105**	**4,707**	**7,845**	**979**	**12**	**205,168**
Financial guarantees and underwriting commitments	1,267	-	805	767	3,547	549	54	2,624	3,682	2,139	449	-	1	15,884
Undrawn loan commitments	-	13,174	1	7,246	45,176	20,454	2,255	11,349	12,032	1,423	5,209	204	-	118,523
Undrawn overdraft/credit card facilities	3,646	7,365	31,015	3,110	3,103	1,687	300	6,026	10,391	1,145	2,187	775	11	70,761
Maximum exposure to credit risk	**56,434**	**191,320**	**388,841**	**125,496**	**132,631**	**155,530**	**28,802**	**72,375**	**131,426**	**36,332**	**25,198**	**9,705**	**1,444**	**1,355,534**
Percentage of maximum exposure to credit risk	4.2%	14.1%	28.7%	9.3%	9.8%	11.5%	2.1%	5.3%	9.7%	2.7%	1.9%	0.7%	0.1%	100%

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

All amounts are in ISK million

60. Maximum exposure to credit risk and concentration by industry sectors (continued)

				Corporations										
As at 31 December 2016	**Financial institutions**	**Public entities***	**Individuals**	**Fisheries**	**Construction companies**	**Real estate companies**	**Holding companies**	**Retail**	**Services**	**ITC****	**Manu-facturing**	**Agriculture**	**Other**	**Carrying amount**
Cash and balances with Central Bank	-	30,662	-	-	-	-	-	-	-	-	-	-	-	**30,662**
Bonds and debt instruments	2,031	142,956	-	-	-	8,294	80	-	-	-	-	-	1,531	**154,892**
Derivative instruments	220	14	-	-	-	-	24	-	-	-	-	-	20	**278**
Loans and advances to financial institutions	20,408	-	-	-	-	-	-	-	-	-	-	-	-	**20,408**
Loans and advances to customers	-	9,783	320,690	123,626	74,962	113,364	40,490	42,235	74,743	19,220	24,167	10,135	1	**853,417**
Other financial assets	3,246	282	301	-	1,217	112	61	5	1,008	2	290	3	1	**6,528**
Total on-balance sheet exposure	**25,905**	**183,697**	**320,991**	**123,626**	**76,179**	**121,770**	**40,655**	**42,240**	**75,751**	**19,222**	**24,457**	**10,138**	**1,553**	**1,066,185**
Off-balance sheet exposure	**5,640**	**16,385**	**29,109**	**17,421**	**39,122**	**10,832**	**2,392**	**18,704**	**15,999**	**4,159**	**9,996**	**1,149**	**382**	**171,289**
Financial guarantees and underwriting commitments	2,022	634	819	6,345	2,650	999	64	2,959	2,179	895	525	10	365	20,465
Undrawn loan commitments	-	9,080	-	7,295	33,898	8,403	1,392	10,724	6,052	2,017	7,246	249	-	86,356
Undrawn overdraft/credit card facilities	3,618	6,671	28,290	3,781	2,574	1,430	936	5,021	7,768	1,247	2,225	890	17	64,468
Maximum exposure to credit risk	**31,545**	**200,082**	**350,100**	**141,047**	**115,301**	**132,602**	**43,047**	**60,944**	**91,750**	**23,381**	**34,453**	**11,287**	**1,935**	**1,237,474**
Percentage of carrying amount	2.5%	16.2%	28.3%	11.4%	9.3%	10.7%	3.5%	4.9%	7.4%	1.9%	2.8%	0.9%	0.2%	100%

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

All amounts are in ISK million

61. Collateral and loan-to-value by industry sectors

The loan-to-value (LTV) ratio expresses the maximum exposure of credit risk (gross carrying amount of loans and off-balance sheet items) as a percentage of the total value of collateral. Loan-to-value is one of the key risk factors assessed when qualifying borrowers for a loan. The risk of default is always at the forefront of lending decisions, and the likelihood of a lender absorbing a loss in the foreclosure process increases as the collateral value decreases. A high LTV indicates that there are smaller buffers to protect against price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance.

	LTV ratio - Fully collateralised					LTV ratio - Partially collateralised				
As at 31 December 2017	0% - 25%	25% - 50%	50% - 75%	75% - 100%	Total	>100%	Collateral value*	Without collateral	Allowance for impairment	Maximum exposure to credit risk
Financial institutions	-	-	-	-	0	-	-	49,779	-	49,779
Public entities	46	295	671	378	1,390	1,448	294	29,046	(102)	31,782
Individuals	21,852	71,263	184,763	45,088	322,966	10,093	6,952	58,679	(2,978)	388,760
Mortgages	14,829	58,678	169,846	33,792	277,145	4,003	3,239	1,351	(824)	281,675
Other	7,023	12,585	14,917	11,296	45,821	6,090	3,713	57,328	(2,154)	107,085
Corporates	15,155	86,703	167,698	155,238	424,794	237,995	137,958	55,670	(13,110)	705,349
Fisheries	1,772	27,719	56,494	35,609	121,594	2,510	1,573	2,064	(691)	125,477
Construction companies	1,357	5,479	5,865	19,584	32,285	99,145	56,836	2,352	(1,886)	131,896
Real estate companies	1,973	12,244	27,071	41,941	83,229	55,976	35,445	8,470	(1,503)	146,172
Holding companies	3,848	1,784	16,245	1,428	23,305	4,261	1,218	1,222	(236)	28,552
Retail	1,154	8,037	11,494	21,445	42,130	24,277	15,003	6,670	(715)	72,362
Services	3,527	15,990	35,432	28,991	83,940	27,897	18,066	20,650	(2,674)	129,813
Information, technology and communication	50	5,085	995	236	6,366	19,132	8,382	11,274	(443)	36,329
Manufacturing	525	9,049	11,841	1,818	23,233	4,019	1,015	2,617	(4,839)	25,030
Agriculture	949	1,316	2,261	4,186	8,712	778	420	339	(123)	9,706
Other	-	-	-	-	-	-	-	12	-	12
Total	37,053	158,261	353,132	200,704	749,150	249,536	145,204	193,174	(16,190)	1,175,670
As at 31 December 2016										
Financial institutions	-	-	-	-	-	-	-	26,047	-	26,047
Public entities	42	263	758	255	1,318	1,174	544	23,922	(246)	26,168
Individuals	20,188	60,457	145,319	52,366	278,330	16,035	9,374	61,589	(6,154)	349,800
Mortgages	12,660	47,845	131,021	42,728	234,255	7,864	5,499	4,228	(1,807)	244,540
Other	7,528	12,612	14,298	9,638	44,075	8,171	3,875	57,361	(4,347)	105,260
Corporates	21,535	81,606	191,261	143,241	437,643	166,424	94,963	53,583	(14,551)	643,099
Fisheries	8,657	32,701	68,975	21,827	132,160	8,125	5,207	1,231	(467)	141,049
Construction companies	1,137	4,820	15,996	27,368	49,321	58,686	34,069	8,012	(1,934)	114,085
Real estate companies	869	5,438	31,890	52,181	90,378	28,662	20,061	7,712	(2,556)	124,196
Holding companies	6,336	4,723	17,310	1,857	30,226	5,382	2,353	7,933	(659)	42,882
Retail	865	6,939	9,787	18,212	35,803	21,067	5,663	5,272	(1,201)	60,941
Services	2,218	16,392	23,697	14,005	56,312	26,516	14,583	14,003	(6,090)	90,741
Information, technology and communication	56	659	5,006	91	5,812	11,733	8,054	5,997	(164)	23,378
Manufacturing	360	9,078	17,079	5,533	32,050	796	492	2,683	(1,368)	34,161
Agriculture	1,037	743	1,521	2,160	5,461	5,392	4,472	542	(112)	11,283
Other	-	113	-	7	120	65	9	198	-	383
Total	41,765	142,326	337,338	195,862	717,291	183,633	104,881	165,141	(20,951)	1,045,114

*If LTV is less than 100% the loan is considered fully secured. If LTV is greater than 100% the loan is partially collateralised and the respective collateral value is shown in the table.

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62. Collateral types

The following tables show the different types of collateral held by the Group against credit exposures. Residential property is the principal collateral held against loans to individuals. Construction projects and commercial property are the main real estate collateral held against loans to corporates. The collateral value amounts are assigned to claim value amounts. The value of each individual collateral item held cannot exceed the maximum credit exposure of the corresponding individual claim. Changes in collateral value amounts between periods result either from changes in the underlying value of collateral or changes in the credit exposure.

As at 31 December 2017	Real estate	Vessels	Deposits	Securities	Other*	Total
Public entities	**1,282**	**-**	**36**	**-**	**346**	**1,664**
Individuals	**311,117**	**97**	**537**	**2,917**	**15,887**	**330,555**
Mortgages	266,979	16	28	112	3,138	270,273
Other	44,138	81	509	2,805	12,749	60,282
Corporates	**303,026**	**79,172**	**2,762**	**60,594**	**111,010**	**556,564**
Fisheries	9,664	77,401	169	16,151	19,682	123,067
Construction companies	78,553	78	1,137	7	7,022	86,797
Real estate companies	114,403	31	196	1,965	910	117,505
Holding companies	1,714	-	15	23,554	11	25,294
Retail	21,096	5	110	3,700	32,218	57,129
Services	62,690	1,602	815	3,975	34,417	103,499
Information, technology and communication	557	-	45	9,618	4,577	14,797
Manufacturing	8,025	48	272	1,624	9,275	19,244
Agriculture	6,324	7	3	-	2,898	9,232
Other	-	-	-	-	-	-
Total	**615,425**	**79,269**	**3,335**	**63,511**	**127,243**	**888,783**

As at 31 December 2016	Real estate	Vessels	Deposits	Securities	Other*	Total
Public entities	**1,692**	**0**	**41**	**0**	**123**	**1,856**
Individuals	**270,629**	**221**	**584**	**3,262**	**14,024**	**288,720**
Mortages	228,954	10	82	191	2,555	231,792
Other	41,675	211	502	3,071	11,469	56,928
Corporates	**271,474**	**93,714**	**3,835**	**57,720**	**102,542**	**529,285**
Fisheries	12,010	91,101	152	16,205	20,948	140,416
Construction companies	71,513	81	823	2,240	6,586	81,243
Real estate companies	107,642	23	265	440	599	108,969
Holding companies	5,528	-	870	26,572	507	33,477
Retail	16,161	11	562	1,066	23,981	41,781
Services	40,368	2,443	640	1,651	28,078	73,180
Information, technology and communication	603	-	121	5,738	7,375	13,837
Manufacturing	10,104	50	384	3,808	12,023	26,369
Agriculture	7,545	5	2	-	2,332	9,884
Other	-	-	16	-	113	129
Total	**543,795**	**93,935**	**4,460**	**60,982**	**116,689**	**819,861**

* Other includes collateral like financial claims, invoices, liquid assets, vehicles, machines, aircrafts and inventories.

63. Loans and advances by geographical area

Geographical segmentation is based on the customer's country of residence rather than the location of the creditor.

As at 31 December 2017	Domestic	Foreign	Carrying amount
Loans and advances to financial institutions	9	44,857	44,866
Loans and advances to customers	892,936	32,700	925,636
Total	**892,945**	**77,557**	**970,502**

As at 31 December 2016	Domestic	Foreign	Carrying amount
Loans and advances to financial institutions	1,878	18,530	20,408
Loans and advances to customers	808,917	44,500	853,417
Total	**810,795**	**63,030**	**873,825**

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64. Loans and advances credit monitoring

The following tables show the credit risk monitoring split by colour classification. Further details on credit risk monitoring and colour classification can be seen in Note 56, Credit risk control and monitoring.

As at 31 December 2017	Green	Yellow	Orange	Red	Carrying amount
Financial institutions	**44,866**	**-**	**-**	**-**	**44,866**
Public entities	**10,940**	**200**	**14**	**89**	**11,243**
Individuals	**330,934**	**9,735**	**12,194**	**4,077**	**356,940**
Mortgages	264,954	6,655	7,969	2,097	281,675
Other	65,980	3,080	4,225	1,980	75,265
Corporates	**495,774**	**40,282**	**12,835**	**8,562**	**557,453**
Fisheries	101,030	11,589	1,395	341	114,355
Construction companies	74,460	3,641	1,155	811	80,067
Real estate companies	106,562	10,454	4,062	2,405	123,483
Holding companies	25,541	201	194	7	25,943
Retail	48,314	2,439	888	722	52,363
Services	89,911	8,714	4,298	783	103,706
Information, technology and communication	31,401	153	59	11	31,624
Manufacturing	12,900	630	227	3,428	17,185
Agriculture	5,654	2,461	557	54	8,726
Other	1	-	-	-	1
Total	**882,514**	**50,217**	**25,043**	**12,728**	**970,502**

As at 31 December 2016	Green	Yellow	Orange	Red	Carrying amount
Financial institutions	**20,408**	**-**	**-**	**-**	**20,408**
Public entities	**8,992**	**470**	**55**	**266**	**9,783**
Individuals	**286,877**	**11,503**	**16,573**	**5,737**	**320,690**
Mortgages	224,043	7,686	9,648	3,161	244,538
Other	62,834	3,817	6,925	2,576	76,152
Corporates	**463,201**	**36,014**	**13,006**	**10,723**	**522,944**
Fisheries	119,346	3,297	660	323	123,626
Construction companies	68,720	4,714	899	629	74,962
Real estate companies	94,970	12,378	3,940	2,077	113,365
Holding companies	38,654	1,069	646	121	40,490
Retail	37,072	2,994	1,339	830	42,235
Services	62,064	5,983	4,147	2,549	74,743
Information, technology and communication	18,646	406	140	28	19,220
Manufacturing	17,745	1,796	469	4,157	24,167
Agriculture	5,983	3,377	766	9	10,135
Other	1	-	-	-	1
Total	**779,478**	**47,987**	**29,634**	**16,726**	**873,825**

65. Credit quality of financial assets

The following tables exhibit the total carrying value of loans and advances to financial institutions and customers in default on their loan obligations.

	Gross carrying amount					
As at 31 December 2017	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Allowance for impairment	Carrying amount
Cash and balances with Central Bank	55,192	-	-	55,192	-	55,192
Bonds and debt instruments	117,237	73	-	117,310	-	117,310
Derivative instruments	1,905	-	-	1,905	-	1,905
Loans and advances to financial institutions	44,866	-	-	44,866	-	44,866
Loans and advances to customers	893,230	20,756	27,840	941,826	(16,190)	925,636
Other financial assets	5,457	-	-	5,457	-	5,457
Total	**1,117,887**	**20,829**	**27,840**	**1,166,556**	**(16,190)**	**1,150,366**

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65. Credit quality of financial assets (continued)

As at 31 December 2016	Gross carrying amount: Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Allowance for impairment	Carrying amount
Cash and balances with Central Bank	30,662	-	-	30,662	-	30,662
Bonds and debt instruments	154,731	161	-	154,892	-	154,892
Derivative instruments	278	-	-	278	-	278
Loans and advances to financial institutions	20,408	-	-	20,408	-	20,408
Loans and advances to customers	815,881	24,437	34,050	874,368	(20,951)	853,417
Other financial assets	6,528	-	-	6,528	-	6,528
Total	**1,028,488**	**24,598**	**34,050**	**1,087,136**	**(20,951)**	**1,066,185**

The allowance for impairment includes both the allowance for individual impairment and the allowance for collective impairment.

