



KVÍKA

Condensed Interim
Consolidated Financial Statements

30 June 2020

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Endorsement and Statement by the Board of Directors and the CEO

The Condensed Interim Consolidated Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the period 1 January to 30 June 2020 have been prepared in accordance with International Accounting Standard IAS 34 Interim Financial Reporting as adopted by the European Union, and additional requirements in the Icelandic Financial Statement Act. The Condensed Interim Consolidated Financial Statements comprise Kvika and its subsidiaries (together the "Group").

Kvika is a specialized bank focusing on asset management and investment services. The Bank operates four business segments, Asset Management, Corporate Finance, Corporate Banking and Capital Markets. Kvika provides businesses, investors and individuals with comprehensive investment banking and asset management services, as well as selected banking services. Kvika's Asset Management has an established reputation and offers solutions covering all major asset classes, including fixed-income securities, equities, and alternative investments in both domestic and international markets. At the end of June 2020 the Group had ISK 514 billion of assets under management, compared to ISK 426 billion at year end 2019. The Bank is listed on the main list of Nasdaq OMX Iceland.

Operations in the reporting period

Profit for the period amounted to ISK 924 million (6m 2019: ISK 1,455 million), corresponding to an annualised 11.8% return on equity based on the equity position at the beginning of the year adjusted for changes in share capital and transactions with treasury shares during the period. The Group's net operating income during the period was ISK 4,147 million (6m 2019: ISK 4,165 million). Net interest income amounted to ISK 868 million (6m 2019: ISK 846 million). Net fee income amounted to ISK 3,014 million (6m 2019: ISK 2,912 million). Other operating income amounted to ISK 266 million (6m 2019: ISK 408 million). Administrative expenses during the period amounted to ISK 2,671 million (6m 2019: ISK 2,658 million).

The COVID-19 pandemic, and the uncertainty related to it, had a considerable impact on the Bank's operations and the Icelandic economy during the reporting period. The Bank has, among other things, updated the economic scenarios which are used in the Expected Credit Loss model to better reflect the economic situation. Furthermore, the economic situation has, to some extent, increased the amount of loan exposures classified as Stages 2 and 3. During the operating period, the Group had a negative impairment charge of ISK 209 million (6m 2019: 22 million). In addition to that, unfavourable market conditions due to the economic situation resulted in the Group recognising a loss on shares and other variable income securities to the amount of ISK 47 million during the operating period while in during the first half of 2019 there was a gain of ISK 402 million.

According to the Consolidated Statement of Financial Position, equity at the end of the period amounted to ISK 16,668 million (31.12.2019: ISK 15,515 million) and total assets amounted to ISK 113,070 million (31.12.2019: ISK 105,584 million).

The Group's total capital ratio at 30.06.2020 is 26.2% (31.12.2019: 24.1%). The Bank's minimum regulatory capital requirement based on Financial Supervisory Authority's Supervisory Review and Evaluation Process (SREP) is 15.1%. In March 2020, the Central Bank of Iceland lowered the countercyclical capital buffer to zero. The minimum regulatory capital requirement including the additional capital requirements imposed following the implementation of CRD IV is 20.6% as at 30 June 2020.

The Bank maintains a strong liquidity position. The Bank's assets are liquid and its access to funding is good, reflected in ample liquidity position. At the end of June 2020 the Group's 30 day liquidity coverage ratio (LCR) was 221%, well above the minimum level of 100%.

The Bank's Annual General Meeting ("AGM") was held on 26 March 2020. It approved the motion of the Board of Directors ("BOD") to the AGM that no dividend be paid for the operating year 2019. The AGM also approved a motion from the BOD to reduce the Bank's share capital by 50,000,000 shares by cancelling the Bank's own shares. The share capital reduction was registered by the Company Registry on 1 April 2020. Further, the AGM approved a motion from the BOD permitting the Bank to purchase up to 10% of own shares subject to regulatory approvals. This authorisation applies until the next annual general meeting in 2021.

Expansion of asset management operations in the UK

KKV Investment Management Ltd. ("KKV"), a subsidiary of Kvika Securities Ltd., is an alternative credit investment manager focusing on collateralised, non-correlated, income-producing investments. During the second quarter of 2020, KKV began providing investment management services to KKV Secured Loan Fund and the Secured Income Fund. The funds have net assets of GBP 394 million, equivalent to ca. ISK 67 billion and are listed on the London Stock Exchange.

Sale of shareholding in Korta hf.

During the second quarter of 2020, the sales process of Korta hf. was finalised. The buyer is the UK based fintech company Rapyd. Kvika sold all of its shareholding and all other shareholders of Korta were also parties to the agreement. Part of the payment is based on Korta's operations for 2020 year and the full price will, thus, not be known until early next year. The sales price is not expected to have an impact on the Group's earnings for the year.

Risk management

The objective of risk management is to promote a good and efficient culture of risk awareness within the Group and to increase the understanding of employees and management on the Group's risk taking, in addition to an assessment process related to risk and capital position. An emphasis is placed on being up to speed on the latest developments and adoption of rules related to risk management, such as regarding capital- and liquidity management. The Group is faced with various kinds of risk that relate to its operations as a financial institution and arise from its day-to-day operations. An active risk management entails analysing risk, measuring it and taking actions to limit it, as well as monitoring risk factors. The Group's risk management, and its main operations, are described in the notes accompanying the Consolidated Financial Statements. Refer to notes 37-50 on analysis of exposure to various types of risk.

Endorsement and Statement by the Board of Directors and the CEO

Statement by the Board of Directors and the CEO

To the best of our knowledge the Condensed Interim Consolidated Financial Statements of Kvika banki hf. for the period 1 January to 30 June 2020 comply with IAS 34 Interim Financial Reporting as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and give a true and fair view of the Group's assets, liabilities and financial position as at 30 June 2020 and the financial performance of the Group and changes of cash flows for the period 1 January to 30 June 2020.

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

The Board of Directors and the CEO of the Bank have today discussed the Condensed Interim Consolidated Financial Statements for the period 1 January to 30 June 2020, and confirm them by the means of their signatures.

Reykjavík, 20 August 2020.

Board of Directors

CEO

Sigríður Hammars

María Óra Þórs

Luca B. Holt

Þrinn Sveinsdóttir

Þórunn

Guðgeir Þegniss

Review Report on Interim Financial Information

To the Board of Directors and Shareholders of Kvika banki hf.

We have reviewed the accompanying Condensed Consolidated Interim Statement of financial position of Kvika banki hf. and its subsidiaries (the "Bank") as of 30 June 2020 and the related Condensed Consolidated Interim Income Statement, Condensed Consolidated Interim Statement of Comprehensive Income, Condensed Consolidated Interim Statement of changes in equity and Condensed Consolidated Interim Statement of cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes.

Management's and the Board of directors Responsibility for the Financial Statements

The board of directors and management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Auditor's Responsibility

Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements, ISRE 2410. A review of interim financial information 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 interim financial information does not give a true and fair view of the financial position of the Bank as at 30 June 2020, and of its financial performance and its cash flows for the six-month period then ended in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Confirmation of Endorsement and Statement by the Board of Directors and the CEO

Pursuant to the requirements of Paragraph 2 Article 104 of the Icelandic Act on Financial Statements No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the CEO includes all information required by the Icelandic Act on Financial Statements that is not disclosed elsewhere in the Condensed Consolidated Interim Financial Statements.

Kópavogur, 20 August 2020.

Deloitte ehf.



