Condensed Consolidated Interim Financial Statements

For the nine months ended 30 September 2018

Content

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, 2017 and 2018.

Nordic Financial CERT

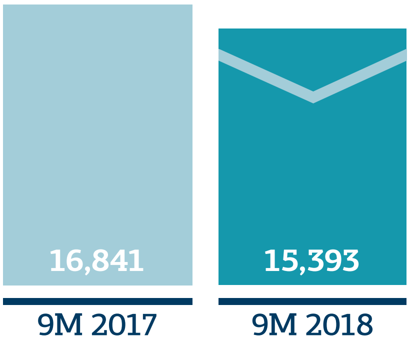
Robust cyber security
Landsbankinn is a member of this Nordic collaboration to boost cyber security.

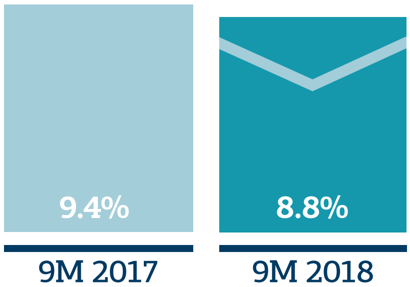
PRI

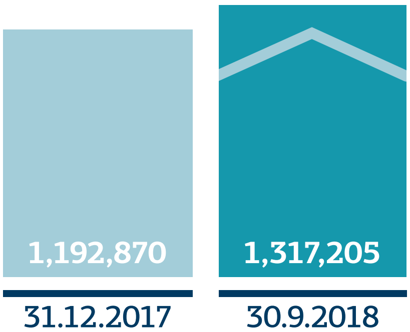
PRI
Landsbankinn is a member of the United Nation's Principles for Responsible Investment (UNPRI).

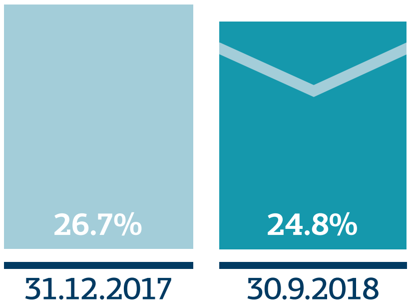
JAFNRÉTTISVÍSIR · CAPACENT ·

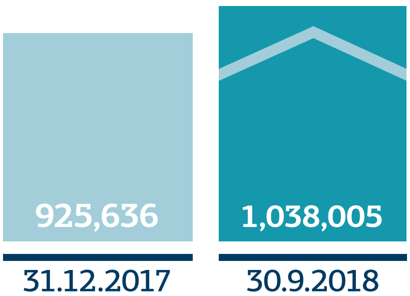
Capacent's Equality Indicator
Landsbankinn became a member of Capacent's Equality Indicator (Jafnréttisvísir) in 2018. The Equality Indicator is a strategy and promotes awareness about equality.

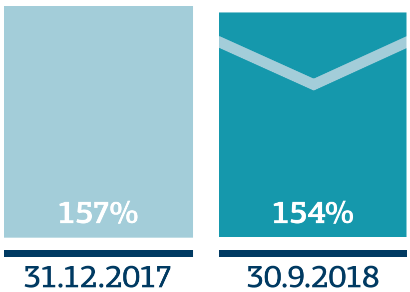
Profit


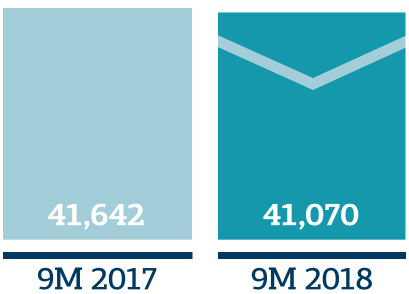
Return on equity


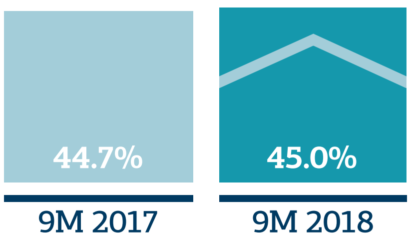
Total assets


Total capital ratio


Loans and advances to customers


Total liquidity coverage ratio (LCR)


Total operating income


Cost-income ratio


Report of the Board of Directors and the CEO

Landsbankinn is a leading financial institution in Iceland, offering a comprehensive range of financial services to individuals, corporates and institutional customers. The Condensed Consolidated Interim Financial Statements of Landsbankinn hf. (the "Bank" or "Landsbankinn") for the first nine months of 2018 include the Bank and its subsidiaries (collectively referred to as the "Group").

Operations

Consolidated profit amounted to ISK 15,393 million for the first nine months of the financial year 2018. Consolidated total equity amounted to ISK 235,892 million and total assets to ISK 1,317,205 million at the end of this period. The total capital ratio of the Group, calculated according to the Act on Financial Undertakings, was 24.8% at the end of the third quarter of 2018.

On 30 August 2018, the Bank completed its inaugural EUR 100 million issuance of Tier 2 subordinated bonds. The bonds have a final maturity in September 2028, but are callable in 2023. They were priced at a spread of 285 basis points above the EUR mid-swap market rate, with a fixed coupon of 3.125%. The bonds are issued under the Bank's 2,000 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange. The subordinated bonds have been rated BBB- by S&P Global Ratings.

Risk factors

The main risk factors of the Group have been within the limits set by its risk appetite during the period. Credit quality continues to be favourable as expected loss has decreased while probability of default has increased from year-end 2017. One additional large exposure was taken on during the period and the total ratio of large exposures to eligible capital is now 40%, which is within the Group's risk appetite.

The Group's loans to customers have increased by ISK 112,369 million during the period and deposits from customers by ISK 87,517 million during the same period. The Bank's borrowings, including subordinated borrowings, have also increased by ISK 39,286 million during the period. The Group's liquidity position remains strong, with both liquidity and financing ratios well above regulatory minimums.

Domestic markets have exhibited increased volatility so far this year. The share prices of twelve out of eighteen companies listed on NASDAQ Iceland have declined and total turnover has contracted by 26% between years. The ISK depreciated in the third quarter following a period of relative stability and the inflation premium on the bond market has increased, as have inflation expectations.

Outlook

Landsbankinn Economic Research forecasts 4.1% economic growth in 2018, and 2.4% growth in 2019 and 2020 - an average economic growth of 3.0% for the forecast period. The Central Bank of Iceland forecasts 3.6% growth in 2018 and an average economic growth of 3.1% for the period 2018 to 2020. Investment and private consumption are expected to be the main drivers of economic growth going forward. Inflation is expected to increase slightly in coming years to average 2.8% in 2019 and 2020.

Other matters

The Bank owns 22.04% of shares in the holding company Eyrir Invest hf. (EI). The Bank's shareholding is considered to involve temporary activity according to Article 22 of Act No. 161/2002, on Financial Undertakings. The Financial Supervisory Authority (FME) has in recent years granted extensions to the time limit given the Bank to lower its shareholding in the company and thereby terminate its temporary activity in EI. In 2016, the Bank publicly advertised its shareholding in EI for sale in an open sale process, without success. Since then, the Bank has publicly held its shareholding in EI for sale. No acceptable offers have been received. On 29 August 2018, the FME decided to impose an ISK 500 thousand per diem fine on the Bank as of 15 September 2018 and until such time as Bank has met the FME's requirement to terminate temporary activity in EI. The Bank continues to work to resolve the matter and evaluates possible responses to the FME's decision.

On 21 March 2018, Landsbankinn's Annual General Meeting (AGM) approved the Board's proposal to pay dividends to shareholders for the operating year 2017 in the amount of ISK 15,366 million, or ISK 0.65 per share. The dividend corresponds to 78% of net profit for the operating year and is in line with the Bank's policy to pay a dividend amounting to 60-80% of annual net profit. The dividend was paid to shareholders on 28 March 2018. The recommendation of the Board of Directors to pay an extraordinary dividend to shareholders in the amount of ISK 9,456 million, or ISK 0.40 per share, was also approved by the AGM. The extraordinary dividend was paid to shareholders on 19 September 2018.

On 1 January 2018, the Group implemented the international financial reporting standard IFRS 9 Financial Instruments. The reporting standard makes fundamental changes to the assessment of impairment on loans and receivables. Under the new standard, the assessment shall be based on expected credit losses rather than, as was the case under the previous standard, on incurred credit losses. The impact of IFRS 9 on the Group's financial statements is described in Note 4.

Statement by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Landsbankinn hf. for the nine months ended 30 September 2018 have been prepared on a going-concern basis in accordance with International Financial Reporting Standards as adopted by the European Union and applicable Icelandic laws and regulations.

In our opinion, the Condensed Consolidated Interim Financial Statements of Landsbankinn hf. give a true and fair view of the consolidated financial performance of the Group for the first nine months of 2018, its consolidated financial position as at 30 September 2018, and its consolidated cash flows for the first nine months of 2018.

Furthermore, in our opinion, the Condensed Consolidated Interim 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 Condensed Consolidated Interim Financial Statements of Landsbankinn hf. for the nine months ended 30 September 2018.

Reykjavík, 25 October 2018.

Board of Directors

Helga Björk Eiríksdóttir

Chairman

Berglind Svavarsdóttir

Einar Thór Bjarnason

Hersir Sigurgeirsson

Jón Guðmann Pétursson

Samúel Guðmundsson

Sigríður Benediktsdóttir

CEO

Lilja Björk Einarsdóttir

Independent Auditor's Review Report

To the Board of Directors and Shareholders of Landsbankinn hf.

Introduction

We have reviewed the accompanying Condensed Consolidated Statement of Financial Position of Landsbankinn hf. (the Bank) as at 30 September 2018 and the related Condensed Consolidated Income Statement, Condensed Consolidated Changes in Equity and Condensed Consolidated Cash Flows for the nine-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of these Condensed Consolidated Interim Financial Statements in accordance with International Financial Reporting Standard IAS 34 "Interim Financial Reporting" as adopted by the European Union. Our responsibility is to express a conclusion on these Condensed Consolidated Interim Financial Statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying Condensed Consolidated Interim Financial Statements do not give a true and fair view of the financial position of the Bank as at 30 September 2018, and of its financial performance and its cash flows for the nine-month period then ended in accordance with IAS 34 "Interim Financial Reporting" as adopted by the European Union.

Reykjavík, 25 October 2018

Grant Thornton endurskoðun ehf.

Davíð Arnar Einarsson
State Authorised Public Accountant

J. Sturla Jónsson
State Authorised Public Accountant

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Condensed Consolidated Income Statement for the nine months ended 30 September 2018

Notes		2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9*
	Interest income	17,622	14,916	49,997	46,586
	Interest expense	(7,252)	(6,022)	(20,151)	(19,516)
6	**Net interest income**	**10,370**	**8,894**	**29,846**	**27,070**
7	Net valuation adjustments and impairment of loans and advances	(89)	766	1,638	2,067
	Net interest income after net valuation adjustments and impairment of loans and advances	**10,281**	**9,660**	**31,484**	**29,137**
	Fee and commission income	2,565	2,923	7,951	8,671
	Fee and commission expense	(639)	(764)	(2,149)	(2,080)
8	**Net fee and commission income**	**1,926**	**2,159**	**5,802**	**6,591**
9	Net gain (loss) on financial assets and liabilities at FVTPL	(151)	509	1,712	5,514
10	Net foreign exchange loss	(352)	(10)	(821)	(893)
11	Other income and (expenses)	348	36	2,893	1,293
	Other net operating income	**(155)**	**535**	**3,784**	**5,914**
	Total operating income	**12,052**	**12,354**	**41,070**	**41,642**
12	Salaries and related expenses	3,222	3,163	10,754	10,308
13	Other operating expenses	2,353	2,475	6,975	7,378
	Total operating expenses	**5,575**	**5,638**	**17,729**	**17,686**
	Profit before tax	**6,477**	**6,716**	**23,341**	**23,956**
14	Income tax	(1,615)	(1,648)	(5,116)	(4,615)
15	Tax on liabilities of financial institutions	(1,082)	(880)	(2,832)	(2,500)
	Profit for the period	**3,780**	**4,188**	**15,393**	**16,841**
	Earnings per share				
34	Basic and diluted earnings per share from operations (ISK)	**0.16**	**0.18**	**0.65**	**0.71**

Condensed Consolidated Statement of Comprehensive Income for the nine months ended 30 September 2018

Notes		2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9*
	Profit for the period	3,780	4,188	15,393	16,841
	Other comprehensive income for the period, before tax	0	0	0	0
	Comprehensive income for the period	**3,780**	**4,188**	**15,393**	**16,841**

* The Group initally applied IFRS 9 and IFRS 15 as of 1 January 2018 using the cumulative effect method. Under this method, the comparative information is not restated.