66. Loans and advances neither past due nor individually impaired

The following tables show the credit quality, measured by rating grade, of loans and advances neither past due nor individually impaired. Further details on rating grades can be seen in Note 55, Credit risk assessment.

As at 31 December 2017	Rating grades: 10-7	6-4	3-1	0	Unrated	Gross carrying amount
Financial institutions	**44,597**	**269**	**-**	**-**	**-**	**44,866**
Public entities	**6,243**	**4,910**	**14**	**-**	**-**	**11,167**
Individuals	**131,287**	**178,166**	**35,372**	**71**	**781**	**345,677**
Mortgages	118,239	133,742	21,804	42	358	274,185
Other	13,048	44,424	13,568	29	423	71,492
Corporates	**33,874**	**446,089**	**54,575**	**1,367**	**481**	**536,386**
Fisheries	5,752	96,502	10,565	58	-	112,877
Construction companies	336	67,010	11,822	71	-	79,239
Real estate companies	688	106,319	10,717	914	324	118,962
Holding companies	185	23,628	2,142	-	42	25,997
Retail	10,338	38,605	1,301	15	-	50,259
Services	12,152	73,132	10,626	172	88	96,170
Information, technology and communication	352	25,712	5,380	9	-	31,453
Manufacturing	3,101	8,538	1,489	1	27	13,156
Agriculture	970	6,642	533	127	-	8,272
Other	-	1	-	-	-	1
Total	**216,001**	**629,434**	**89,961**	**1,438**	**1,262**	**938,096**

As at 31 December 2016	Rating grades: 10-7	6-4	3-1	0	Unrated	Gross carrying amount
Financial institutions	**20,408**	**-**	**-**	**-**	**-**	**20,408**
Public entities	**6,448**	**3,029**	**32**	**5**	**-**	**9,514**
Individuals	**112,366**	**154,564**	**36,527**	**339**	**914**	**304,710**
Mortgages	96,971	114,459	23,500	203	599	235,732
Other	15,395	40,105	13,027	136	315	68,978
Corporates	**35,410**	**423,118**	**41,078**	**1,274**	**777**	**501,657**
Fisheries	12,655	105,283	4,869	35	-	122,842
Construction companies	257	65,878	7,442	8	72	73,657
Real estate companies	172	97,199	8,154	884	341	106,750
Holding companies	-	34,503	4,769	-	245	39,517
Retail	9,976	27,667	2,978	253	21	40,895
Services	6,947	53,077	9,254	42	54	69,374
Information, technology and communication	227	18,583	358	12	-	19,180
Manufacturing	4,395	13,517	1,789	40	-	19,741
Agriculture	781	7,410	1,465	-	44	9,700
Other	-	1	-	-	-	1
Total	**174,632**	**580,711**	**77,637**	**1,618**	**1,691**	**836,289**

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67. Loans and advances past due but not individually impaired

The following table shows the gross carrying amount of loans and advances to financial institutions and customers that have failed to make payments which had become contractually due by one or more days.

As at 31 December 2017	Past due 1-5 days	Past due 6-30 days	Past due 31 - 60 days	Past due 61 - 90 days	Past due over 90 days	Gross carrying amount
Public entities	-	43	-	-	-	43
Individuals	546	3,686	3,517	570	955	9,274
Corporations	1,547	4,283	2,066	1,561	1,982	11,439
Total	**2,093**	**8,012**	**5,583**	**2,131**	**2,937**	**20,756**
As at 31 December 2016						
Public entities	-	-	-	50	-	50
Individuals	2,459	4,561	3,134	1,241	1,509	12,904
Corporations	4,932	3,307	1,143	643	1,458	11,483
Total	**7,391**	**7,868**	**4,277**	**1,934**	**2,967**	**24,437**

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68. Loans and advances by industry sectors

The tables below show credit exposure, allowances and impairment by industry sectors and customer segment.

				Individually impaired				
				Of which performing		Of which non-performing*		
As at 31 December 2017	Gross carrying amount	Gross not individually impaired	Collective allowance	Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	Carrying amount
Financial institutions	**44,866**	**44,866**	**-**	**-**	**-**	**-**	**-**	**44,866**
Public entities	**11,345**	**11,210**	**(56)**	**-**	**-**	**134**	**(45)**	**11,243**
Individuals	**359,918**	**354,956**	**(1,076)**	**1,507**	**(409)**	**3,457**	**(1,495)**	**356,940**
Mortgages	282,499	280,237	(304)	1,039	(152)	1,225	(370)	281,675
Other	77,419	74,719	(772)	468	(257)	2,232	(1,125)	75,265
Corporates	**570,563**	**547,820**	**(2,904)**	**14,299**	**(5,324)**	**8,443**	**(4,881)**	**557,453**
Fisheries	115,045	114,263	(357)	531	(230)	252	(104)	114,355
Construction companies	81,954	79,928	(643)	690	(574)	1,335	(669)	80,067
Real estate companies	124,986	121,234	(548)	2,049	(624)	1,702	(330)	123,483
Holding companies	26,179	26,041	(142)	51	(16)	87	(78)	25,943
Retail	53,078	51,541	(225)	936	(209)	601	(281)	52,363
Services	106,381	100,620	(522)	4,522	(1,562)	1,238	(590)	103,706
Information, technology and communication	32,066	31,984	(374)	55	(48)	28	(21)	31,624
Manufacturing	22,024	13,815	(73)	5,068	(1,978)	3,141	(2,788)	17,185
Agriculture	8,849	8,393	(20)	397	(83)	59	(20)	8,726
Other	1	1	-	-	-	-	-	1
Total	**986,692**	**958,852**	**(4,036)**	**15,806**	**(5,733)**	**12,034**	**(6,421)**	**970,502**
As at 31 December 2016								
Financial institutions	**20,408**	**20,408**	**-**	**-**	**-**	**-**	**-**	**20,408**
Public entities	**10,028**	**9,565**	**(48)**	**-**	**-**	**464**	**(198)**	**9,783**
Individuals	**326,844**	**317,614**	**(1,499)**	**2,170**	**(738)**	**7,059**	**(3,916)**	**320,690**
Mortgages	246,345	242,274	(479)	1,285	(221)	2,785	(1,106)	244,538
Other	80,499	75,340	(1,020)	885	(516)	4,274	(2,810)	76,152
Corporates	**537,496**	**513,139**	**(2,476)**	**9,953**	**(4,446)**	**14,404**	**(7,630)**	**522,944**
Fisheries	124,094	123,314	(145)	326	(71)	452	(250)	123,626
Construction companies	76,897	74,802	(537)	635	(530)	1,460	(867)	74,963
Real estate companies	115,922	111,727	(667)	1,717	(817)	2,478	(1,074)	113,364
Holding companies	41,148	40,503	(251)	156	(35)	489	(372)	40,490
Retail	43,436	41,629	(224)	756	(291)	1,050	(685)	42,235
Services	80,833	71,762	(401)	3,601	(2,029)	5,471	(3,661)	74,743
Information, technology and communication	19,383	19,308	(115)	27	(6)	49	(43)	19,220
Manufacturing	25,535	19,929	(91)	2,695	(632)	2,912	(646)	24,167
Agriculture	10,247	10,164	(45)	40	(35)	43	(32)	10,135
Other	1	1	-	-	-	-	-	1
Total	**894,776**	**860,726**	**(4,023)**	**12,123**	**(5,184)**	**21,927**	**(11,744)**	**873,825**

*Non-performing past due more than 90 days

All amounts are in ISK million

69. Allowance for impairment on loans and advances to financial institutions and customers and other financial assets

	2017			2016		
	Individual allowance	Collective allowance	Total	Individual allowance	Collective allowance	Total
Balance at the beginning of the year	(16,928)	(4,023)	(20,951)	(28,200)	(5,457)	(33,657)
New provisions	(3,668)	(13)	(3,681)	(4,676)	-	(4,676)
Reversals	3,665	-	3,665	8,469	1,434	9,903
Provisions used to cover write-offs	4,777	-	4,777	7,479	-	7,479
Balance at the end of the year	**(12,154)**	**(4,036)**	**(16,190)**	**(16,928)**	**(4,023)**	**(20,951)**

	2017			2016		
	Customers	Financials	Total	Customers	Financials	Total
New provisions	(3,681)	-	(3,681)	(4,676)	-	(4,676)
Write-offs	(6,270)	-	(6,270)	(9,663)	-	(9,663)
Provisions used to cover write-offs	4,777	-	4,777	7,479	-	7,479
Reversals	3,665	-	3,665	9,903	-	9,903
Recoveries	1,815	-	1,815	2,207	-	2,207
Translation difference	200	-	200	-	-	0
Impairment loss for the year	506	0	506	5,250	0	5,250
Impairment of financial institutions and other assets	-	-	0	-	(452)	(452)
Net impairment loss for the year	**506**	**0**	**506**	**5,250**	**(452)**	**4,798**

70. Renegotiated loans

In regard to financial restructuring of customers, the Group has put remedies in place for those experiencing financial difficulties and also presented procedures for financial restructuring. These restructuring approaches include extended and modified repayment arrangements and approved external management plans.

71. Large exposures

As at 31 December 2017, three customer groups were rated as large exposures in accordance with rules on large exposures. Customers are rated as large exposures if their total obligations, or those of financially or administratively connected parties, exceed 10% of the Group's eligible capital. According to the rules, no exposure, after credit risk mitigation, may exceed 25% of the eligible capital. The following table shows the Group's large exposures after credit mitigation

As at 31 December 2017	Number of large exposures	Large exposures
Large exposures between 10% and 20% of the Group's eligible capital	2	53,182
Large exposures between 0% and 10% of the Group's eligible capital	1	-
Total	**3**	**53,182**
Total large exposures to eligible capital		22%
As at 31 December 2016		
Large exposures between 10% and 20% of the Group's eligible capital	2	51,310
Large exposures between 0% and 10% of the Group's eligible capital	1	-
Total	**3**	**51,310**
Total large exposures to eligible capital		20%

72. Bonds and debt instruments

A breakdown of the Group's bond portfolio, by Standard & Poor's ratings, is as follows:

Carrying amount	2017	2016
AAA/AA+/AA/AA-	49,436	24,941
A+/A/A-	44,166	-
BBB+	2,149	107,337
BBB/BBB-	9,790	12,547
Lower than BBB-	496	-
Unrated	11,273	10,067
Total	**117,310**	**154,892**

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72. Bonds and debt instruments (continued)

The following table shows the carrying amounts of bonds for which the issuers have failed, by one or more days, to make contractually due payments.

As at 31 December 2017	Past due 0 - 90 days	Past due over 90 days	Carrying amount
Holding companies	-	70	70
Other	-	3	3
Total	**0**	**73**	**73**
As at 31 December 2016			
Holding companies	-	70	70
Other	-	91	91
Total	**0**	**161**	**161**

73. Derivative instruments

The following table summarises the Group's exposure in derivative instruments, classified by the Bank into equivalent Standard & Poor's ratings by counterparty:

	2017			2016		
	Notional	Fair value		Notional	Fair value	
	amount	Assets	Liabilities	amount	Assets	Liabilities
AAA/AA+/AA/AA-	-	-	-	6	-	-
A+/A/A-	139,555	1,622	672	28,534	180	191
BBB+	2,243	36	5	8,784	28	21
BBB/BBB-	-	-	-	3,100	24	2
Unrated	13,905	247	264	15,556	46	969
Total	**155,703**	**1,905**	**941**	**55,980**	**278**	**1,183**

74. Offsetting financial assets and financial liabilities

The following table shows reconciliation to the net amounts of financial assets and financial liabilities. Those financial assets and financial liabilities are subject to offsetting, enforceable master netting agreements and similar agreements.

As at 31 December 2017

Financial assets subject to offsetting, enforceable master netting arrangement and similar agreements

	Financial assets subject to netting agreements			Netting not recognised on balance sheet				
Types of financial assets	Financial assets	Financial liabilities	Net amount	Financial liabilities	Collateral received	Net financial assets with netting agreements	Financial assets not subject to netting agreements	Net amount on balance sheet
Derivatives	1,905	-	1,905	(204)	(1,312)	389	-	1,905

Financial liabilities subject to offsetting, enforceable master netting arrangement and similar agreements

	Financial liabilities subject to netting agreements			Netting not recognised on balance sheet				
Types of financial liabilities	Financial liabilities	Financial assets	Net amount	Financial assets	Collateral pledged	Net financial liabilities with netting agreements	Financial liabilities not subject to netting agreements	Net amount on balance sheet
Derivatives	(940)	-	(940)	(204)	641	(504)	-	(940)
Short positions	(318)	-	(318)	-	318	-	-	(318)
Total	**(1,258)**	**0**	**(1,258)**	**(204)**	**959**	**(504)**	**0**	**(1,258)**

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74. Offsetting financial assets and financial liabilities (continued)

As at 31 December 2016

Financial assets subject to offsetting, enforceable master netting arrangement and similar agreements

Types of financial assets	Financial assets subject to netting agreements: Financial assets	Financial liabilities	Net amount	Netting not recognised on balance sheet: Financial liabilities	Collateral received	Net financial assets with netting agreements	Financial assets not subject to netting agreements	Net amount on balance sheet
Derivatives	265	-	265	(79)	(46)	140	13	278

Financial liabilities subject to offsetting, enforceable master netting arrangement and similar agreements

Types of financial liabilities	Financial liabilities subject to netting agreements: Financial liabilities	Financial assets	Net amount	Netting not recognised on balance sheet: Financial assets	Collateral pledged	Net financial liabilities with netting agreements	Financial liabilities not subject to netting agreements	Net amount on balance sheet
Derivatives	(1,090)	-	(1,090)	79	117	(894)	(93)	(1,183)
Short positions	(546)	-	(546)	-	546	-	-	(546)
Total	**(1,636)**	**0**	**(1,636)**	**79**	**663**	**(894)**	**(93)**	**(1,729)**

Liquidity risk

75. Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset, or of having to do so at excessive cost. This risk arises from earlier maturities of financial liabilities than financial assets.

76. Liquidity risk management

A liquidity management policy for the Bank and its subsidiaries is in place. The objective of the liquidity management policy is to ensure, even in times of stress, that sufficient liquid assets and funding capacity are available to meet financial obligations in a timely manner and at reasonable cost. Furthermore, the liquidity management policy is to describe the manner in which the Group identifies, evaluates, measures, monitors, manages and reports its liquidity. Enforcing this policy has the further objective of minimising fluctuations in liquidity. The policy is built on a framework published in Basel III standards on liquidity risk measurement where the main metric for measuring liquidity risk is the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). The objective of the LCR is to promote short-term resilience by ensuring that the Group has sufficient high-quality liquid assets to survive a significant stress scenario lasting 30 calendar days. NSFR has a longer time horizon and its objective is to capture structural issues in the balance sheet with the aim to provide a sustainable maturity structure of assets and liabilities and to limit overreliance on short-term wholesale funding.

The Group complies with the liquidity rules set by the Central Bank of Iceland No. 266/2017 which replaced rules No. 1031/2014 on 31 March 2017. The Group also follows Central Bank rules No. 1032/2014 on funding, as well as guidelines No. 2/2010 from the Icelandic Financial Supervisory Authority on best practice for managing liquidity in banking organisation. Rules No. 266/2017 require the Group to maintain a LCR minimum of 100% total and 100% for foreign currencies and rules No. 1032/2014 set requirements for a minimum of 100% NSFR in foreign currencies. The Group submits monthly reports on its liquidity and funding position to the Central Bank of Iceland and the FME.