Pálína Árnadóttir
State Authorized Public Accountant



Guðmundur Ingólfsson
State Authorized Public Accountant

Condensed Interim Consolidated Income Statement

For the period 1 January 2020 to 30 June 2020

	Notes	6m 2020	6m 2019
Interest income		2,043,273	2,552,261
Interest expense		(1,175,522)	(1,706,552)
Net interest income	4	867,751	845,709
Fee and commission income		3,103,838	2,993,444
Fee and commission expense		(90,194)	(81,218)
Net fee and commission income	5	3,013,644	2,912,226
Net financial income	6	221,963	374,472
Share in loss of associates, net of income tax	22	(11,308)	(27,410)
Other operating income		55,276	60,435
Other operating income		265,931	407,498
Net operating income		4,147,327	4,165,433
Administrative expenses	8	(2,670,663)	(2,657,834)
Net impairment	10	(208,790)	22,143
Revaluation of contingent consideration		(251,520)	60,093
Profit before taxes		1,016,354	1,589,835
Income tax	11	(37,359)	(51,727)
Special tax on financial activity	12	(24,588)	0
Special tax on financial institutions	13	(30,383)	(83,400)
Profit for the period		924,025	1,454,708

	Notes	6m 2020	6m 2019
Attributable to the shareholders of Kvika banki hf.		942,569	1,456,665
Attributable to non-controlling interest	21	(18,545)	(1,957)
Profit for the period		924,025	1,454,708
Earnings per share	14		
Basic earnings per share (ISK per share)		0.47	0.79
Diluted earnings per share (ISK per share)		0.44	0.68

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Comprehensive Income

For the period 1 January 2020 to 30 June 2020

	Notes	6m 2020	6m 2019
Profit for the period		924,025	1,454,708
Translation of foreign operations			
Exchange difference on translation of foreign operations		24,265	13,733
Items that may be reclassified subsequently to profit and loss, net of tax		24,265	13,733
Total comprehensive income for the period		948,290	1,468,441
	Notes	6m 2020	6m 2019
Attributable to the shareholders of Kvika banki hf.		966,834	1,470,398
Attributable to non-controlling interest		(18,545)	(1,957)
Total comprehensive income for the period		948,290	1,468,441

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Financial Position

As at 30 June 2020

Assets	Notes	30.6.2020	31.12.2019
Cash and balances with Central Bank	15	26,920,830	26,818,231
Fixed income securities	16	25,222,983	8,097,169
Shares and other variable income securities	17	4,008,499	3,659,208
Securities used for hedging	18	11,234,860	24,274,769
Loans to customers	19	30,348,828	30,105,643
Derivatives	20	628,734	1,259,833
Investment in associates	22	42,331	776,490
Investment properties	23	1,016,905	1,016,553
Intangible assets	24	3,373,752	3,283,256
Property and equipment		600,727	596,336
Deferred tax assets		779,959	872,972
Other assets	25	8,891,478	4,823,577
Total assets		113,069,886	105,584,035
Liabilities			
Deposits from customers	26	61,367,640	51,479,732
Borrowings	27	18,647,770	22,058,747
Issued bills	28	1,983,418	3,945,306
Issued bonds	29	3,607,395	4,261,308
Subordinated liabilities	30	2,029,295	1,999,530
Short positions held for trading	31	910,544	1,239,916
Short positions used for hedging	32	435,076	0
Derivatives	20	626,285	1,282,341
Current tax liabilities		81	136,395
Deferred tax liabilities		210,215	268,613
Other liabilities	33	6,584,455	3,396,965
Total liabilities		96,402,173	90,068,852
Equity			
Share capital	34	1,971,049	1,945,366
Share premium		3,264,964	3,115,992
Option reserve		9,378	7,687
Warrants reserve	35	198,650	206,501
Deficit reduction reserve		3,103,697	3,103,697
Other reserves		29,851	5,586
Restricted retained earnings		1,487,169	778,191
Retained earnings		6,525,781	6,292,189
Total equity attributable to the shareholders of Kvika banki hf.		16,590,539	15,455,209
Non-controlling interest		77,174	59,974
Total equity		16,667,713	15,515,183
Total liabilities and equity		113,069,886	105,584,035

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Changes in Equity

For the period 1 January 2020 to 30 June 2020

	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
1 January 2020 to 30 June 2020												
Equity as at 1 January 2020		1,945,366	3,115,992	7,687	206,501	3,103,697	5,586	778,191	6,292,189	15,455,209	59,974	15,515,183
Profit for the period									942,569	942,569	(18,545)	924,025
Translation of foreign operations												
Exchange difference on translation of foreign operations							24,265			24,265		24,265
Total comprehensive income for the period		0	0	0	0	0	24,265	0	942,569	966,834	(18,545)	948,290
Restricted retained earnings								708,977	(708,977)	0		0
Transactions with owners of the Bank												
Capital increase		25,683	141,121							166,805	35,744	202,549
Stock options				1,691						1,691		1,691
Warrants exercised			7,851		(7,851)					0		0
Equity as at 30 June 2020		1,971,049	3,264,964	9,378	198,650	3,103,697	29,851	1,487,169	6,525,781	16,590,539	77,174	16,667,713

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements

Condensed Interim Consolidated Statement of Changes in Equity

For the period 1 January 2019 to 30 June 2019

	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
1 January 2019 to 30 June 2019												
Equity as at 1 January 2019		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,376,900	12,908,455	61,544	12,969,999
Impact of adopting IFRS 16									(32,637)	(32,637)		(32,637)
Restated opening balance under IFRS 16		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,344,263	12,875,818	61,544	12,937,362
Profit for the period									1,456,665	1,456,665	(1,957)	1,454,708
Translation of foreign operations												
Exchange difference on translation of foreign operations							13,733			13,733		13,733
Total comprehensive income for the period		0	0	0	0	0	13,733	0	1,456,665	1,470,398	(1,957)	1,468,441
Restricted retained earnings								85,529	(85,529)	0		0
Transactions with owners of the Bank												
Dividend paid to shareholders									(442,799)	(442,799)		(442,799)
Stock options				1,681						1,681		1,681
Warrants sold					33,040					33,040		33,040
Equity as at 30 June 2019		1,844,996	2,881,165	5,978	235,567	3,103,697	1,710	592,424	5,272,600	13,938,138	59,587	13,997,726

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements

Condensed Interim Consolidated Statement of Cash Flows

For the period 1 January 2020 to 30 June 2020

	Notes	6m 2020	6m 2019
Cash flows from operating activities			
Profit for the period		924,025	1,454,708
Adjustments for:			
Indexation and exchange rate difference		(1,373,845)	648,415
Share in (profit) loss of associates, net of income tax	22	11,308	27,410
Depreciation and amortisation		141,815	63,603
Net interest income	4	(867,751)	(845,709)
Net impairment		208,790	(22,143)
Income tax		37,359	135,127
Other adjustments		61,700	(58,028)
		(856,600)	1,403,383
Changes in:			
Fixed income securities		(17,125,815)	56,058
Shares and other variable income securities		(349,291)	(51,030)
Securities used for hedging		13,039,909	(8,038,314)
Loans to customers		(45,000)	1,011,082
Derivatives - assets		631,099	1,132
Deferred tax assets and tax liabilities		0	(113,544)
Other assets		(3,873,079)	(5,819,431)
Deposits from customers		9,670,391	9,620,158
Short positions		105,704	766,793
Derivatives - liabilities		(656,057)	889,107
Other liabilities		3,132,845	5,134,214
		4,530,706	3,456,224
Interest received		1,856,701	2,436,732
Interest paid		(929,674)	(1,183,479)
Net cash from operating activities		4,601,134	6,112,860
Cash flows from investing activities			
Acquisition of intangible assets	24	(113,048)	(101,227)
Acquisition of property and equipment		(55,152)	(54,951)
Proceeds from the sale of property and equipment		21,647	0
Dividend from associates		3,750	3,750
Acquisition of subsidiary, net of cash		0	(892,174)
Net sale (investment) in associates		364,426	19,227
Lease receivable payments		13,910	0
Net cash from (to) investing activities		235,533	(1,025,375)
Cash flows from financing activities			
Borrowings		(4,064,889)	5,128,787
Issued bills		(1,961,887)	354,947
Increase in share capital		166,805	0
Increase (decrease) in warrants		0	33,040
Dividend paid to shareholders		0	(442,799)
Lease payments		(102,190)	0
Net cash (to) from financing activities		(5,962,162)	5,073,975
Net increase in cash and balances with Central Bank		(1,125,495)	10,161,460
Cash and balances with Central Bank at the beginning of the year	15	26,818,231	21,339,185
Change in cash and cash equivalents due to acquisition of subsidiary		0	8,016
Effects of exchange rate fluctuations on cash and balances with Central Bank		1,228,094	(724,442)
Cash and balances with Central Bank at the end of the period	15	26,920,830	30,784,218
Investing and financing activities not affecting cash flows due to a acquisitions, refer to note 5			
Assets and liabilities acquired from GAMMA Capital Management hf.		0	1,090,717

The notes on pages 11 to 41 are an integral part of these Condensed Interim Consolidated Financial Statements.