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

All amounts are in ISK million

Condensed Consolidated Statement of Financial Position as at 30 September 2018

Notes		30.9.2018	31.12.2017
	Assets		
19	Cash and balances with Central Bank	61,155	55,192
16, 20, 53	Bonds and debt instruments	88,749	117,310
16, 21	Equities and equity instruments	27,766	27,980
16, 22	Derivative instruments	1,090	1,905
23, 53	Loans and advances to financial institutions	84,513	44,866
24, 53	Loans and advances to customers	1,038,005	925,636
	Investments in equity-accounted associates	1,390	1,086
	Property and equipment	5,202	5,238
	Intangible assets	2,719	3,044
30	Deferred tax assets	88	0
27	Other assets	4,910	6,965
28	Assets classified as held for sale	1,618	3,648
	Total assets	**1,317,205**	**1,192,870**
	Liabilities		
	Due to financial institutions and Central Bank	34,714	32,062
	Deposits from customers	692,675	605,158
22	Derivative instruments and short positions	4,760	1,258
29, 53	Borrowings	308,362	281,874
30	Deferred tax liabilities	0	40
31	Other liabilities	27,854	26,317
28	Liabilities associated with assets classified as held for sale	73	27
32	Subordinated liabilities	12,875	77
	Total liabilities	**1,081,313**	**946,813**
33	**Equity**		
	Share capital	23,640	23,640
	Share premium	120,764	120,764
	Reserves	13,128	12,902
	Retained earnings	78,360	88,751
	Total equity	**235,892**	**246,057**
	Total liabilities and equity	**1,317,205**	**1,192,870**

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

All amounts are in ISK million

Condensed Consolidated Statement of Changes in Equity for the nine months ended 30 September 2018

Notes					Attributable to owners of the Bank					
				Reserves*						
	Change in equity for the nine months ended 30 September 2018	**Share capital**	**Share premium**	**Statutory reserve**	**Unrealised 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 31 December 2017	23,640	120,764	6,000	2,949	3,953	88,751	246,057		246,057
4	Impact of adopting IFRS 9 at 1 January 2018						(482)	(482)		(482)
61	Impact of adopting IFRS 15 at 1 January 2018						(254)	(254)		(254)
	Restated balance at 1 January 2018	**23,640**	**120,764**	**6,000**	**2,949**	**3,953**	**88,015**	**245,321**	**0**	**245,321**
	Profit for the period						15,393	15,393		15,393
	Transferred to restricted retained earnings				1,220	(994)	(226)	0		0
	Dividends paid						(24,822)	(24,822)		(24,822)
33	**Balance as at 30 September 2018**	**23,640**	**120,764**	**6,000**	**4,169**	**2,959**	**78,360**	**235,892**	**0**	**235,892**
	Change in equity for the nine months ended 30 September 2017									
	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 period						16,841	16,841		16,841
	Transferred to restricted retained earnings				(1,161)	4,667	(3,506)	0		0
	Purchase of own shares	(8)	(83)					(91)		(91)
	Dividends paid						(24,822)	(24,822)		(24,822)
	Disposal of subsidiary							0	(27)	(27)
33	**Balance as at 30 September 2017**	**23,640**	**120,764**	**6,000**	**3,422**	**4,959**	**84,347**	**243,132**	**0**	**243,132**

*In accordance with the Public Limited Companies Act, No. 2/1995 and Act No. 3/2006, on Annual Financial Statements

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

All amounts are in ISK million

Condensed Consolidated Statement of Cash Flows for the nine months ended 30 September 2018

Notes		2018 1.1-30.9	2017 1.1-30.9
	Operating activities		
	Comprehensive income for the period	15,393	16,841
	Adjustments for non-cash items included in profit for the period	(25,326)	(26,708)
	Changes in operating assets and liabilities	(30,917)	(33,243)
	Interest received	45,820	42,230
	Interest paid	(5,934)	(7,552)
	Dividends received	2,345	1,540
	Income tax and special tax on financial institutions paid	(3,386)	(5,309)
	Net cash from (used in) operating activities	**(2,005)**	**(12,201)**
	Investing activities		
	Acquisition of additional shares in subsidiaries and associates	(85)	0
	Purchase of property and equipment	(376)	(162)
	Proceeds from sale of property and equipment	240	153
	Purchase of intangible assets	(43)	(571)
	Proceeds from sale of intangible assets	10	0
	Sale of subsidiaries	0	148
	Net cash used in investing activities	**(254)**	**(432)**
	Financing activities		
	Proceeds from borrowings	30,641	101,610
	Purchase of own shares	0	(91)
	Repayment of borrowings	(13,962)	(68,270)
	Proceeds from subordinated liabilities	12,791	0
	Repayment of subordinated liabilities	(10)	(156)
33	Dividends paid	(24,822)	(24,822)
	Net cash from financing activities	**4,638**	**8,271**
	Cash and cash equivalents as at the beginning of the period	53,174	21,252
	Net change in cash and cash equivalents	2,379	(4,362)
	Effect of exchange rate changes on cash and cash equivalents held	(1,103)	(627)
	Cash and cash equivalents as at the end of the period	**54,450**	**16,263**

	Cash and cash equivalents is specified as follows:		
19	Cash and balances with Central Bank	61,155	33,157
23	Bank accounts with financial institutions	26,007	11,100
19	Mandatory and special restricted balances with Central Bank	(32,712)	(27,994)
	Cash and cash equivalents as at the end of the period	**54,450**	**16,263**

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

All amounts are in ISK million

Condensed Consolidated Statement of Cash Flows for the nine months ended 30 September 2018

Notes		2018 1.1-30.9	2017 1.1-30.9
	Adjustments for non-cash items included in profit for the period		
6	Net interest income	(29,846)	(27,070)
7	Net impairment of loans and advances and guarantees	(509)	(952)
7	Reversals of loss from foreign currency linkage of loans and advances to customers	(1,129)	(1,115)
9	Net gain on financial assets and liabilities at FVTPL	(1,712)	(5,514)
10	Net foreign exchange loss	1,924	1,520
	Gain on sale of property and equipment	(121)	(63)
	Net gain on assets classified as held for sale	(2,322)	(1,009)
	Depreciation and amortisation	660	532
	Share of profit of equity-accounted associates	(219)	(152)
14	Income tax	5,116	4,615
15	Tax on liabilities of financial institutions	2,832	2,500
		(25,326)	**(26,708)**
	Changes in operating assets and liabilities		
	Change in reserve requirement with Central Bank	(475)	(4,045)
	Change in bonds and equities	29,212	(6,312)
	Change in loans and advances to financial institutions	(41,240)	(21,854)
	Change in loans and advances to customers	(98,633)	(44,083)
	Change in other assets	(500)	(1,341)
	Change in assets classified as held for sale	(61)	4,711
	Change in due to financial institutions and Central Bank	2,525	1,838
	Change in deposits from customers	75,998	38,051
	Change in tax liability	(128)	(31)
	Change in other liabilities	2,368	809
	Change in liabilities associated with assets classified as held for sale	17	(986)
		(30,917)	**(33,243)**

Change in liabilities due to financing activities

	As at 1.1.2018	Cash flow	Accrued interest	Foreign exchange	Change in the fair value	As at 30.9.2018
Covered bonds - secured	70,253	20,829	2,600	-	-	93,682
EMTN issued	191,485	-	467	5,624	170	197,746
Bills issued	7,433	(3,609)	259	-	-	4,083
Other unsecured loans	12,703	(542)	(16)	706	-	12,851
Subordinated liabilities	77	12,781	27	(10)	-	12,875
Total	**281,951**	**29,460**	**3,337**	**6,320**	**170**	**321,237**

	As at 1.1.2017	Cash flow	Accrued interest	Foreign exchange	Change in the fair value	As at 30.9.2017
Issued bonds to LBI hf.	50,122	(47,707)	(268)	(2,147)	-	0
Covered bonds - secured	38,586	27,509	870	-	-	66,965
EMTN issued	118,513	46,960	1,725	9,254	(146)	176,306
Bills issued	11,554	(1,050)	545	-	-	11,049
Other unsecured loans	5,169	7,627	80	577	-	13,453
Subordinated liabilities	388	(156)	(1)	(2)	-	229
Total	**224,332**	**33,184**	**2,951**	**7,682**	**(146)**	**268,002**

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

All amounts are in ISK million

Notes to the Condensed Consolidated Interim 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 Condensed Consolidated Interim Financial Statements of the Bank for the nine months ended 30 September 2018 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 Condensed Consolidated Interim Financial Statements for the nine months ended 30 September 2018 have been prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union and applicable Icelandic laws and regulations.

The issue of these Condensed Consolidated Interim Financial Statements was authorised by the Board of Directors and the CEO of the Bank on 25 October 2018.

The Condensed Consolidated Interim Financial Statements do not include all the information required for full annual financial statements and should be read in conjunction with the Consolidated Financial Statements of the Group as at and for the year ended 31 December 2017, which are available on the Bank's website, www.landsbankinn.is.

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 Condensed Consolidated Interim Financial Statements have been prepared on a going concern basis.

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 to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

3. Significant accounting policies

The Condensed Consolidated Interim Financial Statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies applied in the Condensed Consolidated Interim Financial Statements are the same as those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2017, except for new significant judgements and key sources of estimation uncertainty related to the application of IFRS 9 and IFRS 15, which are described in Note 61.

4. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Group's financial assets and finanacial liabilities as at 1 January 2018.

Financial assets	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Cash and balances with Central Bank	Loans and receivables	Amortised cost	55,192	55,192
Bonds and debt instruments	Loans and receivables	Amortised cost	49,421	49,421
Bonds and debt instruments	Held for trading	FVTPL	57,176	57,176
Bonds and debt instruments	Designated at fair value	FVTPL	10,713	10,713
Equities and equity instruments	Held for trading	FVTPL	9,298	9,298
Equities and equity instruments	Designated at fair value	FVTPL	18,682	18,682
Derivative instruments	Held for trading	FVTPL	1,905	1,905
Loans and advances to financial institutions	Loans and receivables	Amortised cost	44,866	44,863
Loans and advances to customers	Loans and receivables	Amortised cost	925,636	923,154
Loans and advances to customers	Loans and receivables	FVTPL	-	1,857
Other financial assets	Loans and receivables	Amortised cost	5,457	5,603
Total			**1,178,346**	**1,177,864**

Financial liabilities	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Due to financial institutions and Central Bank	Liabilities at amortised cost	Amortised cost	32,062	32,062
Deposits from customers	Liabilities at amortised cost	Amortised cost	605,158	605,158
Derivative instruments and short positions	Held for trading	FVTPL	1,258	1,258
Borrowings	Liabilities at amortised cost	Amortised cost	281,874	281,874
Other financial liabilities	Liabilities at amortised cost	Amortised cost	7,815	7,815
Subordinated liabilities	Liabilities at amortised cost	Amortised cost	77	77
Total			**928,244**	**928,244**

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

Financial assets	IAS 39 carrying amount 31 December 2017	Reclassifi-cation	Remeasure-ment	IFRS 9 carrying amount 1 January 2018
Cash and balance with Central Bank	55,192	-	-	55,192
Bonds and debt instruments	117,310	-	-	117,310
Equities and equity instruments	27,980	-	-	27,980
Derivative instruments	1,905	-	-	1,905
Loans and advances to financial institutions at amortised cost	44,866	-	(3)	44,863
Loans and advances to customers at amortised cost	925,636	(1,878)	(604)	923,154
Loans and advances to customers at FVPL	-	1,878	(21)	1,857
Other asstes	5,457	-	146	5,603
Total	**1,178,346**	**0**	**(482)**	**1,177,864**

Financial liabilities	IAS 39 carrying amount 31 December 2017	Reclassifi-cation	Remeasure-ment	IFRS 9 carrying amount 1 January 2018
Due to financial institutions and Central Bank	32,062	-	-	32,062
Deposits from customers	605,158	-	-	605,158
Derivative instruments and short positions	1,258	-	-	1,258
Borrowings	281,874	-	-	281,874
Other financial liabilities	7,815	-	-	7,815
Subordinated liabilities	77	-	-	77
Total	**928,244**	**0**	**0**	**928,244**

All amounts are in ISK million

4. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table discloses the after-tax impact of transition to IFRS 9 on reserves and retained earnings.

Retained earnings	Impact of adopting IFRS 9 at 1 January 2018
Closing balance under IAS 39 (31 December 2017)	88,751
Loans and advances to customers at FVTPL	(16)
Recognition of expected credit losses under IFRS 9	(466)
Opening balance under IFRS 9 (1 January 2018)	**88,269**

The table below discloses the closing balance of the impairment allowance of financial assets under IAS 39 and the impact of the adoption of IFRS 9 on the beginning balance of the impairment allowance as at 1 January 2018.

	31 December 2017 (IAS 39/IAS 37)	Reclassifi-cation	Remeasure-ment	1 January 2018 (IFRS 9)
Allowances for impairment on loans and advances to financial institutions	-	-	(3)	(3)
Allowances for impairment on loans and advances to customers	(16,190)	-	(604)	(16,794)
Total	**(16,190)**	**0**	**(607)**	**(16,797)**

5. 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** offers individuals and small and medium-size businesses outside the capital city region diverse financial services through digital service channels, both online banking and apps, alongside conventional service through the Bank's branch network and Customer Service Centre.

• **Corporate Banking** offers financial services to corporate clients and to small and medium-size businesses in the capital city region and manages a corporate online banking platform that offers electronic banking services.

• **Markets** offers 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 of internal transactions and operating items 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 30 September 2018 and 2017.