The Group has implemented a risk appetite where these rules and guidelines alongside the Bank's internal requirements set benchmarks for liquidity management.

The Group's liquidity risk is managed centrally by Treasury and is monitored by Market Risk. This allows management to monitor and manage liquidity risk throughout the Group. The Risk & Finance Committee monitors the Group's liquidity risk, while the Bank's Internal Audit function assesses whether the liquidity management process is designed properly and operating effectively.

The Group monitors intraday liquidity risk, short-term 30 day liquidity risk, medium and longer-term liquidity risk and risk arising from mismatches of longer term assets and liabilities.

The Group's liquidity management process includes: projecting expected cash flows in a maturity profile rather than relying merely on contractual maturities, monitoring balance sheet liquidity, monitoring and managing the maturity profile of liabilities and off-balance sheet commitments, monitoring the concentration of liquidity risk in order to avoid undue reliance on large financing counterparties, projecting cash flows arising from future business, and maintaining liquidity and contingency plans which outline measures to take in the event of difficulties arising from liquidity crisis.

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76. Liquidity risk management (continued)

Market Risk conducts monthly stress tests by applying various hypothetical scenarios on the Group's liquidity position to ensure that it has adequate liquidity to withstand stressed conditions. Different assumptions are drawn for each stress test to estimate the impact of a variety of market conditions.

The key indicator of short-term liquidity risk is measured by the liquidity coverage ratio (LCR) which shows the ratio of high quality liquid assets to expected total net cash outflows over the next 30 days under a specified stress scenario. High quality liquid assets are comprised of cash at hand, balances with the Central Bank, assets eligible for repo transactions with the Central Bank and zero percent risk-weighted foreign government bonds. Estimated inflow and outflow weights, according to rules No. 266/2017, are applied to the total balance amount for each asset and liability group measured in the ratio, reflecting the next 30 calendar days. Financial institutions can at a maximum assume 75% of their estimated inflow net to their estimated outflow. This is done so that financial institutions can not overrely on their estimated inflow in times of stress. The calculations for the ratio at year-end 2017 and 2016 are shown in the following table:

	Total		Foreign currencies	
Liquidity coverage ratio 31.12.2017	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	110,036	110,036	51,112	51,112
Information items	24,333	-	10,273	-
Total liquid assets	**134,369**	**110,036**	**61,385**	**51,112**
Deposits	451,942	115,437	47,910	18,427
Borrowing	220	220	-	-
Other outflows	140,357	17,181	32,796	3,523
Total outflows (0-30 days)	**592,519**	**132,838**	**80,706**	**21,950**
Loans and advances to financial institutions	57,074	43,202	44,836	43,141
Other inflows	42,736	19,443	12,593	6,729
Limit on inflows	-	-	-	(33,407)
Total inflows (0-30 days)	**99,810**	**62,645**	**57,429**	**16,463**
Liquidity coverage ratio		**157%**		**931%**

	Total		Foreign currencies	
Liquidity coverage ratio 31.12.2016	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	143,977	143,977	26,221	26,221
Level 2 liquid assets and information items	28,749	5,589	11,177	5,589
Total liquid assets	**172,726**	**149,566**	**37,398**	**31,810**
Deposits	391,508	123,148	36,126	14,123
Borrowing	2,787	2,787	447	447
Other outflows	173,532	31,002	29,879	2,561
Total outflows (0-30 days)	**567,827**	**156,937**	**66,452**	**17,131**
Loans and advances to financial institutions	18,707	16,732	18,680	16,704
Other inflows	54,673	23,547	28,642	14,317
Limit on inflows	-	-	-	(18,173)
Total inflows (0-30 days)	**73,380**	**40,279**	**47,322**	**12,848**
Liquidity coverage ratio		**128%**		**743%**

The following table shows the composition of the Group's liquidity reserve which is comprised of high quality liquid assets as defined in the Rules on Liquidity Ratio, etc., No. 266/2017, as well as readily available loans and advances to financial institutions.

Liquidity reserves as at 31 December 2017	**Total**	**Foreign currencies**
Cash and balances with the Central Bank	12,151	1,341
Domestic bonds and debt instruments eligible as collateral with the Central Bank	48,114	-
Foreign government bonds with 0% risk weight	49,771	49,771
High quality liquidity assets	**110,036**	**51,112**
Loans and advances to financial institutions	57,074	44,836
Total liquidity reserves	**167,110**	**95,948**

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76. Liquidity risk management (continued)

The Group measures the net stable funding ratio (NSFR) as another key indicator for longer-term liquidity risk. The following table shows the values of the NSFR for foreign currencies and NSFR total as at year-end 2017 and 2016.

	As at 31 December 2017	As at 31 December 2016
Net stable funding ratio FX	179%	154%
Net stable funding ratio total	124%	123%

77. Maturity analysis of financial assets and liabilities

The following tables only take into account the contractual maturity of the Group's assets and liabilities but do not account for measures that the Group could decide upon to convert assets into cash at hand by liquidation either through sale or participation in Central Bank operations. Furthermore all instant access deposits are categorised as outflows in the first time bucket. Further information on the Group's liquidity management can be found in Note 76.

The amounts in the maturity analyses as at year-end 2017 and 2016 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). For loans and advances in moratorium or in the process of liquidation the Group estimates the amounts from the historical recovery rate. For bonds issued by companies in moratorium or in the process of liquidation the amounts presented are future cash flows estimated as their fair value at the reporting date. These bonds and loans all fall in the time span of 1-5 years.

Amounts presented in the maturity analyses are the undiscounted future cash flows receivable and payable by the Group, including both principal and interest cash flows. These amounts differ from the carrying amounts presented in the statement of financial position, which are based on discounted rather than undiscounted future cash flows. If an amount receivable or payable is not fixed, the amount presented in the maturity analysis has been determined by reference to the relevant interest rates and exchange rates prevailing at the reporting date. For inflation-linked assets and liabilities the Group uses a constant yearly inflation according to the 12-month inflation at the reporting date. When there is a choice of when an amount shall be paid, future cash flows are calculated on the basis of the earliest date at which the Group can be required to pay, which is the worst case scenario from Group perspective. An example of this is that demand deposits are included in the earliest time span. Where the Group is committed to have amounts available in installments, each installment is allocated to the earliest period in which the Group might be required to pay. Thus undrawn loan commitments are included in the time span together with the earliest date at which such loans may be drawn. For financial guarantee contracts issued by the Group, the amount included in the maturity analysis is the guarantee's maximum amount, allocated to the earliest period in which the guarantee might be called.

Nonetheless, the Group's expected cash flows on demand deposits vary significantly from the amounts presented in the maturity analysis. Demand deposits from customers have short contractual maturities but are considered a relatively stable financing source with expected maturity exceeding one year, and also it is not expected that every committed loan will be drawn down immediately. The Group conducts, as mentioned in Note 76, a monthly stress test to estimate the impact of fluctuating market conditions and deposit withdrawals.

Amounts presented in non-derivative financial assets and non-derivative financial liabilities include all spot deals at year-end 2017 and 2016. When managing liquidity risk the Group regards spot deals as non-derivative assets or liabilities.

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77. Maturity analysis of financial assets and liabilities (continued)

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2017.

Non-derivative financial assets	0-1 month	1-3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	55,192	-	-	-	-	-	55,192	55,192
Bonds and debt instruments	6,450	31,866	61,773	9,049	18,675	-	127,813	117,310
Equities and equity instruments	-	-	-	-	-	27,980	27,980	27,980
Loans and advances to financial institutions	44,852	-	-	-	-	-	44,852	44,866
Loans and advances to customers	33,426	62,266	147,547	363,955	790,653	-	1,397,847	925,636
Other financial assets	5,457	-	-	-	-	-	5,457	5,457
Total	**145,377**	**94,132**	**209,320**	**373,004**	**809,328**	**27,980**	**1,659,141**	**1,176,441**
Derivative financial assets								
Gross settled derivatives								1,902
Inflow	30,571	17,377	189	48,316	-	-	96,453	
Outflow	(30,263)	(17,141)	(188)	(47,205)	-	-	(94,797)	
Total	**308**	**236**	**1**	**1,111**	**0**	**0**	**1,656**	**1,902**
Net settled derivatives	3	-	-	-	-	-	3	3
Total	**311**	**236**	**1**	**1,111**	**0**	**0**	**1,659**	**1,905**
Non-derivative financial liabilities								
Due to financial institutions and Central Bank	(20,579)	(11,793)	-	(8)	-	-	(32,380)	(32,062)
Deposits from customers	(450,985)	(104,952)	(33,467)	(13,331)	(5,476)	-	(608,211)	(605,158)
Short positions	(2)	-	(17)	(303)	(86)	-	(408)	(317)
Borrowings	(220)	(7,040)	(24,497)	(192,590)	(76,376)	-	(300,723)	(281,874)
Other financial liabilities	(7,815)	-	-	-	-	-	(7,815)	(7,815)
Subordinated liabilities	-	-	-	-	(108)	-	(108)	(77)
Total	**(479,601)**	**(123,785)**	**(57,981)**	**(206,232)**	**(82,046)**	**0**	**(949,645)**	**(927,303)**
Off-balance sheet items								
Financial guarantees and underwriting commitments	(702)	(1,206)	(4,726)	(6,590)	(2,660)	-	(15,884)	
Undrawn loan commitments	(118,523)	-	-	-	-	-	(118,523)	
Undrawn overdraft/credit card commitments	(70,761)	-	-	-	-	-	(70,761)	
Total	**(189,986)**	**(1,206)**	**(4,726)**	**(6,590)**	**(2,660)**	**0**	**(205,168)**	
Derivative financial liabilities								
Gross settled derivatives								(901)
Inflow	11,755	779	34	3,791	37,275	-	53,634	
Outflow	(11,849)	(804)	(42)	(3,791)	(37,275)	-	(53,761)	
Total	**(94)**	**(25)**	**(8)**	**0**	**0**	**0**	**(127)**	**(901)**
Net settled derivatives	(40)	-	-	-	-	-	(40)	(40)
Total	**(134)**	**(25)**	**(8)**	**0**	**0**	**0**	**(167)**	**(941)**
Net liquidity position	**(524,033)**	**(30,648)**	**146,606**	**161,293**	**724,622**	**27,980**	**505,820**	**250,102**

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77. Maturity analysis of financial assets and liabilities (continued)

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2016.

Non-derivative financial assets	0-1 month	1-3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	30,662	-	-	-	-	-	30,662	30,662
Bonds and debt instruments	6,308	17,499	8,022	125,637	18,154	-	175,620	154,892
Equities and equity instruments	-	-	-	-	-	26,688	26,688	26,688
Loans and advances to financial institutions	18,749	-	1,660	-	-	-	20,409	20,408
Loans and advances to customers	41,840	53,626	143,754	335,886	730,522	-	1,305,628	853,417
Other financial assets	6,528	-	-	-	-	-	6,528	6,528
Total	**104,087**	**71,125**	**153,436**	**461,523**	**748,676**	**26,688**	**1,565,535**	**1,092,595**
Derivative financial assets								
Gross settled derivatives								54
Inflow	12,701	2,929	1,964	10,899	-	-	28,493	
Outflow	(12,586)	(2,913)	(1,929)	(10,711)	-	-	(28,139)	
Total	**115**	**16**	**35**	**188**	**0**	**0**	**354**	**254**
Net settled derivatives	24	-	-	-	-	-	24	24
Total	**139**	**16**	**35**	**188**	**0**	**0**	**378**	**278**
Non-derivative financial liabilities								
Due to financial institutions and Central Bank	(12,785)	(7,521)	(79)	(84)	-	-	(20,469)	(20,093)
Deposits from customers	(440,858)	(94,601)	(36,168)	(14,237)	(4,688)	-	(590,552)	(589,725)
Short positions	-	-	(39)	(163)	(799)	-	(1,001)	(546)
Borrowings	(10,234)	(16,266)	(20,278)	(186,892)	(58,333)	-	(292,003)	(223,944)
Other financial liabilities	(7,206)	-	-	-	-	-	(7,206)	(7,206)
Subordinated liabilities	-	(8)	(176)	(142)	(84)	-	(410)	(388)
Total	**(471,083)**	**(118,396)**	**(56,740)**	**(201,518)**	**(63,904)**	**0**	**(911,641)**	**(841,902)**
Off-balance sheet items								
Financial guarantees and underwriting commitments	(1,059)	(1,904)	(7,456)	(4,941)	(5,105)	-	(20,465)	
Undrawn loan commitments	(86,356)	-	-	-	-	-	(86,356)	
Undrawn overdraft/credit card commitments	(64,468)	-	-	-	-	-	(64,468)	
Total	**(151,883)**	**(1,904)**	**(7,456)**	**(4,941)**	**(5,105)**	**0**	**(171,289)**	
Derivative financial liabilities								
Gross settled derivatives								(1,136)
Inflow	15,748	2,225	3,956	188	-	-	22,117	
Outflow	(15,887)	(2,299)	(4,877)	(213)	-	-	(23,276)	
Total	**(139)**	**(74)**	**(921)**	**(25)**	**0**	**0**	**(1,159)**	**(1,136)**
Net settled derivatives	(47)	-	-	-	-	-	(47)	(47)
Total	**(186)**	**(74)**	**(921)**	**(25)**	**0**	**0**	**(1,206)**	**(1,183)**
Net liquidity position	**(518,926)**	**(49,233)**	**88,354**	**255,227**	**679,667**	**26,688**	**481,777**	**249,788**

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78. Maturity analysis of financial assets and liabilities by currency

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2017.

Non-derivative financial assets	0-1 month	1-3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Total in foreign currencies	67,198	49,876	49,756	95,201	1,220	234	263,485	255,661
ISK	78,179	44,256	159,564	277,803	808,108	27,746	1,395,656	920,780
Total	**145,377**	**94,132**	**209,320**	**373,004**	**809,328**	**27,980**	**1,659,141**	**1,176,441**
Derivative financial assets								
Total in foreign currencies	246	964	189	1,049	-	-	2,448	1,902
ISK	65	(728)	(188)	62	-	-	(789)	3
Total	**311**	**236**	**1**	**1,111**	**0**	**0**	**1,659**	**1,905**
Non-derivative financial liabilities								
Total in foreign currencies	(51,261)	(2,954)	(20,696)	(142,610)	(37,756)	-	(255,277)	(257,628)
ISK	(428,340)	(120,831)	(37,285)	(63,622)	(44,290)	-	(694,368)	(669,675)
Total	**(479,601)**	**(123,785)**	**(57,981)**	**(206,232)**	**(82,046)**	**0**	**(949,645)**	**(927,303)**
Off-balance sheet items								
Total in foreign currencies	(25,973)	(901)	(2,708)	(2,587)	(39)	-	(32,208)	
ISK	(164,013)	(305)	(2,018)	(4,003)	(2,621)	-	(172,960)	
Total	**(189,986)**	**(1,206)**	**(4,726)**	**(6,590)**	**(2,660)**	**0**	**(205,168)**	
Derivative financial liabilities								
Total in foreign currencies	2,754	779	34	-	-	-	3,567	(901)
ISK	(2,888)	(804)	(42)	-	-	-	(3,734)	(40)
Total	**(134)**	**(25)**	**(8)**	**0**	**0**	**0**	**(167)**	**(941)**
Net liquidity position in foreign currencies	**(7,036)**	**47,764**	**26,575**	**(48,947)**	**(36,575)**	**234**	**(17,985)**	**(966)**
Net liquidity position in ISK	**(516,997)**	**(78,412)**	**120,031**	**210,240**	**761,197**	**27,746**	**523,805**	**251,068**
Net liquidity position	**(524,033)**	**(30,648)**	**146,606**	**161,293**	**724,622**	**27,980**	**505,820**	**250,102**

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2016.