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Notes to the Condensed Interim Consolidated Financial Statements

General information

1. Reporting entity

Kvika banki hf. ("Kvika" or the "Bank") is a limited liability company incorporated and domiciled in Iceland, with its registered office at Katrínartún 2, Reykjavík. The Bank operates as a bank based on Act No. 161/2002, on Financial Undertakings, and is supervised by the Financial Supervisory Authority of Iceland.

The Condensed Interim Consolidated Financial Statements for the period ended 30 June 2020 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). Kvika is a specialized bank focusing on asset management and investment services. The Bank operates four business segments, Asset Management, Corporate Finance, Corporate Banking and Capital Markets. Kvika provides businesses, investors and individuals with comprehensive investment banking and asset management services as well as selected banking services.

The Condensed Interim Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 20 August 2020.

2. Basis of preparation

a. Statement of compliance

The Condensed Interim Consolidated Financial Statements have been prepared in accordance with International Accounting Standard IAS 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Icelandic Financial Statement Act.

b. Basis of measurement

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

- fixed income securities are measured at fair value;
- shares and other variable income securities are measured at fair value;
- securities used for hedging are measured at fair value;
- loans to customers which are measured at fair value;
- derivatives are measured at fair value;
- investment properties are measured at fair value;
- certain receivables are measured at fair value;
- contingent consideration is measured at fair value; and
- short positions are measured at fair value.

c. Functional and presentation currency

The Condensed Interim Consolidated Financial Statements are prepared in Icelandic Krona (ISK), which is the Bank's functional currency. All financial information has been rounded to the nearest thousand, unless otherwise stated.

The Group's assets and liabilities which are denominated in other currency than ISK are translated to ISK using the exchange rate as at the end of day 30 June 2020.

d. Going concern

The Bank's management has assessed the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue its operations.

e. Estimates and judgements

The preparation of interim financial statements in accordance with IFRSs 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.

The estimates and underlying assumptions are based on historical result and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources.

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period and future periods if the revision affects both current and future periods.

Information about areas of estimation uncertainty and critical judgements made by management in applying accounting policies that can have a significant effect on the amounts recognised in the Condensed Interim Consolidated Financial Statements, is provided in the Consolidated Financial Statements as at and for the year ended 31 December 2019.

f. Relevance and importance of notes to the reader

In order to enhance the informational value of the Financial Statements, the notes are evaluated based on relevance and importance for the reader. This can result in information, that has been evaluated as neither important or relevant for the reader, not being presented in the notes.

Notes to the Condensed Interim Consolidated Financial Statements

3. Significant accounting policies

The accounting policies applied in the Condensed Interim Consolidated Financial Statements are consistent with those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2019. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not effective.

Financial instruments measured at fair value through other comprehensive income

At 30 June 2020 the Bank reclassified certain fixed income securities as financial instruments measured at fair value through other comprehensive income ("FVOCI"). These securities are held by the Bank's treasury department. They are held within a business model whose objective is to collect contractual cash flows and selling financial assets. Their contractual cash flows are solely payments of principal and interest.

Impact of COVID-19 on the Financial Statements

Due to the considerable impact that the COVID-19 pandemic is having on the economy, the Bank has made changes to the macroeconomic outlook used for IFRS 9 provision calculations in accordance with the guidelines of the European supervisors and the Central Bank of Iceland. Economic scenarios, and the weights assigned to them, have been reviewed with respect to the expected impact of the COVID-19 pandemic and used in the assessment of expected credit loss ("ECL"). As a part of this review process, the weights assigned to the downside economic scenario have increased. The Bank continues to monitor developments closely and will adjust its provisions accordingly.

During the first half of 2020 there has been considerable volatility in the pricing of securities with variable income and fair value measurements for securities in certain sectors have decreased. For the Group, this has resulted in fair value losses on a part of its trading portfolio. The impact of the COVID-19 pandemic on the economy, and the uncertainty that it is causing for the near- to mid-term, also has an effect on how the Group estimates the value of some of its receivables, in particular long-term performance related fees. In some cases the book value of these has been reduced.

Notes to the Condensed Interim Consolidated Financial Statements

Income statement

4. Net interest income

Interest income is specified as follows:

	6m 2020	6m 2019
Cash and balances with Central Bank	306,662	403,691
Derivatives	405,883	776,872
Loans to customers	1,262,580	1,308,982
Other interest income	68,148	62,716
Total	2,043,273	2,552,261

Interest expense is specified as follows:

	6m 2020	6m 2019
Deposits from customers	486,549	806,562
Borrowings	424,800	549,024
Issued bills	55,365	93,906
Issued bonds	82,140	90,521
Subordinated liabilities	94,972	94,934
Derivatives	4,967	6,490
Other interest expense*	26,729	65,115
Total	1,175,522	1,706,552

* Thereof are lease liabilities' interest expense amounting to ISK 11 million (6m 2019: ISK 9 million)

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 1.546 million (6m 2019: ISK 1.692 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 1.170 million (6m 2019: ISK 1.700 million).

5. Net fee and commission income

Fee income and expenses are presented on a net fee basis, as presented in internal reporting to management for decision making purposes, and broken down by business segments. The business segments are representative of the nature and types of activity from which the Group generates fee income from. A description of each business segment is provided in note 53.

Net fee and commission income by business segment	6m 2020	6m 2019
Corporate Banking	269,222	366,332
Corporate Finance	166,770	183,374
Capital Markets	491,800	452,311
Proprietary trading and Treasury	84,473	59,578
Asset Management	2,010,329	1,926,005
Support functions and eliminations	(8,950)	(75,374)
Total	3,013,644	2,912,226

6. Net financial income

Net financial income is specified as follows:

	6m 2020	6m 2019
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss		
Fixed income securities	323,864	362
Shares and other variable income securities	(46,729)	402,430
Derivatives	743	(48,914)
Loans to customers	(28,710)	65,129
Foreign currency exchange difference	(27,205)	(44,535)
Total	221,963	374,472

7. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	6m 2020	6m 2019
Gain on financial instruments at fair value through profit and loss	612,253	325,719
Loss on other financial instruments	(639,458)	(370,254)
Total	(27,205)	(44,535)

Notes to the Condensed Interim Consolidated Financial Statements

8. Administrative expenses

Administrative expenses are specified as follows:	6m 2020	6m 2019
Salaries and related expenses	1,771,594	1,749,729
Other operating expenses	723,133	797,645
Depositors' and Investors' Guarantee Fund contributions	34,121	46,857
Depreciation and amortisation	51,314	45,932
Depreciation of right of use asset	90,501	17,671
Total	2,670,663	2,657,834

9. Salaries and related expenses

Salaries and related expenses are specified as follows:	6m 2020	6m 2019
Salaries	1,403,394	1,219,502
Performance based payments excluding share-based payments	3,726	145,103
Share-based payment expenses	1,691	1,681
Pension fund contributions	181,075	155,911
Tax on financial activity	79,940	93,289
Other salary related expenses	101,769	134,243
Total	1,771,594	1,749,729
Average number of full time employees during the period	134	125
Total number of full time employees at the end of the period	145	124

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2019: 5.50%).