All amounts are in ISK million

5. Operating segments (continued)

1 January - 30 September 2018	Personal Banking	Corporate Banking	Markets	Treasury	Support functions	Recon- ciliation	Total
Net interest income	11,045	13,788	433	4,528	19	33	**29,846**
Net valuation adjustments and impairment of loans and advances	633	1,001	-	4	-	-	**1,638**
Net fee and commission income	2,619	581	2,845	(245)	165	(163)	**5,802**
Other net operating income (expenses)	379	(38)	(1,158)	2,093	2,566	(58)	**3,784**
Total operating income (expense)	**14,676**	**15,332**	**2,120**	**6,380**	**2,750**	**(188)**	**41,070**
Operating expenses	(4,871)	(1,459)	(1,679)	(1,356)	(8,539)	175	**(17,729)**
Profit (loss) before cost allocation and tax	**9,805**	**13,873**	**441**	**5,024**	**(5,789)**	**(13)**	**23,341**
Cost allocated from support functions to business segments	(3,658)	(2,188)	(1,107)	(618)	7,571	-	**0**
Profit (loss) before tax	**6,147**	**11,685**	**(666)**	**4,406**	**1,782**	**(13)**	**23,341**
Net revenue (expenses) from external customers	19,355	22,048	1,827	(4,693)	2,721	-	**41,258**
Net revenue (expenses) from other segments	(4,679)	(6,716)	293	11,073	29	-	**0**
Total operating income	**14,676**	**15,332**	**2,120**	**6,380**	**2,750**	**0**	**41,258**
As at 30 September 2018							
Total assets	468,313	562,848	17,278	540,833	13,326	(285,393)	**1,317,205**
Total liabilities	425,233	455,670	10,394	462,083	13,326	(285,393)	**1,081,313**
Allocated capital	43,080	107,178	6,884	78,750	-		**235,892**

1 January - 30 September 2017	Personal Banking	Corporate Banking	Markets	Treasury	Support functions	Recon- ciliation	Total
Net interest income	11,683	12,296	277	2,859	28	(73)	**27,070**
Net valuation adjustments and impairment of loans and advances	620	1,440	-	7	-	-	**2,067**
Net fee and commission income	2,621	754	3,598	(293)	111	(200)	**6,591**
Other net operating income (expenses)	52	1	(585)	5,376	1,079	(9)	**5,914**
Total operating income (expense)	**14,976**	**14,491**	**3,290**	**7,949**	**1,218**	**(282)**	**41,642**
Operating expenses	(4,689)	(1,191)	(1,596)	(1,329)	(9,185)	304	**(17,686)**
Profit (loss) before cost allocation and tax	**10,287**	**13,300**	**1,694**	**6,620**	**(7,967)**	**22**	**23,956**
Cost allocated from support functions to business segments	(3,689)	(2,616)	(1,156)	(775)	8,236	-	**0**
Profit before tax	**6,598**	**10,684**	**538**	**5,845**	**269**	**22**	**23,956**
Net revenue from external customers	16,895	20,224	3,050	599	1,156	-	**41,924**
Net revenue (expenses) from other segments	(1,919)	(5,733)	240	7,350	62	-	**0**
Total operating income	**14,976**	**14,491**	**3,290**	**7,949**	**1,218**	**0**	**41,924**
As at 30 September 2017							
Total assets	440,464	494,836	26,111	438,859	15,307	(216,619)	**1,198,958**
Total liabilities	380,894	378,620	17,514	380,110	15,307	(216,619)	**955,826**
Allocated capital	59,570	116,216	8,597	58,749	-		**243,132**

All amounts are in ISK million

Notes to the Consolidated Income Statement

6. Net interest income

Interest income	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Cash and balances with Central Bank	310	204	1,369	564
Bonds and debt instruments classified as loans and receivables	215	1,045	739	3,526
Loans and advances to financial institutions	9	52	40	143
Loans and advances to customers	17,059	13,601	47,812	42,322
Other interest income	29	14	37	31
Total	**17,622**	**14,916**	**49,997**	**46,586**
Interest expense				
Due to financial institutions and Central Bank	(70)	(118)	(210)	(505)
Deposits from customers	(4,943)	(4,075)	(13,764)	(13,389)
Borrowings	(2,211)	(1,815)	(6,110)	(5,576)
Other interest expense	-	(8)	(37)	(26)
Subordinated liabilities	(28)	(6)	(30)	(20)
Total	**(7,252)**	**(6,022)**	**(20,151)**	**(19,516)**
Net interest income	**10,370**	**8,894**	**29,846**	**27,070**

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

7. Net valuation adjustments and impairment of loans and advances

	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Net impairment on financial assets	(89)	419	509	893
Reversal of impairment of guarantees	-	-	-	59
Reversals of foreign currency linkage loans and advances to customers	-	347	1,129	1,115
Net valuation adjustments and impairment of loans and advances	**(89)**	**766**	**1,638**	**2,067**
Valuation adjustments and impairment of loans and advances by customer type				
Financial institutions	-	-	(4)	-
Individuals	(142)	148	356	530
Corporates	53	618	1,286	1,537
Net valuation adjustments and impairment of loans and advances	**(89)**	**766**	**1,638**	**2,067**

8. Net fee and commission income

Fee and commission income	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Markets	833	1,324	2,950	3,622
Loans and guarantees	241	199	654	905
Payment cards	950	875	2,827	2,620
Collection and payment services	231	222	684	645
Foreign trade	224	216	608	583
Other commissions and fees	86	87	228	296
Total	**2,565**	**2,923**	**7,951**	**8,671**
Fee and commission expense				
Investment banking and capital markets	(86)	(150)	(307)	(346)
Payment cards	(238)	(345)	(917)	(902)
Other fees	(315)	(269)	(925)	(832)
Total	**(639)**	**(764)**	**(2,149)**	**(2,080)**
Net fee and commission income	**1,926**	**2,159**	**5,802**	**6,591**

The net fee and commission income above does not include net fee and commission income which is a part of the effective interest rate on financial assets and liabilities that are not designated at fair value through profit or loss.

During the first nine months of 2018, ISK 622 million was recognised as income from service contracts with customers which fall under the scope of IFRS 15, thereof ISK 219 million during the third quarter. Furthermore, during the third quarter ISK 213 million was recognised as prepaid income under Other liabilities.

for the nine months ended 30 September 2018 16 All amounts are in ISK million

9. Net gain (loss) on financial assets and liabilities at FVTPL

Net income from financial instruments at fair value through profit or loss	2018 1.7-30.9	2018 1.1-30.9
Bonds and debt instruments	112	(117)
Equities and equity instruments	218	2,180
Derivatives and underlying hedges	(735)	(640)
Loans and advances to customers	53	(90)
Total	**(352)**	**1,333**
Net profit gain (loss) on fair value hedges		
Change in fair value of the interest rate swaps	(54)	549
Change in the fair value of bonds, attributable to the interest rate risk	255	(170)
Total	**201**	**379**
Total net gain (loss) on financial assets and liabilities as at 30 September 2018	**(151)**	**1,712**

Net gain (loss) on financial assets and liabilities held for trading	2017 1.7-30.9	2017 1.1-30.9
Bonds and debt instruments	63	331
Equities and equity instruments	(516)	(870)
Derivatives and underlying hedges	(94)	367
Total	**(547)**	**(172)**
Net gain on financial assets designated at fair value through profit or loss		
Bonds and debt instruments	147	920
Equities and equity instruments	923	4,845
Total	**1,070**	**5,765**
Net profit gain (loss) on fair value hedges		
Change in fair value of the interest rate swaps	78	(225)
Change in the fair value of bonds, attributable to the interest rate risk	(92)	146
Total	**(14)**	**(79)**
Total net gain on financial assets and liabilities as at 30 September 2017	**509**	**5,514**

10. Net foreign exchange (loss) gain

Assets	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Cash and balances with Central Bank	(2)	97	(18)	(13)
Bonds and debt instruments	2,478	2,574	2,304	(294)
Equities and equity instruments	16	22	30	8
Derivative instruments	(91)	2,264	(3,302)	3,964
Loans and advances to financial institutions	2,698	2,726	2,780	2,577
Loans and advances to customers	7,117	9,919	7,179	2,355
Other assets	41	47	(143)	23
Total	**12,257**	**17,649**	**8,830**	**8,620**
Liabilities				
Due to financial institutions and Central Bank	-	(11)	-	(12)
Deposits from customers	(3,336)	(4,537)	(3,524)	(1,918)
Borrowings	(9,360)	(13,297)	(6,330)	(7,684)
Other liabilities	75	189	193	99
Subordinated liabilities	12	(3)	10	2
Total	**(12,609)**	**(17,659)**	**(9,651)**	**(9,513)**
Net foreign exchange loss	**(352)**	**(10)**	**(821)**	**(893)**

All amounts are in ISK million

11. Other income and expenses

	Note	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Gain on sale of property and equipment		14	49	129	63
Gain on repossessed collateral	28	11	54	2,322	1,009
Share of profit of equity-accounted associates		228	45	449	152
Other		95	(112)	(7)	69
Total		**348**	**36**	**2,893**	**1,293**

12. Salaries and related expenses

	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Salaries	2,403	2,359	8,295	7,924
Contributions to defined pension plans	412	404	1,219	1,187
Social security contributions, special financial activities tax on salaries and other expenses	407	400	1,240	1,197
Total salaries and related expenses	**3,222**	**3,163**	**10,754**	**10,308**

13. Other operating expenses

	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Information technology	526	552	1,569	1,652
Real estate and fixtures	221	195	653	635
Advertising and marketing	179	230	590	642
Operating lease rentals	148	135	438	405
FME supervisory expenses	152	145	459	437
Contribution to the Debtor's Ombudsman	25	87	76	261
Audit and related services	17	24	92	80
Other professional services	152	148	375	435
Depreciation and amortisation	219	182	660	532
Contribution to the Depositors' and Investors' Guarantee Fund	339	355	981	963
Other operating expenses	375	422	1,082	1,336
Total	**2,353**	**2,475**	**6,975**	**7,378**

14. Income tax

Income tax is recognised based on the tax rates and tax laws enacted by the end of the period, according to which the domestic corporate income tax rate was 20.0% (2017: 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:

	2018 1.1-30.9	2017 1.1-30.9
Current tax expense	(4,145)	(3,884)
Special income tax on financial institutions	(1,022)	(997)
Difference of prior year's imposed and calculated income tax	(78)	178
Origination and reversal of temporary differences due to deferred tax assets/liabilities	129	88
Total	**(5,116)**	**(4,615)**

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

		2018 1.1-30.9		2017 1.1-30.9
Profit before tax		23,341		23,956
Tax on liabilities of financial institutions		(2,832)		(2,500)
Profit before income tax		20,509		21,456
Income tax calculated using the domestic corporate income tax rate	20.0%	(4,102)	20.0%	(4,291)
Special income tax on financial institutions	5.0%	(1,022)	4.6%	(997)
Income not subject to tax	(3.4%)	703	(5.2%)	1,123
Non-deductible expenses	3.2%	(667)	2.9%	(629)
Other	0.1%	(28)	(0.8%)	179
Effective income tax	**24.9%**	**(5,116)**	**21.5%**	**(4,615)**

All amounts are in ISK million

15. 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% (2017: 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.

	2018 1.1-30.9	2017 1.1-30.9
Tax on liabilities of financial institutions	(2,832)	(2,500)

Notes to the Consolidated Statement of Financial Position

16. Classification of financial assets and liabilities

The Group has applied IFRS 9 from 1 January 2018 using the cumulative effect method. As a result, comparative information has not been restated and continues to be reported under IAS 39. The details of accounting policies under IAS 39 are disclosed separately if they are different from those under IFRS 9 and the impact of changes is disclosed in Note 61.

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. The 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. Each category's basis of subsequent measurement is specified below:

- Financial assets measured at amortised cost which the Bank intends to hold to maturity and are held within a business model whose objective is to collect contractual cash flows; and the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principipal amount outstanding.

- 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 fair value through other comprehensive income (FVOCI), as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Under IFRS 9 Financial Instruments, the Group classifies its financial liabilities as measured at amortised cost or FVTPL.

The following table shows the classification of the Group's financial assets and liabilities under IFRS 9 and their fair values as at 30 September 2018:

Financial assets	**Notes**	**Amortised cost**	**Mandatorily at FVTPL**	**Designated at FVTPL**	**Total carrying amount**	**Fair value**
Cash and balances with Central Bank	19	61,155	-	-	61,155	61,155
Bonds and debt instruments	20	8,391	70,339	10,019	88,749	88,988
Equities and equity instruments	21	-	10,567	17,199	27,766	27,766
Derivative instruments	22	-	1,090	-	1,090	1,090
Loans and advances to financial institutions	23	84,513	-	-	84,513	84,513
Loans and advances to customers	24	1,030,061	7,944	-	1,038,005	1,040,489
Other financial assets		4,150	-	-	4,150	4,150
Total		**1,188,270**	**89,940**	**27,218**	**1,305,428**	**1,308,151**
Financial liabilities						
Due to financial institutions and Central Bank		34,714	-	-	34,714	34,714
Deposits from customers		692,675	-	-	692,675	691,222
Derivative instruments and short positions	22	-	4,760	-	4,760	4,760
Borrowings	29	308,362	-	-	308,362	311,708
Other financial liabilities		8,624	-	-	8,624	8,624
Subordinated liabilities	32	12,875	-	-	12,875	12,976
Total		**1,057,250**	**4,760**	**0**	**1,062,010**	**1,064,004**

All amounts are in ISK million

16. Classification of financial assets and liabilities (continued)

Under 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.

The following table shows the classification of the Group's financial assets and liabilities under 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	19	55,192	-	-	-	55,192	55,192
Bonds and debt instruments	20	49,421	57,176	10,713	-	117,310	117,682
Equities and equity instruments	21	-	9,298	18,682	-	27,980	27,980
Derivative instruments	22	-	1,905	-	-	1,905	1,905
Loans and advances to financial institutions	23	44,866	-	-	-	44,866	44,866
Loans and advances to customers	24	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		-	-	-	32,062	32,062	32,062
Deposits from customers		-	-	-	605,158	605,158	604,458
Derivative instruments and short positions	22	-	1,258	-	-	1,258	1,258
Borrowings	29	-	-	-	281,874	281,874	283,353
Other financial liabilities		-	-	-	7,815	7,815	7,815
Subordinated liabilities	32	-	-	-	77	77	89
Total		**0**	**1,258**	**0**	**926,986**	**928,244**	**929,035**

17. Fair value of financial assets and liabilities

The fair value of financial assets and liabilities is determined based on the same valuation methods as those described in the Group's Consolidated Financial Statements as at and for the year ended 31 December 2017.

Fair value hierarchy

The Group has used a valuation hierarchy for disclosure of inputs used to measure fair value of financial assets and liabilities. 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. Valuation of loans and advances to customers is based on market data such as interest and inflation curves and probability of default.

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.

All amounts are in ISK million

17. Fair value of financial assets and liabilities (continued)

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 30 September 2018:

Financial assets	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	71,701	8,580	77	80,358
Equities and equity instruments	11,546	-	16,220	27,766
Derivative instruments	-	1,090	-	1,090
Loans and advances to customers	-	-	7,944	7,944
Total	**83,247**	**9,670**	**24,241**	**117,158**
Financial liabilities				
Derivative instruments	-	1,470	-	1,470
Short positions	3,290	-	-	3,290
Total	**3,290**	**1,470**	**0**	**4,760**

During the period from 1 January to 30 September 2018, 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 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 tables show the reconciliation of fair value measurement in Level 3 for the nine months ended 30 September 2018 and for the year 2017:

1 January - 30 September 2018	Bonds and debt instruments	Equities and equity instruments	Loans and advances to customers	Total financial assets
Carrying amount as at 1 January 2018	83	15,659	1,857	17,599
Net gain (loss) on financial assets and liabilities at FVTPL	16	3,214	(90)	3,140
Net foreign exchange loss	(7)	1	-	(6)
Purchases	-	205	6,520	6,725
Sales	-	(456)	-	(456)
Settlements	(15)	-	(343)	(358)
Dividend received	-	(2,295)	-	(2,295)
Transfers out of Level 3	-	(108)	-	(108)
Carrying amount as at 30 September 2018	**77**	**16,220**	**7,944**	**24,241**
1 January - 31 December 2017				
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)
Transfer out of Level 3	-	(1,440)	-	(1,440)
Carrying amount as at 31 December 2017	**83**	**15,659**	**0**	**15,742**

The following table shows the line items in the Consolidated Income Statement where gains (losses) of financial assets and liabilities categorised in Level 3 and held by the Group as at 30 September 2018 and 30 September 2017, were recognised:

1 January - 30 September 2018	Bonds and debt instruments	Equities and equity instruments	Loans and advances to customers	Total
Net gain (loss) on financial assets and liabilities at FVTPL	16	3,162	(90)	3,088
Net foreign exchange loss	(7)	1	-	(6)
Total	**9**	**3,163**	**(90)**	**3,082**
1 January - 30 September 2017				
Net gain on financial assets and liabilities	19	4,848	-	4,867
Net foreign exchange loss	(1)	2	-	1
Total	**18**	**4,850**	**0**	**4,868**

All amounts are in ISK million

18. 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 30 September 2018 and 31 December 2017.