Non-derivative financial assets	0-1 month	1-3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Total in foreign currencies	53,801	37,204	38,406	101,541	10,800	115	241,867	230,076
ISK	50,286	33,921	115,030	359,982	737,876	26,573	1,323,668	862,519
Total	**104,087**	**71,125**	**153,436**	**461,523**	**748,676**	**26,688**	**1,565,535**	**1,092,595**
Derivative financial assets								
Total in foreign currencies	(593)	16	1,812	118	-	-	1,353	254
ISK	732	-	(1,777)	70	-	-	(975)	24
Total	**139**	**16**	**35**	**188**	**0**	**0**	**378**	**278**
Non-derivative financial liabilities								
Total in foreign currencies	(56,752)	(1,783)	(4,440)	(168,035)	(34,000)	-	(265,010)	(232,506)
ISK	(414,331)	(116,613)	(52,300)	(33,483)	(29,905)	-	(646,631)	(609,396)
Total	**(471,083)**	**(118,396)**	**(56,740)**	**(201,518)**	**(63,904)**	**0**	**(911,641)**	**(841,902)**
Off-balance sheet items								
Total in foreign currencies	(19,754)	(1,641)	(4,960)	(2,064)	(419)	-	(28,838)	
ISK	(132,129)	(263)	(2,496)	(2,877)	(4,686)	-	(142,451)	
Total	**(151,883)**	**(1,904)**	**(7,456)**	**(4,941)**	**(5,105)**	**0**	**(171,289)**	
Derivative financial liabilities								
Total in foreign currencies	808	813	3,956	188	-	-	5,765	(1,136)
ISK	(994)	(887)	(4,877)	(213)	-	-	(6,971)	(47)
Total	**(186)**	**(74)**	**(921)**	**(25)**	**0**	**0**	**(1,206)**	**(1,183)**
Net liquidity position in foreign currencies	**(22,490)**	**34,609**	**34,774**	**(68,252)**	**(23,619)**	**115**	**(44,863)**	**(3,312)**
Net liquidity position in ISK	**(496,436)**	**(83,842)**	**53,580**	**323,479**	**703,285**	**26,573**	**526,640**	**253,100**
Net liquidity position	**(518,926)**	**(49,233)**	**88,354**	**255,227**	**679,666**	**26,688**	**481,777**	**249,788**

The amounts in the maturity analysis as at 31 December 2017 and 31 December 2016 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation as disclosed in Note 77.

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79. Encumbered assets

The following tables show the Group's total encumbered and unencumbered assets as at 31 December 2017 and 31 December 2016.

As at 31 December 2017	Collateral pledged against: Covered bonds	Other*	Un-encumbered	Total
Cash and balances with Central Bank	975	-	54,217	55,192
Bonds and debt instruments	-	5,883	111,427	117,310
Equities and equity instruments	-	-	27,980	27,980
Derivative instruments	-	-	1,905	1,905
Loans and advances to financial institutions	-	1,609	43,257	44,866
Loans and advances to customers	93,021	-	832,615	925,636
Investments in equity-accounted associates	-	-	1,086	1,086
Property and equipment	-	-	5,238	5,238
Intangible assets	-	-	3,044	3,044
Other assets	-	-	6,965	6,965
Assets classified as held for sale	-	-	3,648	3,648
Total	**93,996**	**7,492**	**1,091,382**	**1,192,870**

As at 31 December 2016	Collateral pledged against: Covered bonds	Issued bonds to LBI hf.	Other*	Un-encumbered	Total
Cash and balances with Central Bank	96	-	-	30,566	30,662
Bonds and debt instruments	-	-	8,562	146,330	154,892
Equities and equity instruments	-	-	-	26,688	26,688
Derivative instruments	-	-	-	278	278
Loans and advances to financial institutions	-	-	1,970	18,438	20,408
Loans and advances to customers	52,810	60,800	-	739,807	853,417
Investments in equity-accounted associates	-	-	-	1,184	1,184
Property and equipment	-	-	-	5,452	5,452
Intangible assets	-	-	-	2,634	2,634
Other assets	-	-	-	8,094	8,094
Assets classified as held for sale	-	-	-	7,449	7,449
Total	**52,906**	**60,800**	**10,532**	**986,920**	**1,111,158**

*Other represents assets pledged as collateral to the Central Bank of Iceland to secure settlement in the Icelandic clearing systems, assets pledged as collateral to secure trading lines and credit support for GMRA and ISDA master agreements and other pledges of similar nature.

Market risk

80. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. Market risk arises from open positions in currency, equity and interest rate products, all of which are exposed to general and specific market movements and changing volatility levels in market rates and prices, for instance in interest rates, credit spreads, foreign exchange rates and equity prices. Other market risk is defined as equity price risk and inflation risk, each of which is disclosed in the following notes.

81. Market risk management

The Group separates its exposure to market risk into trading and non-trading portfolios, managing each separately. Trading portfolios include positions arising from market-making, hedges for derivative sales and proprietary position-taking. Non-trading portfolios include positions arising from the Group's retail and commercial banking operations and proprietary position-taking as part of asset and liability management and funding transactions, managed by Treasury. Treasury is also responsible for daily liquidity management, creating exposure to market risk.

The Board of Directors is responsible for determining the Group's overall risk appetite, including for market risk. The CEO of the Bank appoints the Risk & Finance Committee, which is responsible for developing detailed market risk management policies and setting market risk limits. Treasury and the Market Making department within Markets are responsible for managing market-related positions under the supervision of Market Risk. The objective of market risk management is to identify, locate and monitor market risk exposures and analyse and report to appropriate parties.

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81. Market risk management (continued)

Market risks arising from trading and non-trading activities are monitored and reported on a daily, weekly and monthly basis to the head of each business unit along with a comprehensive biannual risk report to the Board of Directors. The Group's market risk is thereby measured and monitored on a daily basis, and Market Risk monitors the limits set in the Group's risk appetite and submits these and other market risk measurements and concerns to the Risk & Finance Committee every other week. Several indicators are used, including daily profits and losses, delta positions and net positions across different attributes such as currency and issuer.

The Group uses risk exposure amounts (REA) and economic capital (EC) as a common denominator for measuring risk across different asset classes, including those assets subject to market risk. Risk exposure amounts are determined by applying specific risk weights to the Group's assets, following capital requirements regulations.

The following table summarises the Group's exposure to market risk as at 31 December 2017 and 31 December 2016. The Group uses the standardized approach to calculate risk exposure amounts for Credit Valuation Adjustment (CVA) according to capital requirement regulations.

	2017	2016
Market risk factor	**% of REA**	**% of REA**
Equity price risk	1.1%	1.1%
Interest rate risk	0.3%	0.4%
Credit Valuation Adjustment	0.1%	-
Foreign exchange risk	0.5%	0.5%
Total	**1.9%**	**2.0%**

The currency risk in the Groups trading portfolios is disclosed together with that in its non-trading portfolios in Notes 87-88 together with the related sensitivity analysis.

82. Equity price risk

Equity price risk is the risk of equity value fluctuations due to open positions in equity-based instruments.

The Group's equity trading portfolio is comprised of proprietary trading positions and exposures due to market making, including equity derivatives and hedging positions, in listed ISK equities. The Group's non-trading portfolio contains listed and unlisted equities as part of asset and liability management. Further details are disclosed in Note 20 and Notes 84-85.

83. Interest rate risk

Interest rate risk is the risk that the fair value or future cash flow of financial instruments will fluctuate due to changes in market interest rates.

Changes in interest rates for the Group's assets and liabilities, other than those in its trading portfolios, have an impact on its interest rate margin. This risk results primarily from duration mismatches between assets and liabilities. Interest rate risk is managed principally by monitoring interest rate gaps. Interest rate risk is managed centrally within the Group by the Treasury of the Bank, and is monitored by Market Risk.

The following tables summarise the Group's exposure to interest rate risk. The tables include interest-bearing financial assets and liabilities at their carrying amounts, while off-balance sheet amounts are the notional amounts of the derivative instruments, see Note 21. The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

As at 31 December 2017	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	55,192	-	-	-	55,192
Bonds and debt instruments	84,184	18,761	3,664	10,701	117,310
Derivative instruments	1,905	-	-	-	1,905
Loans and advances to financial institutions	44,866	-	-	-	44,866
Loans and advances to customers	749,895	53,758	64,417	57,566	925,636
Other financial assets	5,457	-	-	-	5,457
Total	**941,499**	**72,519**	**68,081**	**68,267**	**1,150,366**
Financial liabilities					
Due to financial institutions and Central Bank	(32,062)	-	-	-	(32,062)
Deposits from customers	(599,233)	(4,219)	(1,706)	-	(605,158)
Derivative instruments and short positions	(940)	-	(253)	(65)	(1,258)
Borrowings	(26,822)	(20,557)	(160,441)	(74,054)	(281,874)
Other financial liabilities	(7,815)	-	-	-	(7,815)
Subordinated liabilities	(77)	-	-	-	(77)
Total	**(666,949)**	**(24,776)**	**(162,400)**	**(74,119)**	**(928,244)**
Net on-balance sheet position	274,550	47,743	(94,319)	(5,852)	222,122
Effect of derivatives held for risk management	(41,066)	(37,275)	41,066	37,275	
Net off-balance sheet position	0	0	0	0	
Total interest repricing gap	**233,484**	**10,468**	**(53,253)**	**31,423**	

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83. Interest rate risk (continued)

As at 31 December 2016	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	30,662	-	-	-	30,662
Bonds and debt instruments	131,569	3,212	10,012	10,099	154,892
Derivative instruments	278	-	-	-	278
Loans and advances to financial institutions	18,748	1,660	-	-	20,408
Loans and advances to customers	625,538	100,029	78,192	49,658	853,417
Other financial assets	6,528	-	-	-	6,528
Total	**813,323**	**104,901**	**88,204**	**59,757**	**1,066,185**
Financial liabilities					
Due to financial institutions and Central Bank	(20,093)	-	-	-	(20,093)
Deposits from customers	(583,092)	(5,022)	(1,517)	(94)	(589,725)
Derivative instruments and short positions	(1,183)	(17)	(74)	(455)	(1,729)
Borrowings	(79,316)	(14,009)	(109,785)	(20,834)	(223,944)
Other financial liabilities	(7,206)	-	-	-	(7,206)
Subordinated liabilities	(238)	(150)	-	-	(388)
Total	**(691,128)**	**(19,198)**	**(111,376)**	**(21,383)**	**(843,085)**
Net on-balance sheet position	122,195	85,703	(23,172)	38,374	223,100
Net off-balance sheet position	153	(153)	0	0	
Total interest repricing gap	**122,348**	**85,550**	**(23,172)**	**38,374**	

84. Sensitivity analysis for trading portfolios

The management of market risk in the trading book is supplemented by monitoring sensitivity of the trading portfolios to various scenarios in equity prices and interest rates.

The following table shows the Group's sensitivity to parallel shifts in interest rate curves through changes in the fair value of its trading portfolios at year-end 2017 and 2016.

	2017			2016		
Currency (ISK million)	Parallel shift in yield curve in basis points	Effect of downward shift	Effect of upward shift	Parallel shift in yield curve in basis points	Effect of downward shift	Effect of upward shift
ISK, non-CPI indexed	100	79	(74)	100	119	(110)
ISK, CPI indexed	50	80	(74)	50	65	(61)
Total		**159**	**(148)**		**184**	**(171)**

The following table shows how the Group's profit (loss) before tax would have been affected by a change of +/-5% in the price of equities and equity instruments in the trading book held by the Group at year-end.

	2017		2016	
Currency (ISK million)	Increase	Decrease	Increase	Decrease
ISK	259	(259)	226	(226)
Total	**259**	**(259)**	**226**	**(226)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before tax would have affected retained earnings.

85. Sensitivity analysis for non-trading portfolios

The management of interest rate risk in the Group’s banking book is supplemented by monitoring the sensitivity of financial assets and liabilities to various interest rate scenarios. The Group employs a monthly stress test of the interest rate risk in the Group’s banking book by shifting the interest rate curves for every currency, and measuring the effect on economic value.

85. Sensitivity analysis for non-trading portfolios (continued)

The following table shows how the net present value of the Group's cash flow in the non-trading portfolios for the next 12 months would have been affected by a parallel shift in all interest rate curves, with all other variables held constant, as related to risk exposure at year-end 2017 and 2016.

	2017			2016		
Currency (ISK million)	Parallel shift in yield curve in basis points	Effect of downward shift	Effect of upward shift	Parallel shift in yield curve in basis points	Effect of downward shift	Effect of upward shift
ISK, unindexed	100	92	(90)	400	225	(226)
ISK, CPI indexed	100	245	(148)	240	505	(421)
EUR	100	(183)	183	200	381	(376)
Other	100	49	(49)	200	39	(43)
Total		**203**	**(104)**		**1,150**	**(1,066)**

The following table shows how the Group's profit (loss) before tax would have been affected by a change of +/-5% in the price of equities which are classified into Level 1 or Level 2, as defined in Note 16 and of +/-5% in the key unobservable inputs used in valuation of equities which are classified into Level 3, as defined in Note 16, in the price of equities in the non-trading book at year-end.

	2017		2016	
Currency (ISK million)	Increase	Decrease	Increase	Decrease
ISK	1,029	(1,052)	944	(1,081)
Other	9	(10)	3	-
Total	**1,038**	**(1,062)**	**947**	**(1,081)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before tax would have affected retained earnings.

86. CPI indexation risk (all portfolios)

The consumer price index (CPI) indexation risk is the risk that the fair value or future cash flows of CPI-linked financial instruments may fluctuate due to changes in the Icelandic CPI. The Group has a considerable imbalance in its CPI-linked assets and liabilities. To mitigate this imbalance the Bank offers non-CPI-linked loans, CPI-linked deposits, CPI-linked covered bonds as well as CPI-linked interest rate swaps.

CPI indexation risk is managed centrally within the Group by Treasury, and is monitored by the Market Risk department within the Risk Management division. The following table summarizes the Group's CPI imbalance, calculated as the difference between CPI-linked financial assets and liabilities, as at year-end 2017 and 2016.

Carrying amount	2017	2016
Assets		
Bonds and debt instruments	11,621	10,518
Loans and advances to financial institutions	-	1,660
Loans and advances to customers	365,948	319,013
Total	**377,569**	**331,191**
Liabilities		
Due to financial institutions and Central Bank	(8)	(160)
Deposits from customers	(105,856)	(102,417)
Short positions	(35)	(546)
Borrowings	(49,570)	(20,833)
Subordinated liabilities	-	(278)
Total	**(155,469)**	**(124,234)**
Total on-balance sheet position	222,100	206,955
Total off-balance sheet position	(230)	63
Total CPI indexation balance	**221,870**	**207,018**

Management of the Group's CPI indexation risk is supplemented by monitoring the sensitivity of the Group's overall position in CPI-indexed financial assets and liabilities net on-balance sheet to various inflation/deflation scenarios. As an example, a 1% change in the CPI applied to the inflation risk exposures in existence at 31 December 2017, with no change in other variables, would have changed net interest income by ISK 2.219 million (31 December 2016: ISK 2.070 million). The Group's equity would have been affected by the same amount as the income statement, but net of income tax. This is because the increase/decrease in net interest income would have affected retained earnings. However, in a scenario of ongoing high (low) inflation, floating unindexed interest rates are likely to remain higher (lower) than would be the case in the reverse scenario, thus counterbalancing the positive (negative) income effects for the Group in the medium and longer term.