10. Net impairment

	6m 2020	6m 2019
Net change in impairment of loans	135,571	(33,211)
Net change in impairment of other assets	55,442	7,371
Net change in impairment of loan commitments, guarantees and unused credit facilities	17,777	3,696
Total	208,790	(22,143)

11. Income tax

The Bank and most of its subsidiaries will not pay income tax on its profit for 2020 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2019, the tax loss carry forward of the Group amounted to ISK 7 billion. A substantial part of the tax loss carry forward is utilisable until end of year 2025. Management is of the opinion that the Group's operations in the years to come will result in taxable results which will be offset with the tax loss carry forward. The Group has therefore recognised a part of the tax loss carry forward as a deferred tax asset in the consolidated statement of financial position. The deferred tax asset is recognised only to the extent that it is probable to be utilisable against future taxable profits.

Income tax is recognised based on the tax rates and tax laws enacted during the current year, according to which the domestic corporate income tax rate was 20.0% (2019: 20.0%)

12. Special tax on financial activity

The special tax on financial activity is an additional income tax which becomes effective when the income tax base exceeds ISK 1,000 million. It is levied on the same entities as the tax on financial activity according to Act No. 90/2003. The tax rate is set at 6.0% (2019: 6.0%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

13. Special tax on financial institutions

According to Act No. 155/2010 on Special Tax on Financial Institutions, certain types of financial institutions, including banks, must pay annually a tax based on the carrying amount of their liabilities as determined for tax purposes in excess of ISK 50 billion at year-end. The tax rate is set at 0.145% (2019: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

14. Earnings per share

The calculation of basic earnings per share is based on earnings attributable to shareholders and a weighted average number of shares outstanding during the period. The diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Bank has issued warrants and stock options that have a dilutive effect.

	6m 2020	6m 2019
Net earnings attributable to equity holders of the Bank	942,569	1,456,665
Weighted average number of outstanding shares	1,984,757	1,844,996
Adjustments for warrants and stock options	163,723	287,495
Total	2,148,480	2,132,491
Basic earnings per share (ISK)	0.47	0.79
Diluted earnings per share (ISK)	0.44	0.68

Notes to the Condensed Interim Consolidated Financial Statements

Statement of Financial Position

15. Cash and balances with Central Bank

Cash and balances with Central Bank are specified as follows:

	30.6.2020	31.12.2019
Deposits with Central Bank	16,572,763	19,106,515
Cash on hand	19,205	6,845
Balances with banks	4,068,793	2,268,540
Foreign treasury bills	3,879,732	2,956,550
Included in cash and cash equivalents	24,540,494	24,338,450
Restricted balances with Central Bank - average maintenance level	0	853,192
Restricted balances with Central Bank - fixed reserve requirement	876,670	853,192
Receivables from Central Bank	1,503,666	773,398
Total	26,920,830	26,818,231

The Bank holds mandatory reserve deposit accounts with the Central Bank of Iceland in compliance with the Central Bank's 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 mandatory reserve deposit with the Central Bank and the receivables from the Central Bank are not available for the Group to use in its daily operations.

16. Fixed income securities

Fixed income securities are specified as follows:

	30.6.2020	31.12.2019
Mandatorily measured at fair value through profit or loss		
Listed government bonds and bonds with government guarantees	4,287,559	3,434,851
Listed bonds	2,266,771	3,700,392
Unlisted bonds	1,038,615	961,925
Measured at fair value through other comprehensive income		
Listed government bonds and bonds with government guarantees	15,145,945	0
Listed treasury bills	2,484,094	0
Total	25,222,983	8,097,169

17. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	30.6.2020	31.12.2019
Mandatorily measured at fair value through profit or loss		
Listed shares	875,274	1,271,325
Unlisted shares	2,077,091	1,694,493
Unlisted unit shares	1,056,133	693,390
Total	4,008,499	3,659,208

18. Securities used for hedging

Securities used for hedging are specified as follows:

	30.6.2020	31.12.2019
Listed government bonds and bonds with government guarantees	2,618,389	8,006,643
Listed bonds	1,886,258	2,366,621
Listed shares	6,628,753	13,822,091
Unlisted unit shares	101,460	79,414
Total	11,234,860	24,274,769

19. Loans to customers

The breakdown of the loan portfolio by individuals and corporates is specified as follows:

	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
30.6.2020						
Loans to customers at amortised cost	5,613,381	5,591,155	22,215,616	21,725,196	27,828,998	27,316,351
Loans to customers at fair value through profit or loss	0	0	3,032,476	3,032,476	3,032,476	3,032,476
Total	5,613,381	5,591,155	25,248,093	24,757,672	30,861,474	30,348,828
31.12.2019						
Loans to customers at amortised cost	4,790,146	4,780,053	23,365,514	22,978,928	28,155,660	27,758,981
Loans to customers at fair value through profit or loss	0	0	2,346,662	2,346,662	2,346,662	2,346,662
Total	4,790,146	4,780,053	25,712,176	25,325,590	30,502,322	30,105,643

Notes to the Condensed Interim Consolidated Financial Statements

20. Derivatives

Derivatives are specified as follows:

	Notional		Carrying value	
	Assets	Liabilities	Assets	Liabilities
30.6.2020				
Interest rate derivatives	2,306,726	2,100,991	205,734	0
Currency forwards	2,489,267	2,481,072	17,106	8,910
Bond and equity total return swaps	13,076,035	13,308,038	308,397	540,399
Equity options	318,862	3,860	97,497	76,975
Total	18,190,889	17,893,961	628,734	626,285
31.12.2019				
Interest rate derivatives	3,342,934	3,103,868	239,066	0
Currency forwards	1,963,733	1,938,785	29,636	4,688
Bond and equity total return swaps	27,091,699	27,396,373	727,855	1,033,599
Equity options	326,762	11,760	263,275	244,054
Total	32,725,127	32,450,786	1,259,833	1,282,341

21. Group entities

The main subsidiaries held directly or indirectly by the Group are listed in the table below.

Entity	Nature of operations	Domicile	Share	Share
			30.6.2020	31.12.2019
Fí Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	100%
GAMMA Capital Management hf.	Fund management	Iceland	100%	100%
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Netgíró reikningar ehf.	Holding company	Iceland	100%	100%
Netgíró lán ehf.	Holding company	Iceland	100%	100%
Netgíró lán II ehf.	Holding company	Iceland	100%	100%
Rafklettur ehf.	Holding company	Iceland	100%	100%
AC GP 3 ehf.	Fund management	Iceland	80%	80%
Kvika Securities Ltd.	Business consultancy services	UK	100%	100%

22. Investment in associates

a. Investment in associates is accounted for using the equity method and is specified as follows:

Entity	Nature of operations	Domicile	Share	Share
			30.6.2020	31.12.2019
Akta sjóðir hf.	Fund management	Iceland	19%	34%
Kjölfesta GP ehf.	Holding company	Iceland	50%	50%
KORTA hf.	Payment Institution	Iceland	-	41%
Gláma fjárfestingar slhf.	Holding company	Iceland	24%	24%

The Group does not consider its associates material, neither individually nor as a group. During the period 1 January to 30 June 2020, the Group sold all its shareholding in Korta hf. Furthermore, the Group sold a part of its shareholding in Akta sjóðir hf., resulting in it no longer being classified as an investment in associates.

b. Changes in investments in associates are specified as follows:

	30.6.2020	31.12.2019
Balance at the beginning of the year	776,490	774,832
Acquisition of shares in associates	0	47,201
Dividend received	(3,750)	(7,500)
Disposal of shares in associates	(719,102)	(70,025)
Share in (loss) profit of associates, net of income tax	(11,308)	31,982
Total	42,331	776,490

23. Investment properties

Investment properties are specified as follows:

	30.6.2020	31.12.2019
Balance at year beginning	1,016,553	950,000
Additions	352	66,553
Total	1,016,905	1,016,553

In October 2017, the Group acquired investment properties through one of its subsidiaries, Rafklettur ehf. The intention is to either earn rental income or capital appreciation or both. The book value of investment properties is based on the most recent appraisal values by licensed real estate agents, current listing prices and/or recent transactions for comparable real estates or valuation models based on gross income multipliers. The Group received rental income for the first six months amounting to ISK 38 million (6m 2019: ISK 35 million) and incurred direct operating expenses of ISK 8 million (6m 2019 :ISK 22 million).