					Range of inputs	
As at 30 September 2018	**Assets**	**Liabilities**	**Valuation technique**	**Key un-observable inputs**	**Lower**	**Higher**
Bonds and debt instruments	77	-	See 1) below	See 1) below	n/a	n/a
Equities and equity instruments	16,220	-	See 2) below	See 2) below	n/a	n/a
Loans and advances to customers	7,944	-	See 3) below	See 3) below	n/a	n/a
	24,241	**0**				
As at 31 December 2017						
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**				

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 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, the range of key unobservable inputs is not available.

3. Loans and advances to customers carried at FVTPL are classified as financial assets in Level 3. The valuation technique is based on significant non-observable inputs as loans and advances are unlisted and not traded in an active market. The valuation technique is based on available market data such as interest and inflation curves, probability of default and liquidity spread. Given the nature of the valuation method, the 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 nine months ended 30 September 2018 and 30 September 2017:

	2018 1.1-30.9		2017 1.1-30.9	
Effect on profit before tax	**Favourable**	**Unfavourable**	**Favourable**	**Unfavourable**
Bonds and debt instruments	4	(4)	3	(3)
Equities and equity instruments:				
Equities	755	(756)	532	(714)
Mutual funds	191	(191)	315	(315)
Total equities and equity instruments	946	(947)	847	(1,029)
Loans and advances to customers	77	(77)	-	-
Total	**1,027**	**(1,028)**	**850**	**(1,032)**

The effect on profit was calculated as the difference between results generated using the same valuation methods but changing key unobservable inputs for bonds and equities by +/- 5% and +/- 1% for loans and advances to customers.

19. Cash and balances with Central Bank

	30.9.2018	**31.12.2017**
Cash on hand	5,309	4,472
Unrestricted balances with Central Bank	23,134	18,483
Total cash and unrestricted balances with Central Bank	**28,443**	**22,955**
Restricted balances with Central Bank - fixed reserve requirement	6,329	-
Restricted balances with Central Bank - average maintenance level	6,329	12,942
Assets held with Central Bank, subject to special restrictions	14,071	19,295
Assets pledged as collateral to the Central Bank	5,983	-
Total restricted balances with Central Bank	**32,712**	**32,237**
Total cash and balances with Central Bank	**61,155**	**55,192**

All amounts are in ISK million

19. Cash and balances with Central Bank (continued)

The Bank holds mandatory reserve deposit accounts with the Central Bank of Iceland in compliance with the Central Bank's new Rules on Minimum Reserve Requirements No. 585/2018. Under these rules the reserve requirement is divided into two parts: a fixed reserve requirement bearing no interest and an average maintenance level requirement bearing the same interest as that on deposit-taking institutions' current accounts with the Central Bank. The new rules came into effect for the reserve maintenance period starting 21 June 2018. The average balance of these accounts for each reserve term must be equivalent at least to the mandatory reserve deposit requirement which amounted to ISK 12,657 million for September 2018 (December 2017: ISK 12,942 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.

20. Bonds

	30.9.2018				31.12.2017			
Bonds and debt instruments	**Amortised cost**	**Mandatorily at FVTPL**	**Designated at FVTPL**	**Total**	**Loans and receivables**	**Held for trading**	**Designated at fair value**	**Total**
Domestic								
Listed	8,391	16,761	8,993	34,145	49,421	7,740	9,199	66,360
Unlisted	-	-	1,026	1,026	-	-	1,514	1,514
	8,391	**16,761**	**10,019**	**35,171**	**49,421**	**7,740**	**10,713**	**67,874**
Foreign								
Listed	-	53,578	-	53,578	-	49,436	-	49,436
	0	**53,578**	**0**	**53,578**	**0**	**49,436**	**0**	**49,436**
Total bonds	**8,391**	**70,339**	**10,019**	**88,749**	**49,421**	**57,176**	**10,713**	**117,310**

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

Bonds and debt instruments measured at amortized cost as at 30 September 2018 and classified as loans and receivables as at 31 December 2017 consist partly of the government bonds which the Bank received in settlement of a capital contribution in 2009. The bonds were listed on NASDAQ Iceland in 2010.

21. Equities

	30.9.2018			31.12.2017		
Equities and equity instruments	**Mandatorily at FVTPL**	**Designated at FVTPL**	**Total**	**Held for trading**	**Designated at fair value**	**Total**
Domestic						
Listed	10,509	270	10,779	9,296	2,663	11,959
Unlisted	-	16,900	16,900	-	15,991	15,991
	10,509	**17,170**	**27,679**	**9,296**	**18,654**	**27,950**
Foreign						
Listed	58	-	58	2	-	2
Unlisted	-	29	29	-	28	28
	58	**29**	**87**	**2**	**28**	**30**
Total equities	**10,567**	**17,199**	**27,766**	**9,298**	**18,682**	**27,980**

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

As at 30 September 2018, outstanding commitments of the Group in share subscriptions amounted to ISK 1.456 million (31 December 2017: ISK 1.546 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.

All amounts are in ISK million

22. Derivative instruments and short positions

	30.9.2018			31.12.2017		
	Notional	Fair value		Notional	Fair value	
Foreign exchange derivatives	amount	Assets	Liabilities	amount	Assets	Liabilities
Currency forwards	52,278	325	266	60,484	542	91
Cross-currency interest rate swaps	9,023	377	-	8,601	1,056	40
	61,301	**702**	**266**	**69,085**	**1,598**	**131**
Interest rate derivatives						
Interest rate swaps	13,016	62	164	1,000	35	-
Total return swaps	7,495	25	4	1,428	1	1
	20,511	**87**	**168**	**2,428**	**36**	**1**
Equity derivatives						
Equity forwards	3,563	181	589	2,645	145	139
Total return swaps	1,848	32	4	1,703	2	39
Equity options	155	-	4	1,501	-	15
	5,566	**213**	**597**	**5,849**	**147**	**193**
Fair value hedging						
Interest rate swaps	80,961	88	439	78,341	124	616
	80,961	**88**	**439**	**78,341**	**124**	**616**
Total derivative instruments	**168,339**	**1,090**	**1,470**	**155,703**	**1,905**	**941**
Short positions						
Listed bonds	3,279	-	3,290	450	-	317
	3,279	**0**	**3,290**	**450**	**0**	**317**
Total	**171,618**	**1,090**	**4,760**	**156,153**	**1,905**	**1,258**

The Group uses derivatives both for hedging and trading purposes.

23. Loans and advances to financial institutions

	30.9.2018	31.12.2017
Bank accounts with financial institutions	26,007	30,219
Money market loans	57,181	12,770
Other loans	1,326	1,877
Allowance for impairment	(1)	-
Total	**84,513**	**44,866**

24. Loans and advances to customers

	Notes	30.9.2018	31.12.2017
Loans and advances to customers at amortised cost	25	1,045,686	941,826
Allowance for impairment		(15,625)	(16,190)
Total		**1,030,061**	**925,636**
Loans and advances to customers at FVTPL	26	7,944	-
Total		**1,038,005**	**925,636**

25. Loans and advances to customers at amortised cost

	30.9.2018			31.12.2017		
	Gross carrying amount	Allowance for impairment	Carrying amount	Gross carrying amount	Allowance for impairment	Carrying amount
Public entities	4,466	(136)	4,330	11,345	(102)	11,243
Individuals	398,018	(2,678)	395,340	359,918	(2,978)	356,940
Mortgage lending	318,204	(1,025)	317,179	282,499	(824)	281,675
Other	79,814	(1,653)	78,161	77,419	(2,154)	75,265
Corporates	643,202	(12,811)	630,391	570,563	(13,110)	557,453
	1,045,686	**(15,625)**	**1,030,061**	**941,826**	**(16,190)**	**925,636**

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

All amounts are in ISK million

26. Loans and advances to customers at FVTPL

	30.9.2018	31.12.2017
Corporates	7,944	-
Total	**7,944**	**0**

27. Other assets

	30.9.2018	31.12.2017
Unsettled securities trading	419	1,673
Other accounts receivable	3,731	3,784
Sundry assets	760	1,508
Total	**4,910**	**6,965**

28. Assets and liabilities classified as held for sale

Assets classified as held for sale

	30.9.2018	31.12.2017
Repossessed collateral	1,618	3,648
Total	**1,618**	**3,648**

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	30.9.2018	31.12.2017
Real estate	1,616	3,632
Equipment and vehicles	2	16
Total	**1,618**	**3,648**

Repossessed collateral	30.9.2018	31.12.2017
Carrying amount as at the beginning of the period	3,648	6,356
Repossessed during the period	674	1,337
Disposed of during the period	(5,378)	(5,890)
Impairment and gain of sale	2,674	1,845
Carrying amount as at the end of the period	**1,618**	**3,648**

Liabilities associated with assets classified as held for sale

	30.9.2018	31.12.2017
Liabilities of disposal groups	73	27
Total	**73**	**27**

All amounts are in ISK million

29. Borrowings

Secured borrowings

As at 30.9.2018	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%	16,217
LBANK CB 21	ISK	30.11.2021	3,720	Non-indexed	Fixed 5.5%	3,885
LBANK CBI 22	ISK	28.04.2022	19,540	CPI-indexed	Fixed 3.0%	21,013
LBANK CB 23	ISK	23.11.2023	660	Non-indexed	Fixed 5.0%	679
LBANK CBI 24	ISK	15.11.2024	19,660	CPI-indexed	Fixed 3.0%	21,240
LBANK CBI 28	ISK	04.10.2028	27,860	CPI-indexed	Fixed 3.0%	30,648
Total covered bonds						**93,682**
Total secured borrowings						**93,682**

Unsecured borrowings

As at 30.9.2018	Currency	Final maturity	Outstanding principal	Contractual interest rate	Carrying amount
LBANK 3 10/18	EUR	19.10.2018	EUR 150 million	FIXED 3.0%	19,853
LBANK FLOAT 06/19	SEK	10.06.2019	SEK 350 million	STIBOR + 2.6%	4,366
LBANK FLOAT 06/19	NOK	11.06.2019	NOK 500 million	NIBOR + 2.6%	6,815
LBANK FLOAT 06/20	SEK	22.06.2020	SEK 700 million	STIBOR + 1.0%	8,723
LBANK 0.75 06/20	SEK	22.06.2020	SEK 300 million	FIXED 0.75%	3,734
LBANK 1.375 11/20	SEK	24.11.2020	SEK 750 million	FIXED 1.375%	9,427
LBANK FLOAT 11/20	SEK	24.11.2020	SEK 250 million	STIBOR + 1.5%	3,116
LBANK 1.625 03/21	EUR	15.03.2021	EUR 500 million	FIXED 1.625%	64,595
LBANK 1.375 03/22	EUR	14.03.2022	EUR 300 million	FIXED 1.375%	38,691
LBANK 1.00 05/23	EUR	30.05.2023	EUR 300 million	FIXED 1.0%	38,426
Total EMTN issued					**197,746**

As at 30.9.2018	Currency	Final maturity	Outstanding principal	Indexed/ Non-indexed	Carrying amount
LBANK 181010	ISK	10.10.2018	2,220	Non-indexed	2,217
LBANK 181112	ISK	12.11.2018	1,320	Non-indexed	1,313
LBANK 190110	ISK	10.01.2019	560	Non-indexed	553
Total bills issued					**4,083**

As at 30.9.2018	Carrying amount
Other unsecured loans	12,851
Total other unsecured loans	**12,851**
Total unsecured borrowings	**214,680**
Total borrowings as at 30.9.2018	**308,362**

All amounts are in ISK million

29. Borrowings (continued)

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 CBI 22	ISK	28.04.2022	19,540	CPI-indexed	Fixed 3.0%	20,692
LBANK CB 23	ISK	23.11.2023	420	Non-indexed	Fixed 5.0%	417
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**

30. Deferred tax assets and liabilities

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

	30.9.2018			31.12.2017		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Property and equipment	-	(173)	(173)	-	(210)	(210)
Intangibles	-	(298)	(298)	-	(285)	(285)
Other assets	-	(13)	(13)	-	(6)	(6)
Deferred foreign exchange differences	287	-	287	174	-	174
Other items	101	-	101	106	-	106
Tax losses carried forward	184	-	184	181	-	181
	572	**(484)**	**88**	**461**	**(501)**	**(40)**
Set-off of deferred tax assets together with liabilities of the same taxable entities	(484)	484	-	(461)	461	-
Deferred tax assets (liabilities) total	**88**	**0**	**88**	**0**	**(40)**	**(40)**

All amounts are in ISK million

30. Deferred tax assets and liabilities (continued)

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

As at 30.9.2018	Balance as at1.1	Impact of adopting IFRS 9 and IFRS 15	Recognised in income statement Tax (expense) income	Recognised in income statement Changes from prior year	Balance as at 30.9
Property and equipment	(210)	-	37	-	(173)
Intangibles	(285)	-	(13)	-	(298)
Other assets	(6)	-	(7)	-	(13)
Deferred foreign exchange differences	174	-	113	-	287
Other items	106	258	(263)	-	101
Tax losses carried forward	181	-	3	-	184
Total	**(40)**	**258**	**(130)**	**0**	**88**

As at 31.12.2017	Balance as at 1.1	Recognised in income statement Tax (expense) income	Recognised in income statement Changes from prior year	Balance as at 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)**

31. Other liabilities

	30.9.2018	31.12.2017
Unsettled securities trading	4,680	6,106
Withholding tax	2,649	2,490
Accounts payable	3,486	641
Contribution to the Depositors' and Investors' Guarantee Fund	340	318
Tax on liabilities of financial institutions	6,162	3,253
Current tax liabilities	5,608	6,789
Non-controlling interests - Funds	740	2,326
Sundry liabilities	4,189	4,394
Total	**27,854**	**26,317**

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

32. Subordinated liabilities

As at 30.9.2018	Currency	Final maturity	Remaining principal in currencies	Contractual interest rate	Carrying amount
Subordinated loan	JPY	01.12.2023	JPY 41,2 million	LIBOR + 5%	40
Subordinated loan	CHF	01.12.2023	CHF 0,3 million	LIBOR + 5%	32
Subordinated loan	EUR	06.09.2028	EUR 100,0 million	Fixed 3.125%	12,803
Total subordinated liabilities					**12,875**

As at 31.12.2017	Currency	Final maturity	Remaining principal in currencies	Contractual interest rate	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**

On 30 August 2018, the Bank completed its inaugural EUR 100 million issuance of Tier 2 subordinated bonds. The bonds have a final maturity in September 2028, but are callable in September 2023. They were priced at a spread of 285 basis points above the EUR mid-swap market rate, with a fixed coupon of 3.125%. The bonds are issued under the Bank's 2,000 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange. The subordinated bonds have been rated BBB- by S&P Global Ratings.