87. Currency risk (all portfolios)

The Group follows Rules No. 950/2010, on Foreign Exchange Balances, as set by the Central Bank of Iceland. The Rules stipulate that an institution's foreign exchange balance (whether long or short) must always be within 15% of its capital base, in each currency and for all currencies combined. The Group submits daily and monthly reports to the Central Bank with information on its foreign exchange balance.

The Group's combined net foreign exchange balance as at 31 December 2017 was +1.61% of the Group's capital base (31.12.2016: +1.38%).

88. Concentration of currency risk

The following tables summarise the Group's exposure to currency risk as at year-end 2017 and 2016. The off-balance sheet amounts shown are the notional amounts of the Group's derivative instruments.

Amounts presented under assets and liabilities include all spot deals as at year-end 2017 and 2016. When managing currency risk the Group regards spot deals as non-derivative assets or liabilities.

As at 31 December 2017	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	567	200	305	11	53	258	1,394
Bonds and debt instruments	35,513	11,921	11,858	-	-	-	59,292
Equities and equity instruments	30	-	176	-	-	28	234
Derivative instruments	535	58	1,090	-	-	39	1,722
Loans and advances to financial institutions	26,769	1,887	3,494	645	106	11,636	44,537
Loans and advances to customers	99,455	3,551	38,019	3,386	3,433	1,294	149,138
Other assets	937	-	5	-	-	124	1,066
Total	**163,806**	**17,617**	**54,947**	**4,042**	**3,592**	**13,379**	**257,383**
Liabilities							
Due to financial institutions and Central Bank	(1,347)	(69)	(56)	-	-	(24)	(1,496)
Deposits from customers	(25,154)	(2,911)	(16,576)	(359)	(578)	(3,986)	(49,564)
Derivative instruments and short positions	(618)	(38)	(80)	-	-	(10)	(746)
Borrowings	(158,709)	-	(7,847)	-	-	(37,632)	(204,188)
Other liabilities	(507)	(243)	(893)	(6)	(4)	(711)	(2,364)
Subordinated liabilities	-	-	-	(43)	(34)	-	(77)
Total	**(186,335)**	**(3,261)**	**(25,452)**	**(408)**	**(616)**	**(42,363)**	**(258,435)**
Net on-balance sheet position	(22,529)	14,356	29,495	3,634	2,976	(28,984)	**(1,052)**
Net off-balance sheet position	24,864	(14,119)	(28,993)	(3,258)	(2,865)	29,411	**5,040**
Net currency position	**2,335**	**237**	**502**	**376**	**111**	**427**	**3,988**

As at 31 December 2016	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	358	175	287	16	32	225	1,093
Bonds and debt instruments	10,803	6,296	18,426	-	-	-	35,525
Equities and equity instruments	50	-	59	-	-	6	115
Derivative instruments	57	56	115	-	-	5	233
Loans and advances to financial institutions	10,783	2,075	3,004	302	17	2,502	18,683
Loans and advances to customers	93,433	3,808	61,063	4,481	4,058	6,772	173,615
Other assets	789	-	6	-	-	252	1,047
Total	**116,273**	**12,410**	**82,960**	**4,799**	**4,107**	**9,762**	**230,311**
Liabilities							
Due to financial institutions and Central Bank	(22)	(43)	(32)	-	-	(26)	(123)
Deposits from customers	(27,390)	(11,648)	(12,558)	(200)	(872)	(3,508)	(56,176)
Derivative instruments and short positions	(117)	(327)	(498)	-	-	(187)	(1,129)
Borrowings	(98,786)	-	(50,122)	-	-	(24,896)	(173,804)
Other liabilities	(1,118)	(111)	(810)	(2)	(18)	(569)	(2,628)
Subordinated liabilities	-	-	-	(48)	(37)	-	(85)
Total	**(127,433)**	**(12,129)**	**(64,020)**	**(250)**	**(927)**	**(29,186)**	**(233,945)**
Net on-balance sheet position	(11,160)	281	18,940	4,549	3,180	(19,424)	**(3,634)**
Net off-balance sheet position	13,989	(238)	(18,631)	(4,490)	(3,063)	19,547	**7,114**
Net currency position	**2,829**	**43**	**309**	**59**	**117**	**123**	**3,480**

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89. Sensitivity to currency risk

The following table shows how other net operating income would have been affected by a 5% depreciation/appreciation of the ISK against each foreign currency, with all other variables held constant. The sensitivity analysis is applied to the Group's overall position in foreign currency on-balance sheet as disclosed in Note 88.

	2017		2016	
Currency (ISK million)	**-5%**	**+5%**	**-5%**	**+5%**
EUR	117	(117)	141	(141)
GBP	12	(12)	2	(2)
USD	25	(25)	15	(15)
JPY	19	(19)	3	(3)
CHF	6	(6)	6	(6)
Other	21	(21)	6	(6)
Total	**200**	**(200)**	**173**	**(173)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase/decrease in other net operating income would have affected retained earnings.

90. Foreign exchange rates used

The following foreign exchange rates were used by the Group for the accounting year presented in these Financial Statements.

	As at 31 December 2017	As at 31 December 2016	% change	Average for 1.1-31.12 2017	Average for 1.1-31.12 2016
EUR/ISK	124.25	119.20	4.2%	120.25	133.30
GBP/ISK	139.95	139.69	0.2%	137.66	164.31
USD/ISK	103.46	113.05	(8.5%)	106.25	120.92
JPY/ISK	0.92	0.97	(5.2%)	0.95	1.10
CHF/ISK	106.19	111.25	(4.5%)	108.11	122.36
CAD/ISK	82.59	84.28	(2.0%)	81.79	91.09
DKK/ISK	16.69	16.03	4.1%	16.17	17.90
NOK/ISK	12.65	13.13	(3.7%)	12.86	14.36
SEK/ISK	12.64	12.44	1.6%	12.47	14.13

Operational risk

91. Operational risk

Operational risk is the risk of financial losses resulting from fraud, the failure or inadequacy of internal processes or systems, from employee error or from external events. Operational risk includes legal risks, but excludes reputational risks. It is therefore inherent in all areas of business activities.

Whereas the Managing Director of each division is responsible for that division's operational risk, the daily management of operational risk is overseen by the general managers of each department. The Bank establishes, maintains and coordinates its operational risk management framework. This framework complies with the Basel Committee's 2011 publication, "Principles for the Sound Management of Operational Risk". The Bank ensures that operational risk management stays consistent throughout the Bank by upholding a system of prevention and control that entails detailed procedures, permanent supervision and insurance policies, together with active monitoring by the Internal Audit function. By managing operational risk in this manner, the Bank intends to ensure that all of the Bank's business units are kept aware of any operational risks, that a robust monitoring system remains in place and that controls are implemented to minimize risk in an efficient and effective manner.

Accounting policies

92. Significant accounting policies

The Consolidated Financial Statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies applied in these Consolidated Financial Statements are the same as those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2016.

The principal accounting polices used in preparing these Consolidated Financial Statements are set out in Notes 92.1 to 92.42.

92.1 Consolidation

(a) Subsidiaries

Subsidiaries are investees controlled by the Group. The Group controls an investee if it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group is considered to have power over an entity when it has existing rights that give it the current ability to direct the relevant activities. For the Group to have power over an entity, it must have the practical ability to exercise those rights.

Where voting rights are not relevant in deciding whether the Group has power over an entity, the assessment of control is based on all facts and circumstances. This includes circumstances in which protective rights held become substantive and lead to the Group having power over an investee.

Subsidiaries are fully consolidated from the date on which control is obtained, and are de-consolidated from the date on which control ceases.

The acquisition method is used to account for business combinations by the Group. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred, except for costs related to the issue of debt and equity instruments. Identifiable assets acquired and liabilities assumed in a business combination are initially measured at their fair value on the acquisition date. A contingent liability of an acquiree is only recognised in a business combination if such a liability represents a present obligation and arises from a past event, and its fair value can be measured reliably. More information about how the Group accounts for goodwill acquired in a business combination is disclosed further in this note.

Intercompany transactions, balances, and unrealised gains on transactions between Group entities are eliminated in the Consolidated Financial Statements. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of subsidiaries have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

(b) Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank. Such interests are presented separately in the consolidated income statement and are included in equity in the consolidated statement of financial position, separately from equity attributable to owners of the Bank. The Group chooses on an acquisition-by-acquisition basis whether to measure non-controlling interests in an acquiree at fair value or according to the proportion of non-controlling interests in the acquiree's net assets. Changes in the Bank's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Bank.

(c) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, related non-controlling interests and other components of equity. Any resulting gain or loss is recognised in the income statement. Any interest retained in the former subsidiary is measured at fair value when control is lost.

92.2 Structured entities

Structured entities are entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

The Group acts as investment manager or investment advisor to a number of investment funds for Landsbréf-branded funds. The purpose of these investment funds is to generate fees from managing assets on behalf of third-party investors by providing investment strategies. These investment funds are financed through the issue of units to investors. The Group has no contractual obligation to provide financial support to these structured entities.

From time to time, the Group makes seed capital investments in certain fund products in order to establish track records for new products, to test new investment strategies or to launch new products at a viable minimum size.

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

92. Significant accounting policies (continued)

92.3 Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds, directly or indirectly, between 20 and 50 percent of the voting power of another entity. The Group accounts for investments in associates either using the equity method or as financial assets designated at fair value through profit or loss, as described further in this note.

Equity-accounted associates

Investments in equity-accounted associates are accounted for using the equity method from the date on which significant influence is obtained and are initially recognised at cost. Goodwill relating to an investment in an associate is included in the carrying amount of the investment. Any excess of the Group's share of net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share of the associate's profit or loss in the period which the investment is acquired. Investments in associates which are accounted for by the Group using the equity method are presented in the consolidated statement of financial position in the line "Investments in equity-accounted associates".

Because goodwill included in the carrying amount of an investment in an associate is not recognised separately, it is not separately tested for impairment according to the requirements for goodwill impairment testing in IAS 36, Impairment of Assets. Instead, the entire carrying amount of the investment is tested for impairment under IAS 36 by comparing its recoverable amount with its carrying amount, whenever application of the requirements in IAS 39, Financial Instruments: Recognition and Measurement, indicates the investment may be impaired.

The Group's share of its equity-accounted associates' post-acquisition profits or losses is recognised in the income statement, and its share of movements in their reserves is recognised in the Group's equity reserves. Cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of associates have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

Associates designated at fair value through profit or loss

The Group designates certain investments in associates upon initial recognition at fair value through profit or loss and they are accounted for in accordance with IAS 39, "Financial Instruments: Recognition and Measurement". The Group measures such investments at fair value, with changes in fair value recognised in the income statement in the relevant period as net gain (loss) on financial assets designated at fair value in the line item "Net gain (loss) on financial assets and financial liabilities".

92.4 Joint arrangements

Around year-end 2017, the private limited company JCC ehf. was established around the joint bank-cash centre operated by Landsbankinn, Arion Bank and Íslandsbanki. Each bank holds a 33.33% share in the company. The entity operates as a separate legal entity and is managerially and operationally independent from its owners, in accordance with conditions set out in a settlement between the Competition Authority and the three banks. The tasks of the cash centre consist mainly of receiving banknotes and coins from branches, ATMs and other of the banks' operations, counting and storing cash, preserving it, distributing cash to branches, ATMs, other operational sites and, if appropriate, for storage at the Central Bank.

92.5 Foreign currency translation

Transactions in foreign currencies are translated into the functional currency of the respective Group entity at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are measured at amortised cost or fair value, as applicable, in their respective foreign currencies and are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. All foreign currency differences arising on retranslation are recognised in the income statement.

92.6 Financial assets and liabilities

(a) Recognition

The Group initially recognises loans and advances, deposits and debt securities issued on the date at which they are originated. All other financial assets and liabilities are initially recognised on the date at which the Group becomes a party to contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the date at which the Group committed itself to purchasing or selling the asset.

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

92. Significant accounting policies (continued)

92.6 Financial assets and liabilities (continued)

(b) Classification

The Group classifies all financial assets either as loans and receivables or at fair value through profit or loss. The Group classifies all financial liabilities either at fair value through profit or loss or at amortised cost.

A financial asset or liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Financial assets held for trading consist of debt, equity and derivative instruments. Financial liabilities held for trading consist of derivative liabilities and short positions, i.e. obligations to deliver financial assets borrowed by the Group and sold to third parties.

The Group designates certain financial assets, including certain investments in associates, upon initial recognition at fair value through profit or loss when the financial assets are part of portfolios of financial instruments which are managed and reported to senior management on a fair value basis in accordance with the Group's documented risk management or investment strategy.

Loans and advances are financial assets with fixed or determinable payments that are not quoted in an active market which the Group originates or acquires with no intention of trading them.

(c) Derecognition

The Group derecognises a financial asset when the contractual rights to cash flows from the asset expire, or when the Group transfers the rights to receive contractual cash flows relating to the financial asset in a transaction which substantially transfers all the risks and rewards of owning that asset. Any interest in transferred financial assets created or retained by the Group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets, or a portion of them. In cases where all or substantially all of the risks and rewards are retained, then transferred assets are not derecognised. Asset transfers whereby all or substantially all risks and rewards are retained include, for example, securities lending and repurchase transactions.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or when they expire.

(d) Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off these amounts and intends either to settle on a net basis or to realise the asset and simultaneously settle the liability.

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

(e) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount of the financial asset or liability, as measured at initial recognition, minus principal repayments, plus or minus cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

(f) Fair value measurement

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The fair value of a liability reflects its non-performance risk. The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument, if available. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions at an arm's-length basis. Where available, the relevant market's closing price determines the fair value of financial assets held for trading and of assets designated at fair value through profit or loss; this will generally be the last trading price. If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's-length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates every factor that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank has a valuation committee which estimates fair value by applying models and incorporating observable market information and professional judgement. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available, observable market data.

92. Significant accounting policies (continued)

(f) Fair value measurement (continued)

Should the transaction price differ from the fair value of other observable, current market transactions in the same instrument or be based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a Day 1 profit or loss). In cases where fair value is determined using data which is not observable, the difference between the transaction price and the model value is recognised in the income statement depending on the individual circumstances of the transaction but not later than when the inputs become observable, or when the instrument is derecognised.

The fair value of financial assets and liabilities is determined based on different methods and assumptions depending on what financial asset or liability is being valued. For all financial assets and liabilities the foreign currency exchange rates used are from observable markets both for spot and forward contracts and futures in the world's major currencies.

(g) Impairment of financial assets

Impairment of loans and advances

At each reporting date, the Group assesses whether there is any objective evidence that a loan or loan portfolio is impaired. A loan or loan portfolio is considered impaired and impairment losses are incurred only when there is objective evidence of impairment as a result of one or more events occurring after initial recognition of the asset ("loss events") and these loss events impact future cash flows that can be estimated reliably for the loan or group of loans.

Objective evidence of impairment includes observable data on the following loss events:

- significant financial difficulties of the borrower or issuer;
- a breach of contract, such as defaulting on instalments or on interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter into bankruptcy or undergo other financial reorganisation;
- observable data indicate a measurable decrease in estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with individual financial assets within the group, including adverse changes in the payment status of borrowers in the group or a general deterioration of economic conditions connected to that group of loans.