Notes to the Condensed Interim Consolidated Financial Statements

24. Intangible assets

a. Intangible assets are specified as follows:

30.6.2020	Goodwill	Software	Other	Total
Balance as at 1 January 2020	2,943,881	175,256	164,118	3,283,256
Acquisitions	0	59,911	53,137	113,048
Amortisation	0	(12,237)	(10,315)	(22,552)
Balance as at 30 June 2020	2,943,881	222,930	206,940	3,373,752
Gross carrying amount	2,943,881	287,716	269,740	3,501,337
Accumulated amortisation and impairment losses	0	(64,785)	(62,799)	(127,585)
Balance as at 30 June 2020	2,943,881	222,930	206,940	3,373,752
31.12.2019	Goodwill	Software	Other	Total
Balance as at 1 January 2019	2,244,521	118,428	16,332	2,379,281
Acquisitions	0	76,467	119,167	195,634
Additions through business combinations	699,360	0	46,586	745,946
Disposals	0	(3,244)	(3,301)	(6,545)
Amortisation	0	(16,396)	(14,664)	(31,060)
Balance as at 31 December 2019	2,943,881	175,256	164,118	3,283,256
Gross carrying amount	2,943,881	227,805	216,603	3,388,289
Accumulated amortisation and impairment losses	0	(52,549)	(52,484)	(105,033)
Balance as at 31 December 2019	2,943,881	175,256	164,118	3,283,256

Notes to the Condensed Interim Consolidated Financial Statements

25. Other assets

Other assets are specified as follows:

	30.6.2020	31.12.2019
Unsettled transactions	3,918,291	162,007
Accounts receivable	3,618,563	3,193,923
Right of use asset and lease receivables	525,820	622,415
Sundry assets	828,805	845,232
Total	8,891,478	4,823,577

Right of use asset and lease receivables are specified as follows:

	30.6.2020	31.12.2019
Balance of IFRS 16 leases at the beginning of the year	622,415	353,811
Additions	0	541,118
Disposal	0	(189,692)
Indexation	9,123	3,254
Depreciation and lease receivable installment	(105,719)	(86,076)
Total	525,820	622,415

Right of use assets and lease receivables mostly consist of real estates for the Group's own use, primarily the Bank's headquarters. The Bank has entered into sublease contracts for the parts of the real estates which it does not use for its operations.

26. Deposits from customers

Deposits from customers are specified as follows:

	30.6.2020	31.12.2019
Demand deposits	48,611,559	37,487,799
Time deposits	12,756,080	13,991,933
Total	61,367,640	51,479,732

27. Borrowings

Borrowings are specified as follows:

	30.6.2020	31.12.2019
Loans from credit institutions	1,014,855	803,052
Money market deposits	17,632,916	21,255,695
Total	18,647,770	22,058,747

Money market deposits typically have a principal of ISK 5-500 million and maturity between 1 day and 6 months and pay fixed interest rates.

The Bank has not had any defaults of principal, interest or other breaches with respect to its debt issued and other borrowed funds.

28. Issued bills

Issued bills are specified as follows:

	30.6.2020	31.12.2019
Issued bills	1,983,418	3,945,306
Total	1,983,418	3,945,306

29. Issued bonds

Issued bonds are specified as follows:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	30.6.2020	31.12.2019
KVB 19 01, ISK 1,520 million	2019	2024	Amortizing	Floating, 1 month REIBOR + 1.50%	1,369,165	1,522,432
KVB 17 02, ISK 2,160 million	2017	2020	At maturity	Floating, 1 month REIBOR + 1.25%	1,885,997	1,881,675
Total					3,255,162	3,404,107
Unlisted senior unsecured bonds, total					352,233	857,201
Total					3,607,395	4,261,308

Unlisted senior unsecured bonds are composed of KVB 18 03 and KVB 18 04 which were issued in 2018 and mature in 2021. For further information on the bonds, refer to the issue descriptions which are available on Nasdaq CSD Iceland's website.

Notes to the Condensed Interim Consolidated Financial Statements

30. Subordinated liabilities

a. Subordinated liabilities:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	30.6.2020	31.12.2019
KVB 15 01, ISK 1,000 million	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,170,443	1,122,360
KVB 18 02, ISK 800 million	2018	2028	At maturity	CPI-Indexed, fixed 7.50%	858,851	877,170
Total					2,029,295	1,999,530

At the interest payment date in August 2020 for KVB 15 01, the annual interest rate increases from 5.50% p.a. to 7.50% p.a. At the same date, the Group has the right to repay the subordinated bond and on any subsequent interest payment dates until maturity.

At the interest payment date in the year 2023 for KVB 18 02, the Group has the right to repay the subordinated bond and on any subsequent interest payment dates until maturity.

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within Tier 2 and are a part of the equity base. The amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity or up to 20% a year. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

b. Subordinated liabilities are specified as follows:

	30.6.2020	31.12.2019
Balance at the beginning of the year	1,999,530	1,947,511
Paid interest	(60,000)	(115,000)
Paid interests due to indexation	(3,144)	(7,000)
Accrued interests and indexation	92,909	174,019
Total	2,029,295	1,999,530

31. Short positions held for trading

Short positions held for trading are specified as follows:

	30.6.2020	31.12.2019
Listed government bonds and bonds with government guarantees	71,321	632,124
Listed bonds	839,223	607,792
Total	910,544	1,239,916

32. Short positions used for hedging

Short positions used for hedging are specified as follows:

	30.6.2020	31.12.2019
Listed government bonds and bonds with government guarantees	435,076	0
Total	435,076	0

Short positions used for hedging are classified as mandatorily measured at fair value through profit or loss. Short positions used for hedging were classified 2017 as held for trading. Further discussion about the accounting classification of financial liabilities is provided in notes 51-0.

33. Other liabilities

Other liabilities are specified as follows:

	30.6.2020	31.12.2019
Unsettled transactions	3,726,991	487,683
Expected credit loss allowance for loan commitments, guarantees and unused credit facilities	38,744	21,092
Accounts payable and accrued expenses	336,590	401,230
Special taxes on financial institutions and financial activities	190,766	202,307
Withholding taxes	278,858	459,251
Salaries and salary related expenses	571,841	541,401
Lease liability	523,455	616,521
Contingent consideration	575,227	494,991
Other liabilities	341,983	172,489
Total	6,584,455	3,396,965

Notes to the Condensed Interim Consolidated Financial Statements

33. Other liabilities (cont.)

Lease liability is specified as follows:

	30.6.2020	31.12.2019
Balance of IFRS 16 leases at the beginning of the year	616,521	386,455
Addition	0	541,118
Disposal	0	(217,535)
Installment	(102,190)	(98,493)
Indexation	9,123	4,976
Total	523,455	616,521

34. Share capital

a. Share capital

The nominal value of shares issued by the Bank is ISK 1 per share. All currently issued shares have a nominal value of ISK 1 per share, and are fully paid. The holders of shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per nominal value of ISK 1 at shareholders' meetings. Reference is made to the Bank's Articles of Association for more information about the share capital.

	30.6.2020	31.12.2019
Share capital according to the Bank's Articles of Association	1,971,049	1,995,366
Nominal amount of treasury shares	0	50,000
Authorised but not issued shares	716,433	742,117

b. Changes made to the nominal amount of share capital

The Bank's share capital was increased by ISK 25,683,330 in nominal value during the period 1 January to 30 June 2020 in order to serve the exercising of issued warrants. Furthermore, the share capital was decreased by ISK 50,000,000 in nominal value by cancellation of own shares following a resolution passed by the Annual General Meeting.

c. Share capital increase authorisations

According to the Bank's Articles of Association dated 25 June 2020, the Board of Directors is authorised to increase the share capital of the Bank by up to ISK 100 million through subscription for new shares. This authorisation is based on temporary provision I to the Articles of Association and is valid until 15 March 2022.

The Board of Directors is furthermore authorised to increase the share capital of the Bank in stages by up to ISK 50,000,000 in nominal value, for the purposes of fulfilling share option agreements in accordance with the Bank's share incentive scheme. This authorisation is based on temporary provision I, cf. paragraph B of the provision, to the Articles of Association and is valid until 30 November 2021.