All amounts are in ISK million

33. Equity

Share capital

As of 30 September 2018, 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 21 March 2018, shareholders at the Annual General Meeting (AGM) of the Bank for the operating year 2017 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 2019 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.

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

Act No. 3/2006, on Annual Financial Statements, with subsequent amendments, require 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:

1. 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.

2. 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.

Dividend

On 21 March 2018, shareholders at the Annual General Meeting (AGM) of the Bank for the operating year 2017 approved the Board's proposal to pay dividends to shareholders in the amount of ISK 15,366 million , or ISK 0.65 per share. The dividend was paid to shareholders on 28 March 2018. The recommendation of the Board of Directors to pay an extraordinary dividend in the amount of ISK 9,456 million on outstanding shares, or ISK 0.40 per share, was also approved by the AGM. The extraordinary dividend was paid to shareholders on 19 September 2018. These dividends were payable to shareholders listed on the shareholders' registry of Landsbankinn at end of business on the day of the AGM, 21 March 2018, unless the Bank receives 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 39 Capital requirements.

Other notes

34. Earnings per share

Profit for the period	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Profit for the period attributable to owners of the Bank	3,780	4,188	15,393	16,841

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	2018 1.7-30.9	2017 1.7-30.9	2018 1.1-30.9	2017 1.1-30.9
Number of ordinary shares issued at beginning of period	24,000	24,000	24,000	24,000
Average number of own shares	(360)	(361)	(360)	(360)
Weighted average number of shares outstanding	**23,640**	**23,639**	**23,640**	**23,640**
Basic and diluted earnings per share from operations (ISK)	**0.16**	**0.18**	**0.65**	**0.71**

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.

35. Litigation

Material litigation cases against the Bank and its subsidiaries

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.

In September 2018 the Icelandic Bankers' Pension Fund commenced litigation against the Bank, the Icelandic Central Bank, the Icelandic State and certain companies and association. The Pension Fund demands that an agreement from 1997 between the Fund and the defendants be amended, firstly, that the defendants shall pay around ISK 5,600 million to the Fund, out of which the Bank shall pay around ISK 4,100 million, and, secondly, that the defendants shall guarantee the obligations of the Fund's Rate Department (Hlutfallsdeild) which are higher than its asset at any time. The Bank has rejected the claims of the Fund.

Other cases

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.

On 8 March 2018, the Supreme Court concluded in case no. 159/2017 that a commercial bank, other than Landsbankinn, could not claim penalty rates on two mortgages that had fallen due during a temporary moratorium on payments for an individual under Act no. 101/2010 on Debt Mitigation for Individuals. Landsbankinn is assessing the potential impact of the case on the Bank.

Proceedings relating to the sale of the Bank´s shareholding in Borgun hf.

In January 2017, the Bank commenced proceedings before the Reykjavik District Court against BPS ehf., Eignarhaldsfélagið Borgun slf., Borgun hf. (Borgun) and the then CEO of Borgun. The Bank maintains that in 2014 when the Bank sold its 31.2% shareholding in Borgun the defendants had information on Borgun's shareholding in Visa Europe Ltd. which they did not disclose to the Bank. In the proceedings, the Bank demands the acknowledgement of the defendants' liability for losses incurred by the Bank for this reason. 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 submitted their written defences responding to the substance of the Bank's pleadings. On 10 September 2018 the District Court of Reykjavik ruled on the appointment of assessors to evaluate certain issues regarding Borgun's financial statements. The defendants have appealed the ruling of the District Court to Landsrettur.

All amounts are in ISK million

36. Interest in subsidiaries

The main subsidiaries held directly or indirectly by the Group as at 30 September 2018 were as detailed in the table below. This includes those subsidiaries that are most significant in the context of the Group's business.

Main subsidiaries as at 30 September 2018

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 30 September 2018.

37. Related party transactions

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 42, 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 42, 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:

	2018		2017	
Loans in ISK million	Balance as at 30 September	Highest amount outstanding during the period	Balance as at 31 December	Highest amount outstanding during the period
Key management personnel	226	245	227	245
Parties related to key management personnel	139	154	71	182
Associates	16,344	16,622	15,382	21,189
Other	24	26	26	125
Total	**16,733**	**17,047**	**15,706**	**21,741**

No specific allowance for impairment was recognised during the period in Stage 3 in respect of these loans.

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

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

	2018		2017	
Deposits in ISK million	Balance as at 30 September	Highest amount outstanding during the period	Balance as at 31 December	Highest amount outstanding during the period
Key management personnel	119	189	118	140
Parties related to key management personnel	32	135	30	86
Associates	2,433	15,907	3,718	16,885
Other	348	7,727	211	3,406
Total	**2,932**	**23,958**	**4,077**	**20,517**

37. 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 30 September 2018	Balance as at 31 December 2017
Key management personnel	-	-
Parties related to key management personnel	-	-
Associates	422	578
Total	**422**	**578**

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.

38. 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 Condensed Consolidated Financial Statements for the nine months ended 30 September 2018.

Capital management

39. 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-R 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-R 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):

As at 30.9.2018	CET1	Tier 1	Total
Pillar I	4.5%	6.0%	8.0%
Pillar II-R	2.3%	3.0%	4.0%
Minimum requirement under Pillar I and Pillar II-R	**6.8%**	**9.0%**	**12.0%**
Systemic risk buffer	2.85%	2.85%	2.85%
Capital buffer for systematically important institutions	2.00%	2.00%	2.00%
Countercyclical capital buffer	1.19%	1.19%	1.19%
Capital conservation buffer	2.50%	2.50%	2.50%
Combined buffer requirement under Pillar II-G	**8.54%**	**8.54%**	**8.54%**
Total capital requirement	**15.3%**	**17.5%**	**20.5%**

- 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.

On 15 May 2018, the FME announced its decision, following recommendations of the FSC, to raise the counter-cyclical capital buffer on domestic exposures by 0.50 percentage points, from 1.25% to 1.75%. The raise will be effective as of 15 May 2019.

The Group's capital requirements as at 30.9.2018 were determined by the FME in the annual ICAAP/SREP process and announced to the Bank on 27 September 2018.

40. 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	**30.9.2018**	**31.12.2017**
Share capital	23,640	23,640
Share premium	120,764	120,764
Reserves	13,128	12,902
Retained earnings	78,360	88,751
Total equity attributable to owners of the Bank	**235,892**	**246,057**
Intangible assets	(2,719)	(3,044)
Deferred tax assets	(88)	-
Common equity Tier 1 capital (CET1)	**233,085**	**243,013**
Non-controlling interests	-	-
Tier 1 capital	**233,085**	**243,013**
Subordinated liabilities	12,875	77
General credit risk adjustment	-	4,037
Tier 2 capital	**12,875**	**4,114**
Total capital base	**245,960**	**247,127**
Risk exposure amount (REA)		
Credit risk	876,918	809,492
Market risk	17,711	17,664
Operational risk*	96,962	96,962
Total risk exposure amount	**991,591**	**924,118**
CET1 ratio	23.5%	26.3%
Tier 1 capital ratio	23.5%	26.3%
Total capital ratio	24.8%	26.7%

*The amounts are updated on a yearly basis.

41. Leverage ratio

The following table shows the Group's leverage ratio as at 30 September 2018 and 31 December 2017. 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	**30.9.2018**	**31.12.2017**
- On-balance sheet exposure (excluding derivatives)	1,316,115	1,190,965
- Derivative instrument exposure	1,090	1,905
- Potential future exposure on derivatives	1,628	1,568
- Off-balance sheet exposure	146,225	141,482
- Regulatory adjustments to Tier 1 capital	(2,807)	(3,044)
Total leverage exposure	**1,462,251**	**1,332,876**
Tier 1 capital	**233,085**	**243,013**
Leverage ratio	**15.9%**	**18.2%**

All amounts are in ISK million

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

The following tables show the Group's maximum credit risk exposure as at 30 September 2018 and 31 December 2017. For on-balance sheet assets, the exposures are based on net carrying amounts as reported in the Condensed Consolidated Interim 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 30 September 2018	**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	-	61,155	-	-	-	-	-	-	-	-	-	-	-	**61,155**
Bonds and debt instruments	3,834	74,596	-	-	-	9,313	68	-	-	-	-	-	938	**88,749**
Derivative instruments	809	-	-	-	35	37	136	9	-	-	-	-	64	**1,090**
Loans and advances to financial institutions	84,513	-	-	-	-	-	-	-	-	-	-	-	-	**84,513**
Loans and advances to customers	-	4,330	395,340	148,732	82,676	145,341	27,229	64,041	108,585	31,334	22,657	7,739	1	**1,038,005**
Other financial assets	1,699	-	87	-	12	294	26	3	1,945	1	83	-	-	**4,150**
Total on-balance sheet exposure	**90,855**	**140,081**	**395,427**	**148,732**	**82,723**	**154,985**	**27,459**	**64,053**	**110,530**	**31,335**	**22,740**	**7,739**	**1,003**	**1,277,662**
Off-balance sheet exposure	**4,508**	**3,484**	**31,724**	**9,873**	**58,857**	**24,132**	**1,963**	**19,350**	**20,078**	**4,861**	**23,367**	**1,957**	**6**	**204,160**
Financial guarantees and underwriting commitments	994	-	812	957	3,684	1,025	8	2,773	4,380	2,122	460	1	-	17,216
Undrawn loan commitments	-	-	75	5,971	51,962	21,580	1,567	11,606	7,855	1,545	19,358	1,051	-	122,570
Undrawn overdraft/credit card facilities	3,514	3,484	30,837	2,945	3,211	1,527	388	4,971	7,843	1,194	3,549	905	6	64,374
Maximum exposure to credit risk	**95,363**	**143,565**	**427,151**	**158,605**	**141,580**	**179,117**	**29,422**	**83,403**	**130,608**	**36,196**	**46,107**	**9,696**	**1,009**	**1,481,822**
Percentage of maximum exposure to credit risk	6.4%	9.7%	28.8%	10.7%	9.6%	12.1%	2.0%	5.6%	8.8%	2.4%	3.1%	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

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

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
				Corporations										
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 dredit 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%	100.0%

* 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

43. Collateral and loan-to-value

The loan-to-value (LTV) ratio expresses the gross carrying amount of loans and advances as a percentage of the total value of the 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 30 September 2018	0% - 25%	25% - 50%	50% - 75%	75% - 100%	Total	>100%	Collateral value*	Without collateral	Allowance for impairment	Carrying amount
Financial institutions	-	-	-	-	0	-	-	84,514	(1)	84,513
Public entities	17	66	107	58	248	34	19	4,184	(136)	4,330
Individuals	28,615	86,729	210,887	35,666	361,897	5,349	3,426	30,772	(2,678)	395,340
Mortgages	19,594	74,061	196,319	25,667	315,641	1,468	1,137	1,095	(1,025)	317,179
Other	9,021	12,668	14,568	9,999	46,256	3,881	2,289	29,677	(1,653)	78,161
Corporates	21,615	114,101	245,235	138,906	519,857	98,558	71,684	32,731	(12,811)	638,335
Fisheries	1,192	21,787	90,895	25,298	139,172	9,555	6,494	458	(453)	148,732
Construction companies	1,823	7,488	17,489	31,553	58,353	24,990	18,123	1,232	(1,899)	82,676
Real estate companies	2,955	28,621	55,266	33,215	120,057	21,055	16,659	5,791	(1,562)	145,341
Holding companies	3,263	17,237	2,651	1,982	25,133	1,693	518	563	(160)	27,229
Retail	1,766	10,468	34,005	11,510	57,749	4,757	2,910	2,345	(810)	64,041
Services	4,944	20,561	31,122	31,736	88,363	14,667	8,920	8,271	(2,716)	108,585
Information, technology and communication	3,940	562	1,201	125	5,828	17,053	16,510	8,638	(185)	31,334
Manufacturing	669	6,024	9,261	2,460	18,414	3,981	1,032	5,123	(4,861)	22,657
Agriculture	1,063	1,353	3,345	1,027	6,788	807	518	309	(165)	7,739
Other	-	-	-	-	-	-	-	1	-	1
Total	50,247	200,896	456,229	174,630	882,002	103,941	75,129	152,201	(15,626)	1,122,518
As at 31 December 2017										
Financial institutions	-	-	-	-	0	-	-	44,866	-	44,866
Public entities	46	294	656	591	1,586	71	22	9,674	(102)	11,230
Individuals	21,883	71,281	184,573	43,845	321,581	8,945	5,866	29,126	(2,978)	356,675
Mortgages	14,921	58,762	169,646	33,818	277,147	4,001	2,840	341	(824)	280,664
Other	6,961	12,519	14,927	10,027	44,434	4,945	3,026	28,785	(2,154)	76,010
Corporates	24,590	83,836	197,706	139,143	445,275	92,959	58,284	32,608	(13,111)	557,732
Fisheries	6,758	23,013	72,599	9,794	112,163	1,586	1,235	1,069	(691)	114,127
Construction companies	2,139	6,867	16,400	33,407	58,812	21,681	14,127	1,640	(1,886)	80,247
Real estate companies	2,071	12,944	31,446	51,247	97,709	22,688	16,061	4,615	(1,503)	123,509
Holding companies	3,832	1,230	16,236	2,035	23,334	1,874	478	980	(236)	25,952
Retail	941	8,927	18,815	15,338	44,021	5,005	3,024	4,012	(715)	52,324
Services	3,634	19,098	33,759	22,510	79,001	18,342	13,899	9,151	(2,675)	103,820
Information, technology and communication	3,825	606	434	201	5,067	17,679	8,371	9,552	(443)	31,856
Manufacturing	474	9,792	6,021	742	17,029	3,596	675	1,393	(4,839)	17,178
Agriculture	915	1,360	1,997	3,867	8,138	508	413	197	(123)	8,719
Other	-	-	-	-	-	-	-	1	-	1
Total	46,519	155,411	382,935	183,578	768,443	101,975	64,172	116,274	(16,190)	970,502

*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.