The Group defines loans that are individually significant and assesses first whether objective evidence of their impairment exists, and then makes individual or collective assessments for loans and advances that have not been defined as individually significant. If the Group determines that no objective evidence of impairment exists for a significant loan, it includes this loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Individual significant assets for which an impairment loss is recognised are not included in collective impairment assessments.

If there is objective evidence that an impairment loss has been incurred on loans or advances, the amount of the loss is measured as the difference between the asset's carrying amount and its recoverable value. The recoverable value is the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the amount of impairment, using an allowance account, and the amount of the loss is recognised in the line item "Net valuation adjustments and credit impairment charges" in the income statement. In the case of loans with variable interest rates, the discount rate for measuring impairment losses is the current effective interest rate.

The present value calculated for estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, less the costs involved in obtaining and selling the collateral, whether or not foreclosure is probable.

In order to conduct a collective valuation of impairment, loans are grouped on the basis of similar credit risk characteristics on the basis of the Group's grading process, which considers asset type, collateral type, industry, past-due status and other relevant factors. These characteristics are appropriate for estimating future cash flows in groups of such loans by indicating the debtors' ability to pay every amount due according to contractual terms.

Groups of loans are collectively valuated for impairment on the basis of expected cash flows and of peer review regarding assets with similar credit risk characteristics. Such peer review is also adjusted on the basis of current observable data, in order to reflect the effects of current conditions that did not affect the period on which peer review was originally based and to remove the effects of previous loss factors which no longer exist.

Estimates of changes in future cash flows in groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of trends in the probability and magnitude of Group losses. The Group regularly reviews its methodology and assumptions for estimating future cash flows in order to minimise discrepancies between estimated losses and actual loss experience.

When a loan is uncollectible, it is written off against the provision for loan impairment in the statement of financial position. Loans are written off after all the necessary procedures have been completed, as set out in Group lending policies, and the amount of loss has been determined. Any subsequent recovery of an amount previously written off is recognised in the income statement in the line item "Net valuation adjustments and credit impairment charges".

If the amount of the impairment loss decreases in the subsequent period and the decrease can be related objectively to an event occurring after the original impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement in the line item "Net valuation adjustments and credit impairment charges".

92. Significant accounting policies (continued)

92.6 Financial assets and liabilities (continued)

(g) Impairment of financial assets (continued)

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and an agreement of new loan terms. Loans which are impaired and whose terms are renegotiated are not considered to be new loans. Once the terms have been renegotiated these loans are no longer considered past due and any subsequent impairment is measured using the original effective interest rate as calculated before the modification of terms. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to individual or collective impairment assessment. Loans which are not individually impaired and whose terms are renegotiated are accounted for as new loans. Accordingly, the original loans are derecognised and the renegotiated loans are recognised as new loans.

92.7 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash, unrestricted balances with the Central Bank and unrestricted balances with financial institutions. The carrying amount of balances with the Central Bank is a reasonable approximation of their fair value.

92.8 Bonds and debt instruments

Bonds which are classified as financial assets at fair value through profit or loss are recognised at fair value in the statement of financial position both initially and subsequent to initial recognition. Transaction costs are recognised directly in the income statement. Gains and losses arising from changes in fair value are recognised directly in the income statement, either as net gain (loss) on financial assets and liabilities held for trading or net gain (loss) on financial assets designated at fair value in the line item “Net gain (loss) on financial assets and financial liabilities”. The gains and losses include interest income on bonds but exclude foreign exchange gains and losses, which are included in the line item “Net foreign exchange gain (loss)”.

Bonds which are classified as loans and receivables are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and it is recognised in the line item "Interest income" in the income statement. Quoted prices are generally available for government bonds and certain corporate securities. Where this information is not available, fair value is estimated by adding credit spreads to quoted market rates for similar bonds or relevant interest rate curves. For bonds issued by defaulting or greatly distressed parties recovery values are used for estimating the fair value. These estimated are based on statement of financial position information or expert opinion.

Interest rates are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets. Where available, credit spreads are derived from prices of credit default swaps (CDS) or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. Counterparty credit spreads are estimated based on the creditworthiness of the counterparty when differing from the assumed counterparty in the market.

92.9 Equities

Equities which are classified as financial assets at fair value through profit or loss are recognised at fair value in the statement of financial position both initially and subsequent to initial recognition. Transaction costs are recognised directly in the income statement. Gains and losses arising from changes in fair value are recognised directly in the income statement, either as net gain (loss) on financial assets and liabilities held for trading or net gain (loss) on financial assets designated at fair value in the line item “Net gain (loss) on financial assets and financial liabilities”. Foreign exchange gains and losses are included in the line item „Net foreign exchange (loss) gain“. Quoted prices are generally readily available for equities listed on the world's stock exchanges and for major indices on such shares. In lieu of such information, the fair value is estimated based on market prices and earning multiples from similar securities, recent transactions or by using discounted cash flow methods.

92.10 Derivative instruments

Derivatives are initially recognised in the statement of financial position at fair value, with transaction costs recognised in the income statement. The fair value of derivative instruments is determined using valuation methods whose most significant input is volatility, which is obtained from broker quotations, pricing services or derived from option prices. Subsequently, derivatives continue to be carried at fair value, with all fair value changes recognised in the income statement as net gain on financial assets and liabilities held for trading in the line item “Net gain (loss) on financial assets and financial liabilities”, except for fair value changes of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item “Net foreign exchange (loss) gain” in the income statement. In the statement of financial position, derivatives with positive fair values are recognised as assets and derivatives with negative fair values as liabilities.

92.11 Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Group accounts for an embedded derivative separately from the host contract when:

- the host contract is not itself carried at fair value through profit or loss;
- the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract;
- the economic characteristics and risk of the embedded derivative are not closely related to the economic characteristics and risk of the host contract.

Separated embedded derivatives are measured at fair value, with all change in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment-hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contracts.

92. Significant accounting policies (continued)

92.12 Loans and advances

Loans and advances are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received based on future recovery of the loans. The recovery rates and loss given default are used as input into valuation models as an indicator of severity of losses on default. Expected future cash flows are discounted at current market rates to determine fair value. Accrued interest is included in the carrying amount of loans and advances. Interest income on loans and advances is recognised in the line item "Interest income" in the income statement and foreign exchange differences in the line item "Net foreign exchange (loss) gain".

Loans and advances to financial institutions include inter-bank placements and items in the course of collection. The carrying amount of floating rate placements and overnight deposits is a reasonable approximation of their fair value.

92.13 Property and equipment

All property and equipment is recognised at cost, less accumulated depreciation and accumulated impairment losses. The cost includes expenditures directly attributable to acquiring these assets.

Subsequent costs are included in an asset's carrying amount only if it is probable that future economic benefits associated with the item will flow to the Group and if these costs can be reliably measured. All other repairs and maintenance are charged to the income statement of the financial period in which their costs are incurred.

Depreciation of any property and equipment is calculated using the straight-line method. This method is applied to the depreciable amount of the assets, which is their cost less their residual value over their estimated useful lives, as follows:

Buildings	25-50 years
Computer hardware	3 years
Other equipment and motor vehicles	3-10 years

The assets' residual values and useful lives are reviewed annually and adjusted where appropriate.

Gains and losses on disposals are determined by comparing the sale price of an asset with its carrying amount on the date of sale. Gains and losses are included in the item "Other income and expenses" in the income statement.

92.14 Intangible assets

Computer software

Computer software is capitalised on the basis of cost to acquire or develop and bring into service. Computer software recognised as an intangible asset is amortised over its useful life, which is estimated to be 3 - 5 years.

The costs associated with maintaining computer software are recorded as expenses at the time they are incurred.

Goodwill

Goodwill is recognised as an asset only if acquired in a business combination. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration. Following initial recognition, goodwill is measured at cost, less any accumulated impairment losses. Goodwill is generally reviewed for impairment annually, but more frequently if events or changes in circumstances indicate a potential impairment of the carrying amount. For the purpose of impairment testing, goodwill is allocated as of the acquisition date to each of the Group's cash-generating units (CGUs) or group of CGUs which are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit to which this goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Where goodwill is attached to a particular unit of a CGU (or of a group of CGUs) and part of the operations within that unit is disposed of, the goodwill that is associated with the operations disposed of is included in the carrying amount of these operations when determining the gain or loss incurred upon disposing of the operations.

92.15 Impairment of non-financial assets

Assets with an indefinite useful life are not subject to amortisation but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is either an asset's fair value less selling costs or its value in use, whichever is higher. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). With the exception of goodwill, non-financial assets are reviewed at each reporting date for any possible reversal of impairment.

92. Significant accounting policies (continued)

92.16 Income tax

(a) Income tax

Income tax is recognised based on the domestic corporate income tax rates and tax laws that have been enacted at the reporting date. Income tax recognised in these Consolidated Financial Statements comprises current and deferred tax.

(b) Current tax

Current tax comprises the expected tax payable on the taxable income for the current year and, if applicable, adjustments to the tax payable or receivable in respect of previous years. Current tax is measured based on the domestic corporate income tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

(c) Deferred tax

Deferred tax assets are recognised when it is probable that future taxable profit will be available against which deductible temporary differences can be utilised.

Deferred income tax is recognised in full as a liability, based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements. However, deferred income tax is not recognised if it arises from the initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither the Group's accounting nor its taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

92.17 Assets and liabilities classified as held for sale

The Group classifies non-current assets (or groups of assets together with related liabilities) as held for sale when their carrying amount will be recovered principally through a sale transaction. This is usually the case with collateral foreclosed by the Group which it holds as security for loans and advances, including assets and liabilities of subsidiaries over which the Group obtains control through foreclosure of collateral and/or financial restructuring.

A non-current asset (or group of assets together with related liabilities) is considered to be recovered principally through a sale transaction when the asset's sale is highly probable and it is available for immediate sale in its present condition, subject to ordinary and customary terms on the sale of such assets. Management must be committed to the sale and must actively market the asset for sale at a price that is reasonable in relation to its current fair value. A further condition is that the sale is expected to qualify for recognition as completed within one year from the date of classification.

Assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and their fair value less costs to sell. Additional net assets that become part of a disposal group, for example due to profits generated by the disposal group, increase the carrying amount of the disposal group but not in excess of the fair value less costs to sell of the disposal group as determined at each reporting date.

92.17 Assets and liabilities classified as held for sale (continued)

In the case of single assets classified by the Group as held for sale the Group determines their fair value less costs to sell by reference to the current market price at each reporting date. In the case of subsidiaries classified as held for sale, the Group determines the fair value of disposal groups based on discounted cash flow methodologies. Costs to sell are deemed to be only the costs which are directly attributable to the disposal of the disposal groups, excluding finance costs and income tax expense.

92.18 Deposits

Deposits from customers and financial institutions are the primary source of funding for the Group. The deposits consist of demand deposits and term deposits. Deposits are initially measured at fair value plus any directly attributable transaction costs. Subsequently, they are measured at their amortised cost using the effective interest method. The fair value of a financial liability with a demand feature, such as demand deposits, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

92.19 Secured borrowings

The secured borrowings consist of senior bonds denominated in foreign currencies, which the Bank issued specifically to LBI hf., and series of marketable indexed and non-indexed covered bonds denominated in ISK which have been issued by the Bank and admitted for trading on NASDAQ Iceland. The senior bonds were issued to LBI hf. in December 2014 following an agreement on the extension of the repayment schedule of bonds originally issued by the Bank to LBI hf. in October 2010 and April 2013. The original bonds were issued as a consideration and an additional consideration for the assets and liabilities transferred from LBI hf. to the Bank on 9 October 2008. The remaining amount of the senior bonds was paid off in 2017. The covered bonds are issued under the Bank's ISK 120,000 million Covered Bond Programme. The Bank is obliged to pledge part of its loan portfolio as collateral for the secured borrowings. The Bank was obliged to maintain a coverage ratio of at least 115% on the secured bonds issued to LBI hf. and at least 120% on the covered bonds.

The secured bonds are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and is recognised in the line "Interest expense" in the income statement. Foreign exchange gains and losses are included in the line "Net foreign exchange (loss) gain".

92. Significant accounting policies (continued)

92.20 Unsecured borrowings

The unsecured borrowings consist of senior bonds denominated in foreign currencies and marketable bank bills denominated in ISK. The bonds are issued by the Bank under its 2,000 million Euro Medium Term Note (EMTN) Programme and are listed on the Irish Stock Exchange. The bank bills on the other hand are issued under the Bank's ISK 50,000 million Debt Issuance Programme and listed on NASDAQ Iceland.

The unsecured bonds and bank bills are initially measured at fair value less directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and is recognised in the line "Interest expense" in the income statement. The unsecured senior bonds were issued to refinance the maturities of the senior secured bonds in foreign currencies which the Bank issued specifically to LBI hf., the outstanding amount of which was paid off in 2017.

92.21 Hedge accounting

Towards the end of the first quarter of 2017, the Group started applying fair value hedge accounting. The Group uses interest rate swaps to hedge its exposure to changes in the fair values of some of its notes, issued under the Bank's 2,000 million Euro Medium Term Note (EMTN) programme. Such interest rate swaps are matched to specific issuances of the EMTN fixed-rate notes. The change in fair value of interest rate swaps together with change in the fair value of bonds attributable to interest rate risk is recognised immediately as net gain (loss) on fair value hedges in "Net gain (loss) on financial assets and financial liabilities" in the income statement. Accrued interest on both bonds and swaps is included in the line item "Interest expense".

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

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

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively.

Any adjustments, up to the point of discontinuation, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

92.22 Subordinated liabilities

The subordinated liabilities are comprised of liabilities assumed by Landsbankinn through two separate mergers with the savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands. The subordinated liabilities thus assumed share characteristics of equity in that they are subordinated to other Group liabilities and are included in equity in equity ratio calculation. The outstanding amounts of the subordinated liabilities are subject to regulatory amortisation whereby the amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity.

Subordinated liabilities are initially recognised at fair value less transaction costs and are subsequently measured at amortised cost using the effective interest method. Accrued interest is recognised as part of the carrying amount of subordinated liabilities.

92.23 Short positions

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. These obligations are initially recognised in the statement of financial position at fair value, with transaction costs being recognised in the income statement. Subsequently, they continue to be carried at fair value, with all fair value changes recognised in the income statement as net gain on financial assets and liabilities held for trading in the line item "Net gain (loss) on financial assets and financial liabilities". The short positions are in Icelandic government bonds with readily available quoted market prices.

92.24 Repurchase and reverse repurchase agreements

Repurchase agreements consist of repo and reverse repo transactions with other banks. Repo transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being identical in both cases.

Securities originally sold by the Bank under repurchase agreements continue to be recognised and measured as financial assets in the Bank's financial statements, as the Bank retains all risks and rewards connected with the ownership of securities it sells under repurchase agreements. Inflows of liquidity from repo transactions are recognised in the financial statements of the Bank as financial liabilities to counterparties. Interest payments are recognised as interest expense in net interest income. Inflows are measured either at fair value using the fair value option or at amortised cost.

92. Significant accounting policies (continued)

92.24 Repurchase and reverse repurchase agreements (continued)

Conversely, securities originally bought by the Bank under reverse repurchase agreements are not recognised and measured as financial assets in the Bank's financial statements, as the counterparty retains all risks and rewards connected with the ownership of securities bought by the Bank under repurchase agreements. Outflows of liquidity arising from reverse repos are accounted for as claims on counterparties. Interest payments in reverse repos are recognised as interest income under net interest income. Repurchase agreements and reverse repurchase agreements are initially measured at fair value less transaction costs and subsequently either at fair value using the fair value option or at amortised cost.