The Board of Directors is, according to temporary provision II to the Bank's Articles of Association, authorised to issue warrants for 54 million new shares until the Bank's annual general meeting in 2021. The Board is furthermore, until 26 March 2025, authorised to increase share capital to serve warrants issued under the aforementioned authorisation.

Temporary provision IV to the Articles of Association authorises the Board of Directors to issue warrants and increase the share capital accordingly. According to section A of temporary provision IV the Board of Directors is authorised to increase share capital by up to ISK 362 million to serve issued warrants. According to section B of temporary provision IV the Board of Directors is furthermore granted a conditioned authorisation to increase the share capital by an additional amount of ISK 200 million to serve issued warrants. The authorisation under section B of temporary provision IV is directly linked to the Board of Directors' authorisation under section A of temporary provision I.

The aforementioned authorisation under section B of temporary provision IV currently stands at ISK 150 million. However, should the Board of Directors utilise its authorisation according to section A of temporary provision I and increase the Bank's share capital by ISK 100 million, the authorisation under section B of temporary provision IV will increase from ISK 150 million to ISK 200 million, as stipulated in the provision. The Board of Directors' authorisation under temporary provision IV to increase share capital thus currently totals ISK 512 million but can increase to ISK 562 million by the usage by the Board of Directors of its authorisation pursuant to section A of temporary provision I. This authorisation is valid until 31 December 2022.

A copy of the Bank's Articles of Association, including the temporary provisions, is available on the Bank's website, www.kvika.is, reference is made to them for more information.

Notes to the Condensed Interim Consolidated Financial Statements

35. Warrants

The Bank has issued warrants for shares in the total nominal amount of ISK 557,933,352 as at 30 June 2020. The number of owners of these warrants is 116 and they purchased the warrants for a total consideration of ISK 198,649,938. The purchase price of the warrants was determined using market standard methodology and a valuation from an independent appraiser as applicable. Should the owners of the warrants exercise their warrants, the Bank is obliged to issue new shares and sell to the warrant owners at a predefined price, usually referred to as strike price. If all the warrants would be exercised, the Bank's share capital would increase to 2,528,982,448, and the newly issued shares would represent 22.1% of the Bank's total issued capital, post dilution.

Issue Date	Nominal amount	Purchase price of warrants	Annual increase of strike price	Strike price at expiry date	Exercise period
September 2017	87,100,019	26,217,106	7.5%	6.67	Sept. 2019 - Sept. 2020
September 2017	201,333,333	60,601,333	7.5%	7.74	Sept. 2020 - Sept. 2022
September 2017	201,333,333	60,601,333	7.5%	7.74	Sept. 2021 - Sept. 2022
December 2017	4,000,000	1,348,000	7.5%	7.59	Dec. 2019 - Dec. 2020
December 2017	7,333,333	2,471,333	7.5%	8.80	Dec. 2020 - Dec. 2022
December 2017	7,333,333	2,471,333	7.5%	8.80	Dec. 2021 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	9.27	Dec. 2019 - Dec. 2020
May 2018	1,166,667	505,167	7.5%	10.75	Dec. 2020 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	10.75	Dec. 2021 - Dec. 2022
April 2019	17,500,000	16,520,000	7.5%	15.36	Dec. 2020 - Dec. 2022
April 2019	17,500,000	16,520,000	7.5%	15.36	Dec. 2020 - Dec. 2022
August 2019	5,500,000	5,192,000	7.5%	15.36	Dec. 2020 - Dec. 2022
August 2019	5,500,000	5,192,000	7.5%	15.36	Dec. 2021 - Dec. 2022
Total	557,933,352	198,649,938			

36. Capital adequacy ratio (CAR)

Equity at the end of the period was ISK 16,668 million (31.12.2019: 15,515 million), equivalent to 14.7% of total assets according to the statement of financial position (31.12.2019: 14.7%). The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 26.2% (31.12.2019: 24.1%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Own funds	30.6.2020	31.12.2019
Total equity	16,667,713	15,515,183
Expected dividends according to Dividend Policy	(235,642)	0
Capital eligible as CET1 Capital	16,432,070	15,515,183
Goodwill and intangibles	(3,373,752)	(3,283,256)
Shares in financial institutions	(80,616)	(146,401)
Subordinated fixed income securities	(111,664)	(102,999)
Deferred tax asset	(779,959)	(872,972)
Common equity Tier 1 capital (CET 1)	12,086,079	11,109,555
Tier 2 capital	1,973,960	1,941,695
Total own funds	14,060,040	13,051,251
Risk weighted assets		
Credit risk	38,359,692	37,614,747
Market risk	3,902,677	5,246,577
Operational risk	11,336,890	11,336,890
Total Capital requirements	53,599,258	54,198,213
Capital ratios		
Capital adequacy ratio (CAR)	26.2%	24.1%
CET1 ratio	22.5%	20.5%
Total own funds excluding expected dividends	14,295,682	13,051,251
Capital adequacy ratio, excluding expected dividends	26.7%	24.1%
CET1 ratio, excluding expected dividends	23.0%	20.5%
Minimum Capital adequacy ratio requirement	15.1%	15.1%
Minimum Capital adequacy ratio requirement including supervisory buffers	20.6%	22.4%
Minimum CET 1 ratio requirement including supervisory buffers	14.0%	15.7%

The Icelandic Financial Supervisory Authority (FME) supervises the Bank on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the Bank as a whole. The Bank's regulatory capital calculations for credit risk and market risk are based on the standardised approach and the capital calculations for operational risk are based on the basic indicator approach.

Minimum capital requirement is based on the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and is reviewed by the FME through the Supervisory Review and Evaluation Process (SREP). The Bank's minimum regulatory capital requirement, based on the SREP from 2019, is 15.1%. The minimum regulatory capital requirement including the additional capital buffers is 20.6% as at 30 June 2020.

Notes to the Condensed Interim Consolidated Financial Statements

Risk management

37. Maximum exposure to credit risk

The maximum exposure to credit risk for on-balance sheet and off-balance sheet items, before taking into account any collateral held or other credit enhancements, is specified as follows:

	Public entities	Financial institutions	Corporate customers	Individuals	
30.6.2020					30.6.2020
On-balance sheet exposure					
Cash and balances with Central Bank	22,852,037	4,068,793			26,920,830
Fixed income securities	22,604,685	2,411,617	206,681		25,222,983
Loans to customers		312,535	24,445,137	5,591,155	30,348,828
Derivatives		290,575	316,103	22,056	628,734
Other assets	117,793	540,818	7,707,047		8,365,658
	45,574,516	7,624,338	32,674,968	5,613,211	91,487,033
Off-balance sheet exposure					
Loan commitments		37,807	1,407,084	652,841	2,097,732
Financial guarantee contracts			606,211		606,211
Maximum exposure to credit risk	45,574,516	7,662,145	34,688,263	6,266,052	94,190,976
31.12.2019					31.12.2019
On-balance sheet exposure					
Cash and balances with Central Bank	24,549,691	2,268,540			26,818,231
Fixed income securities	4,306,557	2,782,322	1,008,289		8,097,169
Loans to customers		258,556	25,072,034	4,775,053	30,105,643
Derivatives		404,345	811,802	43,686	1,259,833
Other assets	67,451	230,117	3,903,594		4,201,162
	28,923,699	5,943,881	30,795,719	4,818,739	70,482,037
Off-balance sheet exposure					
Loan commitments		2,073,113	1,258,009	336,493	3,667,615
Financial guarantee contracts		197,415	642,515		839,930
Maximum exposure to credit risk	28,923,699	8,214,408	32,696,243	5,155,232	74,989,582

38. Credit quality of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses ("ECL") in the statement of financial position. The ECL are recalculated for each asset on at least a quarterly basis. The assessment of ECL is based upon calculations being derived from models on PD, LGD and EAD. Furthermore, the assessment is based upon management's assumptions regarding the development of macroeconomic factors over the next three years. The assumptions for macroeconomic development are decided for three scenarios: a base case, an upside case and a downside case, including a probability weight for each scenario. The assumptions are used for calculations of the probability weighted ECLs. The amount of ECL to be recognized is dependent on the Bank's definition of significant increase in credit risk, which controls the impairment stage each asset is allocated to. The factors that are used to measure significant increase in credit risk include comparison of changes in PD values, annualized lifetime PD values, days past due and watch list.

a. Credit quality of financial assets by credit quality band

The following tables show financial assets subject to the impairment requirements of IFRS 9 broken down by credit quality bands where band i denotes the lowest and iv the highest credit risk. Assets serviced by debtors already recognised as being in default by the rating agency are shown outside credit quality bands. Assets measured at fair value through profit or loss are not subject to the impairment requirements of IFRS 9 but are nevertheless included in the tables in order to give a more complete picture of the credit quality of loans to customers and reconcile the tables to the carrying amount on the balance sheet. Exposures which are non-rated relate to Legal Entities not rated by rating agency or Individuals where individual rating has not been obtained. Probability of default for these exposures is based on average probability for similar exposures and is furthermore individually assessed by credit specialists.