All amounts are in ISK million

44. Collateral types

The following tables disclose the assignments of collateral values to claim values, whereby the value of each individual collateral item held cannot exceed the gross carrying amount 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 gross carrying amount.

As at 30 September 2018	Real estate	Vessels	Deposits	Securities	Other*	Total
Public entities	**212**	**-**	**2**	**-**	**51**	**265**
Individuals	**343,777**	**107**	**203**	**2,705**	**17,589**	**364,381**
Mortgages	311,598	20	117	49	4,199	315,983
Other	32,179	87	86	2,656	13,390	48,398
Corporates	**316,663**	**98,315**	**3,371**	**79,249**	**93,783**	**591,381**
Fisheries	9,389	96,609	129	27,035	12,504	145,666
Construction companies	69,142	57	1,303	21	5,952	76,475
Real estate companies	134,238	38	364	1,310	742	136,692
Holding companies	2,992	-	181	22,461	12	25,646
Retail	24,551	8	219	12,201	23,662	60,641
Services	59,576	1,596	771	3,893	31,350	97,186
Information, technology and communication	1,363	-	16	10,963	9,997	22,339
Manufacturing	10,024	-	381	1,365	7,675	19,445
Agriculture	5,388	7	7	-	1,889	7,291
Other	-	-	-	-	-	-
Total	**660,652**	**98,422**	**3,576**	**81,954**	**111,423**	**956,027**

As at 31 December 2017	Real estate	Vessels	Deposits	Securities	Other*	Total
Public entities	**1,218**	**-**	**41**	**-**	**348**	**1,608**
Individuals	**307,811**	**87**	**118**	**2,852**	**15,773**	**326,641**
Mortgages	275,785	13	35	80	3,396	279,310
Other	32,025	74	83	2,772	12,377	47,331
Corporates	**278,009**	**81,586**	**2,454**	**52,372**	**89,125**	**503,545**
Fisheries	8,711	79,959	257	11,241	13,230	113,398
Construction companies	65,727	62	1,067	7	6,077	72,939
Real estate companies	110,733	25	339	1,876	797	113,770
Holding companies	1,600	-	20	22,181	11	23,812
Retail	19,482	1	156	3,584	23,823	47,046
Services	57,416	1,486	261	3,906	29,831	92,900
Information, technology and communication	517	-	31	8,431	4,459	13,438
Manufacturing	7,866	46	319	1,146	8,328	17,705
Agriculture	5,958	7	4	-	2,569	8,538
Other	-	-	-	-	-	-
Total	**587,038**	**81,673**	**2,614**	**55,224**	**105,246**	**831,795**

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

All amounts are in ISK million

45. Credit quality of loans and advances

The following tables show the credit quality of loans and advances, measured by rating grade.

	Gross carrying amount						
As at 30 September 2018	**10-7**	**6-4**	**3-1**	**0**	**Unrated**	**Allowance for impairment**	**Carrying amount**
Financial institutions	**84,500**	**13**	**1**	**-**	**-**	**(1)**	**84,513**
Public entities	**629**	**3,837**	**-**	**-**	**-**	**(136)**	**4,330**
Individuals	**146,043**	**197,318**	**49,318**	**4,673**	**666**	**(2,678)**	**395,340**
Mortgages	131,757	150,497	33,257	2,282	411	(1,025)	317,179
Other	14,286	46,821	16,061	2,391	255	(1,653)	78,161
Corporations	**52,148**	**505,010**	**68,719**	**24,421**	**848**	**(12,811)**	**638,335**
Fisheries	7,197	133,004	7,222	1,513	249	(453)	148,732
Construction companies	929	62,610	18,819	1,988	229	(1,899)	82,676
Real estate companies	591	126,030	16,003	4,165	114	(1,562)	145,341
Holding companies	-	25,780	1,466	143	-	(160)	27,229
Retail	25,768	34,220	3,307	1,556	-	(810)	64,041
Services	8,951	81,530	14,580	6,066	174	(2,716)	108,585
Information, technology and communication	189	25,878	5,352	100	-	(185)	31,334
Manufacturing	7,187	10,517	1,515	8,217	82	(4,861)	22,657
Agriculture	1,335	5,441	455	673	-	(165)	7,739
Other	1	-	-	-	-	-	1
Total	**283,320**	**706,178**	**118,038**	**29,094**	**1,514**	**(15,626)**	**1,122,518**

	Gross carrying amount						
As at 31 December 2017	**10-7**	**6-4**	**3-1**	**0**	**Unrated**	**Allowance for impairment**	**Carrying amount**
Financial institutions	**44,597**	**269**	**-**	**-**	**-**	**-**	**44,866**
Public entities	**6,236**	**4,947**	**15**	**134**	**-**	**(102)**	**11,230**
Individuals	**131,053**	**179,032**	**42,638**	**6,130**	**800**	**(2,978)**	**356,675**
Mortgages	117,826	133,698	26,650	2,957	357	(824)	280,664
Other	13,227	45,334	15,988	3,173	443	(2,154)	76,011
Corporates	**34,143**	**449,295**	**61,019**	**25,903**	**481**	**(13,110)**	**557,731**
Fisheries	5,741	96,367	10,791	1,919	-	(691)	114,127
Construction companies	337	67,305	12,272	2,219	-	(1,885)	80,248
Real estate companies	711	106,438	12,358	5,180	324	(1,503)	123,508
Holding companies	185	23,635	2,155	171	42	(236)	25,952
Retail	10,360	38,286	2,754	1,638	-	(715)	52,323
Services	12,278	75,726	12,540	5,862	88	(2,675)	103,819
Information, technology and communication	393	26,370	5,442	93	-	(443)	31,855
Manufacturing	3,163	8,473	2,127	8,227	27	(4,839)	17,178
Agriculture	975	6,694	580	594	-	(123)	8,720
Other	-	1	-	-	-	-	1
Total	**216,029**	**633,543**	**103,672**	**32,167**	**1,281**	**(16,190)**	**970,502**

All amounts are in ISK million

46. Loans and advances by past due status

The following tables show the gross carrying amount of loans and advances to financial institutions and customers by past due status.

	Gross carrying amount							
		Days past due						
As at 30 September 2018	Not past due	1-5	6-30	31-60	61-90	over 90	Allowance for impairment	Carrying amount
Financial institutions	**84,511**	**-**	**-**	**-**	**3**	**-**	**(1)**	**84,513**
Public entities	**4,466**	**-**	**-**	**-**	**-**	**-**	**(136)**	**4,330**
Individuals	**381,742**	**3,554**	**7,447**	**849**	**1,079**	**3,347**	**(2,678)**	**395,340**
Mortgages	309,910	2	5,680	624	695	1,293	(1,025)	317,179
Other	71,832	3,552	1,767	225	384	2,054	(1,653)	78,161
Corporates	**620,386**	**7,180**	**8,107**	**1,982**	**4,637**	**8,854**	**(12,811)**	**638,335**
Fisheries	148,352	199	124	42	241	227	(453)	148,732
Construction companies	80,397	530	2,340	5	13	1,290	(1,899)	82,676
Real estate companies	140,542	395	2,914	189	1,887	976	(1,562)	145,341
Holding companies	27,027	149	145	-	-	68	(160)	27,229
Retail	62,646	573	296	89	296	951	(810)	64,041
Services	102,861	810	1,972	1,582	1,953	2,123	(2,716)	108,585
Information, technology and communication	31,309	32	8	71	10	89	(185)	31,334
Manufacturing	19,784	4,426	215	-	16	3,077	(4,861)	22,657
Agriculture	7,467	66	93	4	221	53	(165)	7,739
Other	1	-	-	-	-	-	-	1
Total	**1,091,105**	**10,734**	**15,554**	**2,831**	**5,719**	**12,201**	**(15,626)**	**1,122,518**

	Gross carrying amount							
		Days past due						
As at 31 December 2017	Not past due	1-5	6-30	31-60	61-90	over 90	Allowance for impairment	Carrying amount
Financial institutions	**44,866**	**-**	**-**	**-**	**-**	**-**	**-**	**44,866**
Public entities	**11,155**	**-**	**43**	**-**	**-**	**134**	**(102)**	**11,230**
Individuals	**346,324**	**557**	**3,747**	**3,736**	**831**	**4,458**	**(2,978)**	**356,675**
Mortgages	273,771	3	2,892	2,637	466	1,719	(824)	280,664
Other	72,553	554	855	1,099	365	2,739	(2,154)	76,011
Corporations	**545,319**	**5,926**	**4,415**	**2,880**	**1,869**	**10,431**	**(13,110)**	**557,731**
Fisheries	113,181	81	148	133	7	1,268	(691)	114,127
Construction companies	80,066	78	333	130	92	1,434	(1,885)	80,248
Real estate companies	120,393	91	1,007	882	517	2,121	(1,503)	123,508
Holding companies	26,055	-	2	5	6	120	(236)	25,952
Retail	51,090	86	593	103	482	684	(715)	52,323
Services	100,367	731	2,065	1,408	374	1,549	(2,675)	103,819
Information, technology and communication	31,710	464	70	7	19	28	(443)	31,855
Manufacturing	13,840	4,369	139	139	372	3,158	(4,839)	17,178
Agriculture	8,617	26	58	73	-	69	(123)	8,720
Other	1	-	-	-	-	-	-	1
Total	**947,664**	**6,483**	**8,205**	**6,616**	**2,700**	**15,023**	**(16,190)**	**970,502**

All amounts are in ISK million

47. Loans and advances by stage allocation

The tables below show both gross carrying amount and expected credit loss (ECL) by industry sectors and the three-stage criteria under IFRS 9.

		Stage 1		Stage 2		Stage 3			
As at 30 September 2018	**Gross carrying amount**	**Gross carrying amount**	**12-month ECL**	**Gross carrying amount**	**Lifetime ECL**	**Gross carrying amount**	**Lifetime ECL**	**Allowance for impairment**	**Carrying amount**
Financial institutions	**84,514**	**84,510**	**(1)**	**4**	**-**	**-**	**-**	**(1)**	**84,513**
Public entities	**4,466**	**1,481**	**(4)**	**2,985**	**(132)**	**-**	**-**	**(136)**	**4,330**
Individuals	**398,018**	**343,163**	**(657)**	**50,182**	**(655)**	**4,673**	**(1,366)**	**(2,678)**	**395,340**
Mortgages	318,204	280,830	(279)	35,092	(386)	2,282	(360)	(1,025)	317,179
Other	79,814	62,333	(378)	15,090	(269)	2,391	(1,006)	(1,653)	78,161
Corporates	**651,146**	**584,521**	**(1,810)**	**42,204**	**(534)**	**24,421**	**(10,467)**	**(12,811)**	**638,335**
Fisheries	149,185	139,066	(134)	8,606	(45)	1,513	(274)	(453)	148,732
Construction companies	84,575	74,335	(669)	8,252	(109)	1,988	(1,121)	(1,899)	82,676
Real estate companies	146,903	134,492	(559)	8,246	(164)	4,165	(839)	(1,562)	145,341
Holding companies	27,389	27,241	(55)	5	-	143	(105)	(160)	27,229
Retail	64,851	58,283	(76)	5,012	(43)	1,556	(691)	(810)	64,041
Services	111,301	96,179	(143)	9,056	(148)	6,066	(2,425)	(2,716)	108,585
Information, technology and communication	31,519	31,182	(123)	237	(2)	100	(60)	(185)	31,334
Manufacturing	27,518	18,070	(42)	1,231	(17)	8,217	(4,802)	(4,861)	22,657
Agriculture	7,904	5,672	(9)	1,559	(6)	673	(150)	(165)	7,739
Other	1	1	-	-	-	-	-	-	1
Total	**1,138,144**	**1,013,675**	**(2,472)**	**95,375**	**(1,321)**	**29,094**	**(11,833)**	**(15,626)**	**1,122,518**

All amounts are in ISK million

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

The following tables show changes in the impairment allowance of loans and advances during the period. Further explanation of terms is disclosed in Note 61.