92.25 Collateral swaps

Collateral swaps consist of collateral swaps with other banks whereby the collateral provided is in the form of securities. In essence, collateral swaps are a form of securities lending whereby the Bank borrows relatively liquid securities from another bank in exchange for a pledge of less liquid securities. The securities borrowed by the Bank from the counterparty are not recognised and measured as financial assets in the Bank's financial statements, as the counterparty retains all risks and rewards connected with the ownership of the securities. However, the securities lent to the counterparty by the Bank continue to be recognised and measured as financial assets in the Bank's financial statements, as the Bank retains all risks and rewards connected with the ownership of the securities. The Bank pays a fee to the lender to compensate for the risk of holding less liquid collateral. Interest and expenses from collateral swaps are recognised in net interest income. Collateral swaps are initially measured at fair value less transaction costs and subsequently at amortised cost.

92.26 Financial guarantee contracts

Financial guarantee contracts are contracts requiring the issuer to make specified payments to reimburse the holder for a loss it will incur if a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are issued by the Group to banks, financial institutions or other parties on behalf of Group customers so that they can secure loans, overdrafts and other banking facilities.

Financial guarantees issued by the Group are primarily bank guarantees and documentary letters of credit. Fees of long-term guarantees are claimed up-front periodically over the life of each guarantee, initially at the inception of a guarantee. Fees of short-term guarantees are in essence claimed up-front at inception. Fee income arising from the guarantees is recognised over time as the fees become payable. Provisions for losses on guarantees are subject to the uncertainty of assessing the extent to which guarantees may be called upon. For this purpose outstanding bank guarantees and documentary letters of credit are assessed quarterly in respect of credit losses and recognition of provisions. The provision assessment is based on experience with similar transactions and the history of past losses, supplemented by management judgement.

92.27 Contingent liabilities and provisions

The Group does not recognise contingent liabilities as liabilities in the statement of financial position, other than contingent liabilities which are assumed in a business combination and which have a fair value that can be measured reliably. A contingent consideration transferred by the Group in a business combination is recognised at its acquisition-date fair value. The Group classifies the obligation to pay contingent considerations as liability or equity and accounts for changes in fair value in accordance with applicable IFRSs.

Provisions for expenditures such as those related to legal claims or restructuring are recognised as incurred when (i) the Group has as a result of past events a present legal or constructive obligation to pay, (ii) it is more likely than not that an outflow of resources will be required to settle the obligation, and (iii) the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected for settling the obligation. A pre-tax rate is used which reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in the provision due to the passage of time is recognised as interest expense.

92.28 Pension liabilities

When the savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands merged with Landsbankinn in 2015, the Bank took over pension obligations towards the former employees and part of the current employees of these savings banks. The pension liability is calculated annually by an actuary. The increase in the liability in 2017 is expensed in the income statement with salaries and related expenses.

92.29 Employee benefits

All Group entities have defined contribution plans, with the entities paying a fixed contribution to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognised as an expense when they become due. The Group has no defined benefit pension plan.

92.30 Share capital

(a) Share issue costs

Costs directly attributable to the issue of new shares are presented separately in equity as a deduction from share premium.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity during the period in which they are approved by the Bank's shareholders' meeting.

92. Significant accounting policies (continued)

92.31 Fiduciary activities

The Group acts as a custodian, holding or placing assets on behalf of individuals, institutions and pension funds, including various mutual funds managed by the Group. These assets, together with the income arising from them, are excluded from these financial statements, since they are not assets of the Group.

92.32 Interest income and expense

The interest income, expense and inflation indexation presented in the Consolidated Income Statement consist of interest income and expense from financial assets and liabilities measured at amortised cost.

The interest income and expense is recognised in the Consolidated Income Statement using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument but it does not consider any future credit losses. The calculation of the effective interest rate includes all fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

92.33 Net impairment loss on loans and advances

Impairment charges relating to loans and advances to financial institutions and customers are presented in the Consolidated Income Statement under the item "Net valuation adjustments and credit impairment charges". Once impairment has been recognised, subsequent interest income is recognised at the rate of interest used for discounting future cash flows when measuring impairment losses.

92.34 Fee and commission income and expense

Fees and commissions are generally recognised on an accrual basis as the related services are performed. Arrangement fees are generally deferred together with related direct costs and recognised as an adjustment to the effective interest rate of a loan. Commissions and fees for participation in negotiating a transaction for a third party, such as arrangement of transactions with equities or other securities or the purchase or sale of businesses, are recognised upon completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis. Asset management fees related to investment funds are recognised rateably over the period when the service is provided. The same principle for reporting income is applied to other custody services that are continuously provided over an extended period of time.

92.35 Net gain (loss) on financial assets and liabilities

Net gain (loss) on financial assets and financial liabilities is composed of: 1) net gain (loss) on financial assets designated at fair value through profit or loss; 2) net profit (loss) on fair value hedges; and 3) net gain (loss) on financial assets and liabilities held for trading.

1) The net gain (loss) on financial assets designated at fair value through profit or loss includes:
• All realised and unrealised changes in fair value.
• Interest income on an accrual basis.
• Dividend income, which is recognised when the Group's right to receive payment is established.

2) The net profit (loss) on fair value hedges includes:
• All realised and unrealised changes in fair value of hedging instruments.
• All realised and unrealised changes in the value of hedged items.
• Interest income/expense on an accrual basis that is included in the line item "Interest expense" in the income statement.

3) The net gain (loss) on financial assets and financial liabilities held for trading includes:
• All realised and unrealised changes in fair value.
• Interest income/expense on an accrual basis.
• Dividend income recognised when the Group's right to receive payment is established.
• Foreign exchange gains and losses arising from derivative financial assets and liabilities, except for changes in the fair value of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

92.36 Net foreign exchange (loss) gain

Net foreign exchange gain (loss) includes all gains and losses arising from settlement of transactions in foreign currencies and translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, including non-derivative financial assets and liabilities classified as held for trading and financial assets designated at fair value through profit or loss. Foreign exchange gains and losses arising from derivative financial assets and liabilities are included in the line item "Net gain (loss) on financial assets and financial liabilities" in the income statement, except for fair value changes of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

92.37 Other income and expenses

Other income and expenses include, *inter alia*, revenue arising from recharging agreements and gains and losses on repossessed collateral and property and equipment.

92. Significant accounting policies (continued)

92.38 Leases

(a) When a Group entity is the lessee

The leases into which the Group enters as a lessee are primarily operating leases. Over the period of the lease, payments for operating leases are charged to the income statement on a straight-line basis, in the line item "Other operating expenses".

If an operating lease is terminated before the lease period has expired, any payment to the lessor required by way of penalty is recognised as an expense in the period in which termination occurs.

(b) When a Group entity is the lessor

When assets are held subject to a finance lease, the present value of lease payments is recognised as a receivable, under loans and advances to customers. Finance income from such a lease is recognised over the term of the lease, using a method that reflects a constant periodic rate of return on the Group's net investment in the lease.

92.39 Discontinued operations

The Group presents discontinued operations in a separate line of the Consolidated Income Statement if an entity or a component of an entity has been disposed of or is classified as held for sale and:
• Represents a major separate line of business;
• Is a part of a single co-ordinated plan to dispose of a major separate line of business;
• Is a subsidiary acquired exclusively with a view to resale.

The profit from discontinued operations disclosed in the Consolidated Income Statement consists of (a) post-tax profit or loss from discontinued operations and (b) post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or the disposal groups constituting the discontinued operation. A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting, from the rest of the Group's operations and cash flows.

92.40 Earnings per share

The Group presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss that is attributable to ordinary shareholders of the Bank by the weighted average number of shares outstanding during the period. The Bank's basic and diluted earnings per share are equal as the Bank has not issued any options, warrants, convertibles or other potential sources of dilution.

92.41 Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the Executive Board (being the chief operating decision-maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

92.42 New standards, amendments to standards and interpretations of standards

The Group has adopted amendments to accounting standards which became effective for the first time in 2017. The amendments had an insignificant impact on the Consolidated Financial Statements. The International Accounting Standards Board (IASB) has also issued new IFRS standards and amendments to standards which have not yet taken effect. The following is a summary of the new standards which will either have a significant or insignificant effect on the Group's Consolidated Financial Statements.

IFRS 9 - Financial instruments. The IASB released IFRS 9 Financial Instruments (2014), completing its project to replace IAS 39 Financial Instruments: Recognition and Measurement. The new standard introduces extensive changes to previous guidance on the classification and measurement of financial assets and introduces a new 'expected credit loss' model for the impairment of financial assets.

IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018. As of 1 January 2018, the Group will adopt the version of IFRS 9 issued in 2014. Based on the Group's current assessment, the total adjustment (net of tax) of the adoption of IFRS 9 on the opening balance of equity at 1 January 2018 is expected to be a reduction in the range of ISK 1,000-1,500 million.

92. Significant accounting policies (continued)

92.42 New standards, amendments to standards and interpretations of standards (continued)

The above assessment is preliminary because not all transition work has been finalised. The actual impact of adopting IFRS 9 on 1 January 2018 may change because:

- IFRS 9 requires the Group to revise its accounting processes and internal controls and work on revision is on-going;
- although parallel runs were carried out in 2017, the new approach and associated controls have not been operational for a more extended period;
- the Group has not finalised the testing and assessment of controls over its new approach and changes to its governance framework;
- the Group is refining and finalising its models for financial assets measured at fair value; and
- the new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Group finalises its first financial statements that include the date of initial application.

Governance

As part of the implementation of IFRS 9, the Group has designed and implemented new controls and governance procedures in several areas that contribute to the calculation of expected credit losses. These include controls over credit risk data and systems, expected credit loss models, forecasts of future macroeconomic variables, design and probability-weighting of future macroeconomic scenarios, and the determination of significant increase in credit risk. The IFRS 9 Steering Committee (SteerCo) is responsible for the design and delivery of business processes, governance and organisational design to support the implementation of IFRS 9. SteerCo is comprised of the CFO, the CRO and personnel from Risk Management, Operations & IT and Accounting.

Classification and measurement Classification and measurement

IFRS 9 espouses a new classification and measurement approach for financial assets that reflects the business model in which assets and their cash flow characteristics are managed. Classification determines how financial instruments are measured at initial recognition in financial statements and following initial recognition. The Group is obligated to re-classify financial assets if the objective of the business model for a group of financial assets has changed since initial recognition and if significant changes have taken place in the Bank's operation. Financial assets are classified into three main categories according to IFRS 9:

- Financial assets measured at amortised cost which the Bank intends to hold to maturity to collect cash flows which contractual terms give rise to on specified dates and are solely payments of principal and interest. Financial assets belong to a business model designed to collect contractual cash flows.

- Financial assets measured at fair value through comprehensive income (FVOCI) which the Bank intends to hold to maturity to collect cash flows which contractual terms give rise to on specified dates and are solely payments of principal and interest, and sale of financial asset. Financial asset in this category belong to a business model designed to collect contractual cash flows and to sell financial asset.

- Financial assets measured at fair value through profit or loss (FVTPL) includes all other financial assets. In addition, on initial recognition the Group may irrevocably designate a financial asset, which otherwise meets the requirements to be measured at amortised cost or at FVOCI, as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Investments in equities and equity instruments held for trading are measured at fair value through profit or loss. For all other investments in equity instruments an irrevocable choice can be made to measure at fair value through comprehensive income (FVOCI) on an instrument-by-instrument basis.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset under the scope of the standard, are not separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. The standard requires financial liabilities to be classified into two measurements categories: amortised cost and FVTPL. Under IFRS 9, almost all financial liabilities other than loan commitments and financial guarantees are measured at amortised cost. Financial liabilities held for sale and derivatives that are liabilities are measured at FVTPL. Financial liabilities that arise when a transfer of a financial asset does not qualify for de-recognition or when the continuing involvement approach applies.

Hedge accounting

IFRS 9 incorporates new hedge accounting rules intended to align hedge accounting with risk management practices. IFRS 9 includes an accounting choice to defer the adoption of IFRS 9 hedge accounting and to continue with IAS 39 hedge accounting. The Group has elected to continue to apply IAS 39. However, the Group will provide the expanded disclosures on hedge accounting introduced by the amendments IFRS 9 makes to IFRS 7 Financial Instruments.

92. Significant accounting policies (continued)

92.42 New standards, amendments to standards and interpretations of standards (continued)

Impairment

IFRS 9 replaces the 'incurred loss´ model in IAS 39 with a forward-looking 'expected credit loss' model. This will require considerable judgement over how changes in economic factors affect expected credit loss (ECL). ECL reflects the present value of cash shortfalls due to default events either over the following twelve months or over the expected life of a financial instrument, depending on credit deterioration from inception. ECL should reflect an unbiased, probability-weighted outcome as opposed to the single best estimate allowed under the current approach. The probability-weighted outcome considers multiple scenarios based on reasonable and available information.

The Group's approach was to leverage as much as possible the existing models and processes to meet the requirements of IFRS 9. Where shortfalls presented themselves, the Group has developed new methodologies and models. IFRS 9 requires the calculation of an ECL that takes probability-weighted economic scenarios into account. In general, the calculation of ECL is based on the following parameters: probability of default (PD), loss given default (LGD), exposure at default (EAD) and macroeconomic parameters.

Under IFRS 9, credit loss allowance on all loans will be measured on each reporting date according to a three-stage expected credit loss model. Allowance should be calculated as either the 12-month expected credit loss or the lifetime ECL.

- Stage 1 – No increase in credit risk. Loans whose credit risk has not increased significantly shall be stage 1 and the loss allowance measured as the 12-month expected credit losses.
- Stage 2 – Significant increase in credit risk. Loans whose credit risk has increased significantly since initial recognition shall be stage 2 and the loss allowance measured as the lifetime ECL.
- Stage 3 – Default. Loans where the obligor is in default shall be stage 3 and the loss allowance measured as the lifetime ECL.

Stage 1 and Stage 2 credit loss allowances effectively replace the collective allowance for loans not yet identified as impaired under IAS 39, while Stage 3 credit loss allowances effectively replace the individually and collectively assessed allowance for impaired loans. Under IFRS 9, the population of financial assets and corresponding allowance disclosed as Stage 3 will not necessarily correspond to the amounts of financial assets currently disclosed as impaired in accordance with IAS 39. Consistent with IAS 39, loans are written off when there is no realistic probability of recovery. Accordingly, the Group's policy on the timing of write-offs of financial assets will not change with the adoption of IFRS 9.

Movements between Stage 1 and Stage 2 are based on whether an instrument's credit risk as measured at the reporting date has increased significantly relative to the credit risk measured at initial recognition. For the purpose of this assessment, credit risk is based on an instrument's lifetime PD, not the loss amounts. The assessment of significant increase in credit risk is a new concept under IFRS 9 and will require significant judgement.

Loss allowances for lease receivables will always be measured at an amount equal to lifetime ECL.

Credit Risk Management is responsible for assessing impairment on loans and receivables and a Valuation Team, comprised of the CEO, the Managing Directors of Finance, Risk Management, Corporate Banking and Personal Banking, reviews and approves the assessment.

Significant increase in credit risk

When determining whether the credit risk on a financial instrument has increased significantly since initial recognition, the Group will consider reasonable and supportable information that is relevant and available without undue cost and effort, including both quantitative and qualitative information and analysis based on the Group's historical experience, expert credit assessment and forward-looking information.