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

30.6.2020

<i>Loans to customers:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	17,535,384	395,159	802	1,281,292	19,212,637
Credit quality band II	2,055,589	389,198	27,215	107,587	2,579,589
Credit quality band III	790,286	608,882	17,152	799,074	2,215,395
Credit quality band IV	1,123,323	1,218,797	54,598		2,396,718
In default		0	576,194	844,524	1,420,718
Non-rated	2,210,002	826,414			3,036,417
Gross carrying amount	23,714,584	3,438,451	675,962	3,032,476	30,861,474
Expected credit loss	(229,509)	(123,045)	(160,092)		(512,646)
Book value	23,485,074	3,315,407	515,871	3,032,476	30,348,828
<i>Loan commitments, guarantees and unused credit facilities:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	1,900,193	1,896		1,287	1,903,376
Credit quality band II	100,187	132,196			232,383
Credit quality band III	24,231	39,229			63,460
Credit quality band IV	41,400	35,743			77,143
In default			20,057	28,577	48,634
Non-rated	219,211	159,736			378,947
Total off-balance sheet amount	2,285,222	368,799	20,057	29,864	2,703,943
Expected credit loss	(13,010)	(19,834)	(5,900)		(38,744)
Net off-balance sheet amount	2,272,212	348,965	14,157	29,864	2,665,199

31.12.2019

<i>Loans to customers:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	16,746,578	542,505	17,566	890,560	18,197,209
Credit quality band II	2,517,738	2			2,517,740
Credit quality band III	1,105,650	1,370,939		812,293	3,288,882
Credit quality band IV	1,793,786	1,137,340		643,809	3,574,935
In default	35,037	0	297,331		332,369
Non-rated	2,591,158	29			2,591,186
Gross carrying amount	24,789,948	3,050,814	314,898	2,346,662	30,502,322
Expected credit loss	(167,078)	(100,185)	(129,416)		(396,679)
Book value	24,622,870	2,950,629	185,482	2,346,662	30,105,643
<i>Loan commitments, guarantees and unused credit facilities:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	2,140,892	6,283		11,215	2,158,389
Credit quality band II	484,628	0			484,628
Credit quality band III	38,059	176,503		149,929	364,491
Credit quality band IV	56,437	36,459			92,896
In default	100,000		9,739		109,739
Non-rated	1,297,403				1,297,403
Total off-balance sheet amount	4,117,418	219,245	9,739	161,143	4,507,545
Expected credit loss	(15,592)	(2,746)	(2,754)		(21,092)
Net off-balance sheet amount	4,101,826	216,499	6,985	161,143	4,486,453

b. Breakdown of loans to customers into not past due and past due

30.6.2020

	Claim value	Expected credit loss	Carrying amount
Not past due	28,456,557	(445,596)	28,010,962
Past due 1-30 days	1,676,402	(11,909)	1,664,493
Past due 31-60 days	140,833	(7,777)	133,056
Past due 61-90 days	291,604	(5,879)	285,725
Past due 91-180 days	48,682	(14,817)	33,865
Past due 181-360 days	246,930	(26,436)	220,494
Past due more than 360 days	467	(233)	233
Total	30,861,474	(512,646)	30,348,828

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

31.12.2019	Claim value	Expected credit loss	Carrying amount
Not past due	28,752,106	(297,606)	28,454,500
Past due 1-30 days	1,168,884	(2,705)	1,166,179
Past due 31-60 days	417,918	(95,485)	322,433
Past due 61-90 days	141,431	(543)	140,888
Past due 91-180 days	21,492	(95)	21,397
Past due 181-360 days	492	(246)	246
Past due more than 360 days			0
Total	30,502,322	(396,679)	30,105,643

c. Breakdown of loans to customers by industry

The breakdown of the loan portfolio by industries is specified as follows:

30.6.2020	Claim value	Expected credit loss	Carrying amount	%
Financial institutions	312,805	(270)	312,535	1.0%
Corporate				
Services	7,092,730	(185,009)	6,907,721	22.8%
Holding companies	7,565,138	(72,804)	7,492,334	24.7%
Real estate, construction and industry	8,645,166	(182,869)	8,462,297	27.9%
Retail	463,320	(18,198)	445,122	1.5%
Other	1,168,934	(31,271)	1,137,663	3.7%
Individual	5,613,381	(22,226)	5,591,155	18.4%
Total	30,861,474	(512,646)	30,348,828	100.0%

31.12.2019	Claim value	Expected credit loss	Carrying amount	%
Financial institutions	258,665	(108)	258,556	0.9%
Corporate				
Services	7,522,777	(106,675)	7,416,102	24.6%
Holding companies	7,656,488	(47,285)	7,609,203	25.3%
Real estate, construction and industry	9,281,142	(207,116)	9,074,027	30.1%
Retail	449,783	(11,325)	438,458	1.5%
Other	543,322	(9,077)	534,245	1.8%
Individual	4,790,146	(15,093)	4,775,053	15.9%
Total	30,502,322	(396,679)	30,105,643	100.0%

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

d. Allowance for expected credit loss on loans to customers and loan commitments, guarantees and unused credit facilities

The following tables show changes in the expected credit loss allowance of loans to customers and for loan commitments, guarantees and unused credit facilities during the period.

30.6.2020

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2019	182,670	102,932	132,170	417,771
Transfer to Stage 1 - (Initial recognition)	9,747	(7,993)	(1,755)	0
Transfer to Stage 2 - (significantly increased credit risk)	(16,966)	16,966		0
Transfer to Stage 3 - (credit impaired)	(365)	(6,909)	7,274	0
Net remeasurement of loss allowance	39,116	30,375	(52,351)	17,140
New financial assets, originated or purchased	73,722	12,907	93,732	180,361
Derecognitions and maturities	(45,405)	(5,398)	(13,078)	(63,882)
Write-offs				0
Balance as at 30 June 2020	242,520	142,879	165,992	551,391

Expected credit loss allowance for loans to customers

Transfers of financial assets:

Balance as at 31 December 2019	183,078	100,185	129,416	412,679
Transfer to Stage 1 - (Initial recognition)	9,033	(7,454)	(1,579)	0
Transfer to Stage 2 - (significantly increased credit risk)	(11,131)	11,131		0
Transfer to Stage 3 - (credit impaired)	(348)	(6,599)	6,947	0
Net remeasurement of loss allowance	22,428	20,382	(53,568)	(10,758)
New financial assets, originated or purchased	69,613	10,334	91,173	171,120
Derecognitions and maturities	(43,164)	(4,935)	(12,296)	(60,395)
Write-offs				0
Balance as at 30 June 2020	229,509	123,045	160,092	512,646

Expected credit loss allowance for loan commitments, guarantees and unused credit facilities