	12-months ECL	Lifetime ECL	Lifetime ECL	Total
	Stage 1	Stage 2	Stage 3	
Restated balance as at 1 January 2018 - Financial institutions	**(3)**	**-**	**-**	**(3)**
New financial assets originated	-	(1)	-	(1)
Transfer to Stage 2 - Lifetime ECL	4	(4)	-	0
Changes in models/risk parameters	(3)	-	-	(3)
Balance at the end of the period - Financial institutions	**(2)**	**(5)**	**0**	**(7)**
-thereof classified as liabilities	(1)	(5)	-	(6)

	12-months ECL	Lifetime ECL	Lifetime ECL	Total
	Stage 1	Stage 2	Stage 3	
Restated balance as at 1 January 2018 - Loans and advances to customers	**(2,671)**	**(1,048)**	**(13,075)**	**(16,794)**
New financial assets originated	(1,118)	(292)	(389)	(1,799)
Reversals due to financial assets that have been derecognised	809	168	926	1,903
Transfer to Stage 1 - 12-month ECL	(176)	67	109	0
Transfer to Stage 2 - Lifetime ECL	479	(498)	19	0
Transfer to Stage 3 - Lifetime ECL	742	316	(1,058)	0
Changes in models/risk parameters	(764)	(52)	732	(84)
Provisions used to cover write-offs	-	-	879	879
Balance at the end of the period - Loans and advances to customers	**(2,699)**	**(1,339)**	**(11,857)**	**(15,895)**
-thereof classified as liabilities	(228)	(18)	(24)	(270)

	1.1-30.9.2018				
	Financial institutions	Public entities	Individuals	Corporates	Total
New financial assets originated	(2)	-	(294)	(1,504)	(1,800)
Reversals due to financial assets that have been derecognised	-	124	457	1,322	1,903
Changes due to financial assets recognised in the opening balance	(2)	21	2	(108)	(87)
Write-offs	-	-	(717)	(556)	(1,273)
Provisions used to cover write-offs	-	-	469	410	879
Recoveries	-	-	439	244	683
Translation difference	-	-	-	204	204
Net impairment loss for the period	**(4)**	**145**	**356**	**12**	**509**

49. Large exposures

As at 30 September 2018, five 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 30 September 2018	Number of large exposures	Large exposures
Large exposures between 10% and 20% of the Group's eligible capital	3	98,853
Large exposures between 0% and 10% of the Group's eligible capital	2	-
Total	**5**	**98,853**
Total ratio of large exposures to eligible capital		40%
As at 31 December 2017		
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 ratio of large exposures to eligible capital		22%

All amounts are in ISK million

50. Bonds and debt instruments

Government bonds and treasury bills	30.9.2018	31.12.2017
Rated AAA	27,067	35,475
Rated AA- to AA+	26,511	13,961
Rated A- to A+	14,707	43,789
Rated BBB+ and below	756	496
	69,041	**93,721**
Corporate bonds		
Rated A- to A+	482	377
Rated BBB- to BBB+	3,614	9,837
Unrated	11,793	11,274
	15,889	**21,488**
Asset-backed securities		
Rated BBB- to BBB+	3,819	2,101
	3,819	**2,101**
Total	**88,749**	**117,310**

51. Offsetting financial assets and financial liabilities

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

As at 30 September 2018

Financial assets subject to offsetting, enforceable master netting arrangement and other 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 subject to netting agreements	Financial assets not subject to netting agreements	Net amount on balance sheet
Derivatives	1,090	-	1,090	(242)	(790)	58	-	1,090

Financial liabilities subject to offsetting, enforceable master netting arrangement and other 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 subject to netting agreements	Financial liabilities not subject to netting agreements	Net amount on balance sheet
Derivatives	(1,470)	-	(1,470)	(242)	616	(1,095)	-	(1,470)
Short positions	(3,290)	-	(3,290)	-	3,290	-	-	(3,290)
Total	**(4,760)**	**0**	**(4,760)**	**(242)**	**3,906**	**(1,095)**	**0**	**(4,760)**

All amounts are in ISK million

51. Offsetting financial assets and financial liabilities (continued)

As at 31 December 2017

Financial assets subject to offsetting, enforceable master netting arrangement and other 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 subject to 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 other 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 subject to 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)**

Liquidity risk

52. Liquidity risk management

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 ratios in foreign currencies, as well as guidelines No. 2/2010 from the Icelandic Financial Supervisory Authority on best practice for managing liquidity in banking organisation. The Central Bank's liquidity rules require the Group to maintain a liquidity coverage ratio (LCR) minimum of 100% total and 100% for foreign currencies and rules No. 1032/2014 set requirements for a minimum of 100% net stable funding ratio (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 key indicator of short-term liquidity risk is measured by the 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 overly rely on their estimated inflow in times of stress. The calculations for the ratio as at 30 September 2018 and 31 December 2017 are shown in the following table:

	Total		Foreign currencies	
Liquidity coverage ratio 30 September 2018	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	95,707	95,707	55,338	55,338
Information items	18,154	-	3,906	-
Total liquid assets	**113,861**	**95,707**	**59,244**	**55,338**
Deposits	497,443	125,832	77,877	33,482
Borrowing	22,104	22,104	19,884	19,884
Other outflows	149,760	17,208	30,406	3,033
Total outflows (0-30 days)	**669,307**	**165,144**	**128,167**	**56,399**
Loans and advances to financial institutions	97,829	83,178	84,324	83,137
Other inflows	42,274	19,709	10,588	5,524
Limit on inflows	-	-	-	(46,362)
Total inflows (0-30 days)	**140,103**	**102,887**	**94,912**	**42,299**
Liquidity coverage ratio		**154%**		**392%**

for the nine months ended 30 September 2018 43 All amounts are in ISK million

52. Liquidity risk management (continued)

	Total		Foreign currencies	
Liquidity coverage ratio 31 December 2017	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	110,036	110,036	51,112	51,112
Level 2 liquid assets and 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%**

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 30 September 2018	**Total**	**Foreign currencies**
Cash and balances with the Central Bank	28,303	1,760
Domestic bonds and debt instruments eligible as collateral at the Central Bank	13,826	-
Foreign government bonds with 0% risk weight	53,578	53,578
High quality liquidity assets	**95,707**	**55,338**
Loans and advances to financial institutions	97,829	84,324
Total liquidity reserves	**193,536**	**139,662**

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 at 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**

The Group measures the net stable funding ratio (NSFR) as another key indicator of liquidity risk up to 12 months. The following table shows the values of the NSFR for foreign currencies and NSFR total as at 30 September 2018 and 31 December 2017:

	As at 30 September 2018	**As at 31 December 2017**
Net stable funding ratio FX	168%	179%
Net stable funding ratio total	120%	124%

53. Encumbered assets

The following tables show the Group's total encumbered and unencumbered assets as at 30 September 2018 and 31 December 2017.

	Collateral pledged against			
As at 30 September 2018	**Covered bonds**	**Other***	**Un-encumbered**	**Total**
Cash and balances with Central Bank	796	5,983	54,376	61,155
Bonds and debt instruments	-	5,804	82,945	88,749
Equities and equity instruments	-	-	27,766	27,766
Derivative instruments	-	-	1,090	1,090
Loans and advances to financial institutions	-	1,185	83,328	84,513
Loans and advances to customers	122,285	-	915,720	1,038,005
Investments in equity-accounted associates	-	-	1,390	1,390
Property and equipment	-	-	5,202	5,202
Intangible assets	-	-	2,719	2,719
Deferred tax assets	-	-	88	88
Other assets	-	-	4,910	4,910
Assets classified as held for sale	-	-	1,618	1,618
Total	**123,081**	**12,972**	**1,181,152**	**1,317,205**

All amounts are in ISK million

53. Encumbered assets (continued)

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**

*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

54. Market risk management

The following table summarises the Group's exposure to market risk as a percentage of risk exposure amount (REA) as at 30 September 2018 and December 2017. The Group uses the standardized approach to calculate risk exposure amounts of derivatives for credit valuation adjustment (CVA) according to capital requirement regulations.

Market risk factor	30.9.2018 % of REA	31.12.2017 % of REA
Equity price risk	1.0%	1.1%
Interest rate risk	0.4%	0.3%
CVA of derivatives	0.0%	0.1%
Foreign exchange risk	0.3%	0.5%
Total	**1.8%**	**1.9%**

The currency risk in the Group's trading portfolios is disclosed together with that in its non-trading portfolios in Notes 58-59.

55. 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 21.

All amounts are in ISK million

56. Interest rate 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 22. The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

As at 30 September 2018	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	61,155	-	-	-	61,155
Bonds and debt instruments	46,513	19,277	9,146	13,813	88,749
Derivative instruments	1,090	-	-	-	1,090
Loans and advances to financial institutions	84,513	-	-	-	84,513
Loans and advances to customers	875,967	44,953	66,293	50,792	1,038,005
Other financial assets	4,150	-	-	-	4,150
Total	**1,073,388**	**64,230**	**75,439**	**64,605**	**1,277,662**
Financial liabilities					
Due to financial institutions and Central Bank	(34,714)	-	-	-	(34,714)
Deposits from customers	(685,875)	(4,598)	(2,202)	-	(692,675)
Derivative instruments and short positions	(1,469)	(309)	(1,695)	(1,287)	(4,760)
Borrowings	(59,254)	(16,771)	(179,770)	(52,567)	(308,362)
Other financial liabilities	(8,624)	-	-	-	(8,624)
Subordinated liabilities	(72)	-	-	(12,803)	(12,875)
Total	**(790,008)**	**(21,678)**	**(183,667)**	**(66,657)**	**(1,062,010)**
Net on-balance sheet position	283,380	42,552	(108,228)	(2,052)	215,652
Derivatives held for hedging	(80,961)	0	80,961	0	
Net off-balance sheet position	(3,219)	(53)	3,272	0	
Total interest repricing gap	**199,200**	**42,499**	**(23,995)**	**(2,052)**	

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
Derivatives held for hedging	(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**	

All amounts are in ISK million

57. 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 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 30 September 2018 and 31 December 2017.

Carrying amount	30.9.2018	31.12.2017
Assets		
Bonds and debt instruments	13,774	11,621
Loans and advances to customers	400,209	365,948
Total	**413,983**	**377,569**
Liabilities		
Due to financial institutions and Central Bank	-	(8)
Deposits from customers	(108,865)	(105,856)
Derivative instruments and short positions	(2,981)	(35)
Borrowings	(72,901)	(49,570)
Total	**(184,747)**	**(155,469)**
Total on-balance sheet position	229,237	222,100
Total off-balance sheet position	(8,040)	(230)
Total CPI indexation balance	**221,197**	**221,870**

58. Currency risk (all portfolios)

The Group follows Central Bank Rules No. 784/2018, on Foreign Exchange Balances. The Rules stipulate that a foreign exchange balance (whether long or short) of a systemically important financial institution must always be within 10% of its capital base, in each currency and for all currencies combined, although the total foreign exchange balance should never exceed ISK 25,000 million. The Group submits monthly reports to the Central Bank on its foreign exchange balance.

The Group's combined net foreign exchange balance as at 30 September 2018 was - 0,93% of the Group's capital base (31.12.2017: +1.61%).

59. Concentration of currency risk

The following tables summarise the Group's exposure to currency risk as at 30 September 2018 and 31 December 2017. 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. When managing currency risk the Group regards spot deals as non-derivative assets or liabilities.

As at 30 September 2018	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	729	176	404	15	51	539	1,914
Bonds and debt instruments	27,102	29	30,051	-	-	-	57,182
Equities and equity instruments	34	-	189	-	-	29	252
Derivative instruments	254	23	519	-	-	10	806
Loans and advances to financial institutions	50,362	7,472	7,275	290	181	18,745	84,325
Loans and advances to customers	112,601	2,629	39,532	3,235	2,995	3,686	164,678
Other assets	1,264	-	72	-	-	42	1,378
Total	**192,346**	**10,329**	**78,042**	**3,540**	**3,227**	**23,051**	**310,535**
Liabilities							
Due to financial institutions and Central Bank	(944)	(39)	(88)	-	-	(16)	(1,087)
Deposits from customers	(31,377)	(3,706)	(37,980)	(853)	(818)	(6,498)	(81,232)
Derivative instruments and short positions	(526)	(118)	(56)	-	(1)	(11)	(712)
Borrowings	(164,331)	-	(8,357)	-	-	(37,908)	(210,596)
Other liabilities	(1,787)	(83)	(953)	(3)	(1)	(427)	(3,254)
Subordinated liabilities	(12,803)	-	-	(40)	(32)	-	(12,875)
Total	**(211,768)**	**(3,946)**	**(47,434)**	**(896)**	**(852)**	**(44,860)**	**(309,756)**
Net on-balance sheet position	(19,422)	6,383	30,608	2,644	2,375	(21,809)	779
Net off-balance sheet position	18,298	(6,389)	(30,676)	(2,882)	(2,470)	21,165	(2,954)
Net currency position	**(1,124)**	**(6)**	**(68)**	**(238)**	**(95)**	**(644)**	**(2,175)**

All amounts are in ISK million

59. Concentration of currency risk (continued)

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**

60. Foreign exchange rates used

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

	As at 30 September 2018	As at 31 December 2017	% change	Average for 1.1-30.9 2018	Average for 1.1-30.9 2017
EUR/ISK	128.70	124.25	3.6%	123.88	119.33
GBP/ISK	144.55	139.95	3.3%	140.05	137.01
USD/ISK	110.75	103.46	7.0%	103.89	106.93
JPY/ISK	0.9758	0.9184	6.3%	0.9445	0.9544
CHF/ISK	113.51	106.19	6.9%	107.06	108.86
CAD/ISK	85.68	82.59	3.7%	80.89	81.89
DKK/ISK	17.259	16.687	3.4%	16.628	16.045
NOK/ISK	13.614	12.650	7.6%	12.886	12.924
SEK/ISK	12.472	12.638	(1.3%)	12.087	12.454

All amounts are in ISK million

Accounting policies

61. Changes to accounting policies

The accounting policies applied in the Condensed Consolidated Interim Financial Statements are the same as those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2017, except for the changes set out below.

IFRS 9 - Financial instruments

The Group has adopted IFRS 9 Financial Instruments (2014) with 1 January 2018 as the date of initial application. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard introduces extensive changes to previous guidelines on the classification and measurement of financial assets and introduces a new 'expected credit loss' model for the impairment of financial assets.

As permitted under IFRS 9, the Group has elected to continue to apply the hedge accounting requirements of IAS 39.

Transition to IFRS 9

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and is therefore not comparable to the information presented for 2018 under IFRS 9.

- The following assessments have been made on the basis of facts and circumstances prevailing at the date of initial application:
  - The determination of the business models within which financial assets are held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities measured at FVTPL.

- If a debt security had low credit risk at the date of initial application of IFRS 9, the Group assumes that credit risk on the asset has not increased significantly since its initial recognition.