The Group will primarily identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime PD as at the reporting date; with
- the remaining lifetime PD as at the reporting date that was estimated at initial recognition.

The framework aligns with the Group's internal credit risk management process, and includes a backstop based on delinquencies so that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due.

Forward-looking information

The Group will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since initial recognition and its measurement of ECL. The Group will formulate a 'base case' view of the future direction of relevant economic variables and a representative range of other possible forecast scenarios based on advice from the Group's Risk & Finance Committee, the Bank's Economic Research department and consideration of a variety of external actual and forecast information.

The Group has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. These key drivers include e.g. interest rates, unemployment rates and GDP forecasts. Observed relationships between the key indicators and default and loss rates on various portfolios of financial assets are based on statistical analysis of historical data over the past 10 to 15 years. The economic scenarios used will be approved by the Group's Risk & Finance Committee.

The base case will represent a most-likely outcome and be aligned with information used by the Group for other purposes, such as strategic planning and budgeting. The other scenarios will represent more optimistic and more pessimistic outcomes.

92. Significant accounting policies (continued)

92.42 New standards, amendments to standards and interpretations of standards (continued)

Definition of default

The Group's definition of default is unchanged for the implementation of IFRS 9 and is consistent for all measurements of credit risk. The default definition is applied on an obligor level.

The Group considers a financial asset to be in default and the borrower unlikely to pay its credit obligations to the Group in full when one or both of the following conditions have been met: (1) the borrower is unlikely to pay its credit obligations to the Group in full without recourse by the Group to actions such as realising collaterals, and (2) the borrower is past due more than 90 days on any material credit obligation to the Group.

IFRS 15 - Revenue from Contracts with Customers. IASB has released IFRS 15 Revenue from Contracts with Customers (2014), completing the replacement of existing guidelines on recognition of revenue, i.e. IAS 11: Construction Contracts and IAS 18: Revenue.

The new standard, IFRS 15, prescribes the accounting treatment for revenue from sale of goods and services to customers, that is whether, to what extent and when revenues are accounted for. As a general rule, a company is to recognise revenue up to a certain amount which reflects the price the company expects to receive in exchange for goods and services provided to customers. The standard also requires additional disclosures.

Two methods are permitted under IFRS 15 on initial adoption:

1. The cumulative effect method – comparative information is not restated (correction in the opening balance of the Group's equity at 1 January 2018).
2. The retrospective method – comparative information is restated.

The Group will apply the cumulative effect method where comparative information is not restated; rather, the guidelines of IFRS 15 are applied retrospectively on contracts that are still valid on initial adoption of the standard and the accumulated effect will be accounted for in the opening balance of the Group's equity.

IFRS 15 is effective for annual reporting periods beginning as of 1 January 2018. The Group will apply the version of IFRS 15 issued in 2014 as of 1 January 2018.

Applying the standard will have insignificant effect on the Group's retained earnings and the opening balances as at 1 January 2018. The Group's revenues consist largely of interest income which is outside the scope of IFRS 15. Prior-year income which is within the scope of IFRS 15 will be adjusted through retained earnings as at 1 January 2018 and the income will be allocated over the appropriate period of time. The core principle of IFRS is that the time period in which income is recognised should be consistent with the transfer of the service to the customer. Based on the Group's current assessment, the total adjustment (net of tax) of the adoption of IFRS 15 on the opening balance of equity at 1 January 2018 is expected to be a reduction of ISK 255 million.

IFRS 16 - Leases. The IASB issued IFRS 16 - Leases in January 2016 and it becomes effective as of January 2019. IFRS 16 will replace IAS 17 - Leases. The adoption of the new standard will result in only minor changes to the financial reporting of lessors. For lessees, the financial reporting will be substantially altered, as all leasing contracts (apart from short-term leasing contracts and leasing contracts for small assets) will now be recognised on the balance sheet as right-of-use assets. Initially, the lease liability and the right-of-use asset will be measured at the present value of the lease payments (defined as unavoidable payments). A right-of-use asset is then depreciated in a similar manner as other assets, usually on a straight-line basis over the lease period. The standard also requires additional disclosures.

The Group does not intend to early-adopt the standard and work is currently underway on assessing the standard's impact on the Consolidated Financial Statements. The standard requires new assets and liabilities to be recognised under the operating lease commitments of the Group as lessee, which are disclosed in Note 38. In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. No significant impact is expected on the Consolidated Financial Statements upon transition.

On adoption of IFRS 16, the Group as a lessee can either apply the standard using a:

- retrospective approach; or
- modified retrospective approach with optional practical expedients.

The Group is currently assessing the optional practical expedients and their potential impact on the Consolidated Financial Statements and the number of contracts identified as leases on transition.

Consolidated Key Figures

93. Operations by years

Operations	2017	2016	2015	2014	2013
Interest income	62,556	64,612	58,005	53,735	63,224
Interest expense	(26,285)	(29,962)	(25,681)	(25,662)	(28,910)
Net interest income	**36,271**	**34,650**	**32,324**	**28,073**	**34,314**
Net adjustments in valuation of loans and advances	1,785	(318)	18,216	20,128	13,053
Net interest income after adjustments in valuation	**38,056**	**34,332**	**50,540**	**48,201**	**47,367**
Fee and commission income	11,289	10,290	8,977	7,737	8,451
Fee and commission expense	(2,858)	(2,481)	(2,136)	(1,901)	(3,160)
Net fee and commission income	**8,431**	**7,809**	**6,841**	**5,836**	**5,291**
Other net operating income	**7,025**	**6,559**	**15,230**	**9,577**	**15,635**
Total operating income	**53,512**	**48,700**	**72,611**	**63,614**	**68,293**
Salaries and related expenses	(14,061)	(14,049)	(13,754)	(13,567)	(17,304)
Other operating expenses	(9,789)	(9,465)	(9,978)	(10,521)	(9,947)
Total operating expenses	**(23,850)**	**(23,514)**	**(23,732)**	**(24,088)**	**(27,251)**
Pre-tax profit	**29,662**	**25,186**	**48,879**	**39,526**	**41,042**
Income and bank tax	(9,896)	(8,543)	(12,419)	(9,789)	(12,283)
Profit for the year	**19,766**	**16,643**	**36,460**	**29,737**	**28,759**
Attributable to:					
Shareholders of Landsbankinn	19,766	16,633	36,460	29,737	28,750
Minority interests	-	10	-	-	9

Balance sheet	2017	2016	2015	2014	2013
Cash and cash balances with Central Bank	55,192	30,662	25,164	10,160	21,520
Bonds and debt instruments	117,310	154,892	203,684	243,589	290,595
Equities and equity instruments	27,980	26,688	29,192	29,433	36,275
Loans and advances to financial institutions	44,866	20,408	20,791	49,789	67,916
Loans and advances to customers	925,636	853,417	811,549	718,355	680,468
Other assets	18,238	17,641	16,323	28,832	29,719
Assets classified as held for sale	3,648	7,449	11,955	18,212	25,023
Total assets	**1,192,870**	**1,111,157**	**1,118,658**	**1,098,370**	**1,151,516**
Due to financial institutions and Central Bank	32,062	20,093	56,731	53,827	167,218
Deposits from customers	605,158	589,725	559,051	551,435	456,662
Borrowings	281,874	223,944	209,344	207,028	239,642
Other liabilities	27,615	24,681	26,844	32,443	42,750
Liabilities associated with assets classified as held for sale	27	1,095	1,518	2,834	3,885
Subordinated liabilities	77	388	639	-	-
Equity	246,057	251,231	264,531	250,803	241,359
Total liabilities and equity	**1,192,870**	**1,111,157**	**1,118,658**	**1,098,370**	**1,151,516**

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94. Operations by quarters

	2017				2016			
Operations	**Q4***	**Q3**	**Q2**	**Q1**	**Q4***	**Q3**	**Q2**	**Q1**
Interest income	15,970	14,916	17,125	14,545	16,241	15,528	18,071	14,772
Interest expense	(6,769)	(6,022)	(6,967)	(6,527)	(7,798)	(6,932)	(7,926)	(7,306)
Net interest income	**9,201**	**8,894**	**10,158**	**8,018**	**8,443**	**8,596**	**10,145**	**7,466**
Reversals of loss from foreign currency linkage of loans and advances to customers	105	347	13	755	(5,435)	-	-	-
Net impairment	(387)	419	(550)	1,024	379	2,144	1,964	311
Reversal of impairment of guarantees	-	-	59	-	319	-	-	-
Net adjustments in valuation	**(282)**	**766**	**(478)**	**1,779**	**(4,737)**	**2,144**	**1,964**	**311**
Net interest income after net adjustments in valuation	**8,919**	**9,660**	**9,680**	**9,797**	**3,706**	**10,740**	**12,109**	**7,777**
Fee and commission income	2,618	2,923	2,953	2,795	2,638	2,634	2,487	2,531
Fee and commission expense	(778)	(764)	(637)	(679)	(738)	(619)	(573)	(551)
Net fee and commission income	**1,840**	**2,159**	**2,316**	**2,116**	**1,900**	**2,015**	**1,914**	**1,980**
Net gain (loss) on financial assets and liabilities	288	509	1,742	3,263	958	(534)	1,042	289
Net foreign exchange (loss) gain	(482)	(10)	(518)	(365)	(212)	25	(154)	162
Other income and (expenses)	1,305	36	355	902	656	864	2,150	1,313
Other net operating income	**1,111**	**535**	**1,579**	**3,800**	**1,402**	**355**	**3,038**	**1,764**
Total operating income	**11,870**	**12,354**	**13,575**	**15,713**	**7,008**	**13,110**	**17,061**	**11,521**
Salaries and related expenses	3,753	3,163	3,654	3,491	3,640	3,096	3,559	3,754
Other operating expenses	2,411	2,475	2,477	2,426	2,292	2,230	2,444	2,499
Total operating expenses	**6,164**	**5,638**	**6,131**	**5,917**	**5,932**	**5,326**	**6,003**	**6,253**
Profit before tax	**5,706**	**6,716**	**7,444**	**9,796**	**1,076**	**7,784**	**11,058**	**5,268**
Income tax	(2,028)	(1,648)	(1,572)	(1,395)	(130)	(1,937)	(2,288)	(1,215)
Tax on liabilities of financial institutions	(753)	(880)	(795)	(825)	(703)	(745)	(787)	(738)
Profit for the period	**2,925**	**4,188**	**5,077**	**7,576**	**243**	**5,102**	**7,983**	**3,315**

Balance sheet	**31.12.17**	**30.09.17**	**30.06.17**	**31.03.17**	**31.12.16**	**30.09.16**	**30.06.16**	**31.03.16**
Cash and cash balances with Central Bank	55,192	33,157	32,216	35,826	30,662	52,822	43,997	23,228
Bonds and debt instruments	117,310	160,223	162,520	147,992	154,892	168,029	157,898	195,175
Equities and equity instruments	27,980	31,049	30,934	30,868	26,688	30,896	29,042	29,381
Loans and advances to financial institutions	44,866	41,485	49,292	70,230	20,408	16,835	21,885	15,221
Loans and advances to customers	925,636	905,927	870,483	872,350	853,417	837,494	827,241	814,669
Other assets	18,238	22,740	20,317	19,009	17,641	19,653	21,523	21,255
Assets classified as held for sale	3,648	4,377	4,866	6,192	7,449	8,073	8,258	7,771
Total assets	**1,192,870**	**1,198,958**	**1,170,628**	**1,182,467**	**1,111,157**	**1,133,802**	**1,109,844**	**1,106,700**
Due to financial institutions and Central Bank	32,062	21,946	23,486	31,613	20,093	41,307	34,643	42,606
Deposits from customers	605,158	638,781	627,954	594,565	589,725	583,715	556,841	545,208
Borrowings	281,874	267,853	242,274	244,649	223,944	220,800	220,837	217,658
Other liabilities	27,615	26,862	37,441	76,261	24,681	34,913	48,310	31,445
Liabilities associated with assets classified as held for sale	27	155	155	1,095	1,095	1,514	1,510	1,305
Subordinated liabilities	77	229	374	390	388	407	412	632
Equity	246,057	243,132	238,944	233,894	251,231	251,146	247,291	267,846
Total liabilities and equity	**1,192,870**	**1,198,958**	**1,170,628**	**1,182,467**	**1,111,157**	**1,133,802**	**1,109,844**	**1,106,700**

*The result for the first three quarters of the years 2017 and 2016 were reviewed by the Bank's independent auditors.

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95. Key figures and ratios

	2017	2016	2015	2014	2013
Return on equity before taxes	12.3%	9.9%	19.9%	16.7%	17.6%
Return on equity after taxes	8.2%	6.6%	14.8%	12.5%	12.4%
Total capital ratio	26.7%	30.2%	30.4%	29.5%	26.7%
Cost-income ratio	46.1%	48.4%	43.8%	56.0%	42,9%*
Operating expenses as a ratio of average total assets	2.0%	2.1%	2.1%	2.1%	2,0%*
Interest spread	2.5%	2.3%	2.2%	1.9%	2.4%
Loans / deposits	153.0%	144.7%	145.2%	130.3%	149.0%
Deposits / total assets	50.7%	53.1%	50.0%	50.2%	39.7%
Number of full-time positions at year-end	997	1,012	1,063	1,126	1,183
Earnings per share	0.84	0.70	1.54	1.26	1.22
Dividend per share	1.05	1.20	1.00	0.84	0.42
Leverage ratio	18.2%	20.3%	21.5%		
Liquidity coverage ratio Total (LCR)	157%	128%	113%	131%	102%
Net stable funding ratio FX (NSFR)	179%	154%	136%	134%	

*Adjusted for one-off items

Key figures and ratios	Definition
Return on equity before taxes	Profit before taxes / average total equity
Return on equity after taxes	Profit after taxes / average total equity
Adjusted return on equity after taxes	(Profit after taxes - tax on liabilities of financial institutions - positive net valuations *0,74) / average total equity
Total capital ratio	Capital base (CET1 + AT1 + T2) / risk exposure amount
Cost-income ratio	Total operating expenses / (total operating income - net valuation adjustments)
Operating expenses as a ratio of average total assets	Total operating expenses as a ratio of average total assets
Interest spread as a ratio of assets and liabilities	(Interest income / average total assets) - (interest expenses / average total liabilities)
Loans/ deposits	Loans and advances to customers/ deposits from customers
Deposits / total assets	Deposits from customers/ total assets
Number of full-time equivalent positions at year-end	Number of full-time equivalent positions at year-end
Earnings per share	Profit for the year attributable to owners of the Bank / Weighted average number of shares outstanding
Dividend per share	Dividends paid/ number of shares outstanding
Common equity Tier 1 capital (CET1)	Total equity - deductions (intangible assets, deferred tax assets)
Additional Common equity Tier 1 capital (AT1)	Capital instruments under Tier 1 other than (CET1)
Tier 1 capital (T1)	Common equity Tier 1 capital + additional Common equity Tier 1 capital
Tier 2 capital (T2)	Common equity Tier 1 capital + additional Common equity Tier 1 capital + subordinated liabilities - regulatory amortisation + general credit risk adjustment
Leverage ratio	Common equity Tier 1 capital + additional Common equity Tier 1 capital / (total assets + off balance sheet items)
Liquidity coverage ratio (LCR)	High quality liquid assets / total net liquidity outflows over 30 days
Net stable funding ratio (NSFR)	Available amount of stable funding / required amount of stable funding

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