For more information and details on the implications of and changes resulting from the adoption of IFRS 9, see Note 4. Also new or amended interim disclosures have been provided for the current period and, where applicable, comparative period disclosures are consistent with those made the previous year.

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 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

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. The 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 in this category belong to a business model designed to collect contractual cash flows.

- Financial assets measured at fair value through other 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 the financial asset. Financial assets in this category belong to a business model designed to collect contractual cash flows and to sell financial assets.

- 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 other comprehensive income (FVOCI) on an instrument-by-instrument basis.

61. Changes to accounting policies (continued)

Transition to IFRS 9 (continued)

Classification and measurement (continued)

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.

Business model assessment

The Bank determines its business models based on the objective under which its portfolios of financial assets are managed and information provided to management. In determining its business models, the Bank takes the following factors into consideration:

- Management's stated policies and objectives for the portfolio and the operation of those policies in practice.
- The primary risks that affect the performance of the business model and how those risks are managed.
- The methods by which the performance of assets in a portfolio is evaluated and reported to management.
- The frequency and significance of financial asset sales in previous periods, the reasons for such sales and expected future sales activities. Sales in themselves do not determine the business model and are not considered in isolation. Instead, sales provide evidence about how cash flows are realized.

Cash flow characteristics assessment

The SPPI (solely payments of principal and interest) test is used to determine whether loans and advances to financial institutions and to customers are measured at amortised cost or at fair value through profit or loss (FVTPL).

For the purposes of this test, principal is defined as the fair value of the financial asset on initial recognition. Interest is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time, and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows in such a way that it would not meet the condition of being solely payment of principal and interest. The SPPI test is applied to the Bank's loan portfolio to decide if the classification of loans complies with IFRS 9.

Market bonds and other debt instruments

Market bonds and other debt instruments are either measured at amortized cost or at fair value through profit or loss.

Market bonds and other debt instruments classified as financial assets at fair value through profit or loss (FVTPL) are recognized at fair value in the Statement of Financial Position both initially and subsequent to initial recognition.

Market bonds and other debt instruments classified at amortized cost are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortized cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and it is recognized in the line item "Interest income" in the income statement. Bonds and other debt instruments within a held-to collect business model under which their contractual cash flows are solely payment of principal and interest are measured at amortized cost.

Market bonds and other debt instruments measured at FVTPL include financial assets held for trading purposes, financial assets held as part of a portfolio managed on a fair value basis and financial assets whose cash flows do not represent payments that are solely payments of principal and interest. These instruments are measured at fair value in the Statement of Financial Position, with transaction costs recognized immediately as income as part of non-interest income. Realized and unrealized gains and losses are recognized as part of net gain on financial assets and liabilities.

Equities and other equity instruments

Equities and other equity instruments 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 earnings multiples from similar securities, recent transactions or by using discounted cash flow methods.

61. Changes to significant accounting policies (continued)

Fair value option

Financial assets measured at fair value through profit or loss show separately i) those designated as such upon initial recognition and ii) those mandatorily measured at fair value through profit or loss.

Bonds and other debt instruments and equities and other equity instruments measured at fair value through profit or loss are measured at fair value with changes in fair value and related transaction costs recorded in line item “Net gain (loss) on financial assets and liabilities”. This category includes the following:

Market bonds and other debt instruments and equities and other equity instruments (securities) designated at fair value through profit or loss

To qualify for this designation, the security must have reliably measurable fair value and the designation must eliminate or significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities, or recognizing related gains and losses on a different basis (sometimes referred to as "an accounting mismatch"). This includes, inter alia, bonds and equities held for trading.

Market bonds and other debt instruments and equities and equity instruments (securities) mandatorily measured at fair value through profit or loss

Securities managed on a fair value basis but not held for trading, or debt securities whose cash flows do not represent solely payments of principal and interest, and equities not held for trading.

Loans and advances to customer mandatorily measured at fair value through profit or loss

Certain loans and advances to customers are classified under IFRS 9 as mandatorily measured at FVTPL because they are held within a business model in which they are managed, their performance is evaluated on a fair value basis and their cash flows do not represent solely payments on principal and interest.

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. The Group will nevertheless provide the expanded disclosures on hedge accounting introduced by the amendments IFRS 7 Financial Instruments.

Loans and advances

Loans and advances are initially measured at fair value and subsequently in accordance with the classification policy of financial assets provided above. The majority of the Group’s loans are carried at amortized cost using the effective interest method, which represents the gross carrying amount less allowance for credit losses. Interest on loans is recognized under interest income. The estimated future cash flows used in this calculation include those determined by the contractual terms of the asset and all fees that are considered to be integral to the effective interest rate. Also included in this amount are transaction costs and all other premiums or discounts. For loans carried at amortized cost, impairment losses are recognized at each balance sheet date in accordance with the three-stage expected credit loss model.

Loans and advanced measured at fair value through profit and loss are assets whose cash flows do not represent payments that are solely payments of principal and interest but are non-trading assets. Changes in fair value, as well as any gains or losses realized on disposal, are recognized under the line item “Net gain (loss) on financial assets and liabilities”.

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 previous 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 significant 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.

61. Changes to significant accounting policies (continued)

Impairment (continued)

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 significantly 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.

The Group will recognise loss allowances at an amount equal to lifetime ECL, except in the following cases, for which the amount recognised will be 12-month ECL:

- Debt investment securities that are determined to have low credit risk at the reporting date. The Group considers a debt security to low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment-grade'.
- Other financial instruments (other than lease receivables) for which credit risk has not increased significantly since initial recognition.
- Loss allowances for lease receivables will always be measured at an amount equal to lifetime ECL.

The Bank's Credit Risk Management department 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 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.

Measurement of expected credit losses (ECL)

ECL is a probability-weighted estimate of credit loss. Credit loss is measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due in accordance with the contracts and the cash flows expected to be received).

ECL is discounted at the effective interest rate of the financial asset.

The probability of default (PD), exposure at default (EAD), and loss given default (LGD) inputs used to estimate expected credit losses are modelled on macroeconomic variables that are most closely related to credit losses in the relevant portfolio.

Details of these statistical parameters/inputs are as follows:

- Probability of default is an estimate of the likelihood of default within the next 12 months.
- Exposure at default is an estimate of the exposure at a future, unknown default date.
- Loss given default is an estimate of the loss arising upon default occurring at a given time.

Expected lifetime

The expected lifetime of loans is based on the maturity of the loans, according to the current contractual terms, and is measured in years. If the nature of a loan agreement provides that the expected lifetime differs from the maturity date of the loan, the lifetime is estimated based on the expected lifetime of the loan.

61. Changes to significant accounting policies (continued)

Use of forward-looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an financial instrument has increased significantly since initial recognition and its measurement of ECL. The Group then formulates 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 macroeconomic 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.

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

As of 1 January 2018, the Group adopted IFRS 15 using the cumulative effect method and as a result, comparative information has not been restated and continues to be reported under IAS 18 and IAS 11. The guidelines of IFRS 15 are applied retrospectively on contracts that are still valid upon initial adoption of the standard and the accumulated effect will be accounted for in the opening balance of equity 2018. The details of accounting policies under IAS 18 and IAS 11 are disclosed separately if they differ from IFRS 15. The impact of the implementation 1 January 2018 of IFRS 15 results in a pre-tax reduction of retained earnings by ISK 344 million.

IFRS 15 provides for the accounting treatment of revenue from sale of goods and services to customers, that is whether, to what extent and when revenues are accounted for. The core principle of IFRS 15 is that the time period in which income is recognised should be consistent with the transfer of the service to the customer.

Consolidated Key Figures

62. Operations by quarters

	2018			2017			
Operations	**Q3**	**Q2**	**Q1**	**Q4***	**Q3**	**Q2**	**Q1**
Interest income	17,622	16,316	16,059	15,970	14,916	17,125	14,545
Interest expense	(7,252)	(6,481)	(6,418)	(6,769)	(6,022)	(6,967)	(6,527)
Net interest income	**10,370**	**9,835**	**9,641**	**9,201**	**8,894**	**10,158**	**8,018**
Reversals of loss from foreign currency linkage of loans and advances	-	1,129	-	105	347	13	755
Net impairment (loss) gain	(89)	(426)	1,024	(387)	419	(550)	1,024
Reversal of impairment of guarantees	-	-	-	-	-	59	-
Net valuation adjustments and impairment	**(89)**	**703**	**1,024**	**(282)**	**766**	**(478)**	**1,779**
Net interest income after net valuation adjustments and impairment	**10,281**	**10,538**	**10,665**	**8,919**	**9,660**	**9,680**	**9,797**
Fee and commission income	2,565	2,926	2,460	2,618	2,923	2,953	2,795
Fee and commission expense	(639)	(741)	(769)	(778)	(764)	(637)	(679)
Net fee and commission income	**1,926**	**2,185**	**1,691**	**1,840**	**2,159**	**2,316**	**2,116**
Net (loss) gain on financial assets and liabilities at FVTPL	(151)	(333)	2,196	288	509	1,742	3,263
Net foreign exchange (loss) gain	(352)	(399)	(70)	(482)	(10)	(518)	(365)
Other income and (expenses)	348	195	2,350	1,305	36	355	902
Other net operating income	**(155)**	**(537)**	**4,476**	**1,111**	**535**	**1,579**	**3,800**
Total operating income	**12,052**	**12,186**	**16,832**	**11,870**	**12,354**	**13,575**	**15,713**
Salaries and related expenses	3,222	3,869	3,663	3,753	3,163	3,654	3,491
Other operating expenses	2,353	2,287	2,335	2,411	2,475	2,477	2,426
Total operating expenses	**5,575**	**6,156**	**5,998**	**6,164**	**5,638**	**6,131**	**5,917**
Profit before tax	**6,477**	**6,030**	**10,834**	**5,706**	**6,716**	**7,444**	**9,796**
Income tax	(1,615)	(1,609)	(1,892)	(2,028)	(1,648)	(1,572)	(1,395)
Tax on liabilities of financial institutions	(1,082)	(910)	(840)	(753)	(880)	(795)	(825)
Profit for the period	**3,780**	**3,511**	**8,102**	**2,925**	**4,188**	**5,077**	**7,576**

Balance sheet	**30.09.18**	**30.6.2018**	**31.3.2018**	**31.12.2017**	**30.9.2017**	**30.6.2017**	**31.3.2017**
Cash and cash balances with Central Bank	61,155	68,372	82,266	55,192	33,157	32,216	35,826
Bonds and debt instruments	88,749	97,214	100,216	117,310	160,223	162,520	147,992
Equities and equity instruments	27,766	28,756	25,666	27,980	31,049	30,934	30,868
Loans and advances to financial institutions	84,513	47,937	41,796	44,866	41,485	49,292	70,230
Loans and advances to customers	1,038,005	989,481	936,636	925,636	905,927	870,483	872,350
Other assets	15,399	16,261	17,455	18,238	22,740	20,317	19,009
Assets classified as held for sale	1,618	1,832	2,113	3,648	4,377	4,866	6,192
Total assets	**1,317,205**	**1,249,853**	**1,206,148**	**1,192,870**	**1,198,958**	**1,170,628**	**1,182,467**
Due to financial institutions and Central Bank	34,714	27,504	30,943	32,062	21,946	23,486	31,613
Deposits from customers	692,675	654,689	622,021	605,158	638,781	627,954	594,565
Borrowings	308,362	297,684	284,484	281,874	267,853	242,274	244,649
Other liabilities	32,614	37,764	39,984	27,615	26,862	37,441	76,261
Liabilities associated with assets classified as held for sale	73	27	41	27	155	155	1,095
Subordinated liabilities	12,875	72	74	77	229	374	390
Equity	235,892	232,113	228,601	246,057	243,132	238,944	233,894
Total liabilities and equity	**1,317,205**	**1,249,853**	**1,206,148**	**1,192,870**	**1,198,958**	**1,170,628**	**1,182,467**

*The first two quarters result for the year 2018 and the first three quarter results for the year 2017 were reviewed by the Bank's independent auditors.

All amounts are in ISK million

Consolidated Key Figures

63. Key figures and ratios

	2018			2017			
	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Return on equity before taxes	11.1%	10.5%	18.3%	9.3%	11.1%	12.6%	16.2%
Return on equity after taxes	6.5%	6.1%	13.7%	4.8%	6.9%	8.6%	12.5%
Total capital ratio	24.8%	24.1%	24.7%	26.7%	26.8%	27.6%	27.4%
Leverage ratio	15.9%	16.4%	16.7%	18.2%	18.1%	18.1%	17.70
Cost-income ratio	45.9%	53.6%	37.9%	50.7%	48.7%	43.6%	42.5%
Operating expenses as a ratio of average total assets	1.7%	2.0%	2.0%	2.1%	1.9%	2.1%	2.1%
Interest spread as a ratio of assets and liabilities	2.7%	2.7%	2.7%	2.5%	2.5%	2.9%	2.2%
Loans / deposits	149.9%	151.1%	150.6%	153.0%	141.8%	138.6%	146.7%
Deposits / total assets	52.6%	52.4%	51.6%	50.7%	53.3%	53.6%	50.3%
Number of full-time positions at the end of the period	948	955	998	997	998	988	1,000
Earnings per share	0.16	0.15	0.34	0.12	0.18	0.21	0.32
Liquidity coverage ratio (LCR)	154%	164%	171%	157%	158%	183%	158%
Net stable funding ratio (NSFR)	168%	165%	168%	179%	185%	169%	159%

Key figures and ratios	Definition
Return on equity before taxes	Profit before taxes / average total equity
Return on equity after taxes	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	Total capital base / risk-weighted assets
Leverage ratio	Tier 1 capital / (total assets + off balance sheet items)
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 the end of the period	Number of full-time equivalent positions at the end of the period
Earnings per share	Profit for the period attributable to owners of the Bank / Weighted average 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)	Subordinated liabilities - regulatory amortisation
Total capital base	CET1 + AT1 + T2
Liquidity coverage ratio (LCR)	High quality liquid assets / total net liquidity outflows over 30 days under stressed conditions
Net stable funding ratio (NSFR)	Available amount of stable funding / required amount of stable funding

All amounts are in ISK million