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2019	15,592	2,746	2,754	21,092
Transfer to Stage 1 - (Initial recognition)	715	(539)	(176)	0
Transfer to Stage 2 - (significantly increased credit risk)	(5,835)	5,835		0
Transfer to Stage 3 - (credit impaired)	(17)	(310)	327	0
Net remeasurement of loss allowance	688	9,992	1,217	11,898
New financial assets, originated or purchased	4,109	2,573	2,559	9,241
Derecognitions and maturities	(2,241)	(464)	(782)	(3,487)
Balance as at 30 June 2020	13,010	19,834	5,900	38,744

31.12.2019

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	176,146	28,614	33,657	238,416
Transfer to Stage 1 - (Initial recognition)	5,847	(438)	(5,410)	0
Transfer to Stage 2 - (significantly increased credit risk)	(22,672)	22,672		0
Transfer to Stage 3 - (credit impaired)	(2,701)	(19)	2,719	0
Net remeasurement of loss allowance	(13,866)	45,580	10,318	42,032
New financial assets, originated or purchased	127,749	26,700	113,056	267,505
Derecognitions and maturities	(86,640)	(20,178)	(19,922)	(126,739)
Write-offs	(1,194)		(2,249)	(3,443)
Balance as at 31 December 2019	182,670	102,932	132,170	417,771

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	160,684	27,930	32,363	220,977
Transfer to Stage 1 - (Initial recognition)	5,844	(434)	(5,410)	0
Transfer to Stage 2 - (significantly increased credit risk)	(22,404)	22,404		0
Transfer to Stage 3 - (credit impaired)	(2,677)	(19)	2,695	0
Net remeasurement of loss allowance	(13,575)	43,767	8,912	39,103
New financial assets, originated or purchased	120,333	26,468	112,592	259,393
Derecognitions and maturities	(79,932)	(19,931)	(19,488)	(119,351)
Write-offs	(1,194)		(2,249)	(3,443)
Balance as at 31 December 2019	167,078	100,185	129,416	396,679

Expected credit loss allowance for loan commitments, guarantees and unused credit facilities

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	15,462	683	1,293	17,439
Transfer to Stage 1 - (Initial recognition)	4	(4)		0
Transfer to Stage 2 - (significantly increased credit risk)	(268)	268		0
Transfer to Stage 3 - (credit impaired)	(24)		24	0
Net remeasurement of loss allowance	(290)	1,813	1,407	2,929
New financial assets, originated or purchased	7,417	232	464	8,113
Derecognitions and maturities	(6,708)	(246)	(434)	(7,388)
Write-offs				0
Balance as at 31 December 2019	15,592	2,746	2,754	21,092

Notes to the Condensed Interim Consolidated Financial Statements

39. Collateral and other credit enhancements

a. Valuation

The Group applies the same valuation methods to collateral held as other comparable assets held by the Group. The methods used for financial assets are outlined in note 52. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.6.2020
Financial institutions	188,611	9,818	807,261	743,219			1,748,910
Corporate customers	283,063	630,353	6,709,811	13,281,204		103,074	21,007,505
Individuals	49,397	12,397	811,799	2,173,574			3,047,168
Total	521,072	652,569	8,328,871	16,197,997	0	103,074	25,803,583

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2019
Financial institutions	382,137	15,159	773,001	887,268		193,049	2,250,614
Corporate customers	211,923	892,170	7,188,215	10,129,828	100,651	97,695	18,620,482
Individuals	26,351	10,033	724,757	937,911			1,699,052
Total	620,411	917,361	8,685,973	11,955,008	100,651	290,744	22,570,148

Amounts have been adjusted to exclude collateral in excess of claim value, i.e. overcollateralisation. Other collateral includes financial claims, inventories, receivables and letters of credit and guarantees.

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.6.2020
Financial institutions	411,033	328,613	577				740,222
Corporate customers	330,507	37,008	643,417				1,010,933
Individuals	69,256	12,112	7,121				88,488
Total	810,796	377,732	651,114	0	0	0	1,839,643

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2019
Financial institutions	776,901	469,180	709,118				1,955,199
Corporate customers	499,619	13,234	1,463,259				1,976,112
Individuals	81,341		72,169				153,510
Total	1,357,861	482,414	2,244,546	0	0	0	4,084,821

Amounts have been adjusted to exclude collateral in excess of claim value, i.e. overcollateralisation.

40. Loan-to-value

a. General

The loan-to-value ratio (LTV) is the ratio of the gross amount of the loan to the value of the collateral, if any. The general creditworthiness of a customer is viewed as the most reliable indicator of credit quality of a loan. Besides collateral included in the LTV ratios the Bank uses other risk mitigation measures, such as guarantees, negative pledge, cross-collateral and collateralization of non-quantifiable assets.

b. Breakdown

The breakdown of loans to customers by LTV is specified as follows:

	30.6.2020	%	31.12.2019	%
Less than 50%	12,033,721	39.7%	12,784,235	42.5%
51-70%	5,080,461	16.7%	4,655,736	15.5%
71-90%	6,966,419	23.0%	2,440,778	8.1%
91-100%	1,180,940	3.9%	673,622	2.2%
More than 100%	1,342,335	4.4%	4,895,571	16.3%
No collateral:				
Purchased short-term retail claims	2,281,261	7.5%	2,763,804	9.2%
Other loans with no collateral	1,463,691	4.8%	1,891,896	6.3%
Total	30,348,828	100.0%	30,105,643	100.0%

The Group has entered into an agreement to purchase short term consumer credit (the claims) from an originator. The purchase of claims are subject to conditions such as credit rating of the borrower and maximum maturity of 24 months. Further, the originator receives final payment of the purchased claim when the claim is fully repaid, until then a part of the purchase price is held as collateral against defaults.

Notes to the Condensed Interim Consolidated Financial Statements

41. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 625/2013 on financial institutions' large exposures, total exposure towards a customer is classified as a large exposure if it exceeds 10% of the Bank's capital base (see note 36).

According to the regulation a single exposure, net of risk adjusted mitigation, cannot exceed 25% of the capital base. Single large exposures net of risk adjusted mitigation take into account the effects of collateral held by the Bank, and other credit enhancements, in accordance with the Financial Supervisory Authority's regulation no. 625/2013.

	30.6.2020		31.12.2019	
	Number	Amount	Number	Amount
Large exposures before risk adjusted mitigation				
10-20% of capital base	3	4,536,422	7	10,931,359
20-25% of capital base	0	0	0	0
Exceeding 25% of capital base	1	3,868,609	0	0
Total	4	8,405,031	7	10,931,359
Thereof nostro accounts with foreign banks with a rating of investment grade or higher ..	1	1,667,188	0	0
Thereof foreign governments and central banks exposures	1	3,868,609	1	2,413,067
Large exposures net of risk adjusted mitigation	1	1,746,735	2	4,138,396

No single large exposure net of risk adjusted mitigation exceeds 25% of capital base in accordance with the Financial Supervisory Authority's regulation no. 625/2013.

42. Liquidity risk

a. Definition

Liquidity risk is the risk that the Group will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. This risk mainly arises from mismatches in the timing of cash flows. The Group has internal rules that require certain matching of the maturities of assets and liabilities. Furthermore, to ensure the ability to meet liquidity needs, the Group maintains a stock of highly liquid unencumbered assets, e.g. cash, treasury bills and treasury bonds.

b. Management

Liquidity is managed by treasury and monitored by risk management. Liquidity position is reported to the ALCO committee. The Central Bank of Iceland sets minimum requirements for the coverage ratio between cash flows of assets and liabilities (LCR) and stable funding in foreign currencies (NSFR). The minimum 30 day LCR regulatory requirement is 100%. The minimum regulatory requirement for foreign currencies NSFR is 100%.

The Group was in compliance with internal and external liquidity requirements throughout the years 2020 and 2019. At end of June 2020 the LCR was 221% and at year-end 2019 it was 246%.

Notes to the Condensed Interim Consolidated Financial Statements

42. Liquidity risk (cont.)

c. Maturity analysis of financial assets and financial liabilities

30.6.2020	Up to 1	1-3	3-12	1-5	Over 5	Gross	Carrying
Financial assets by type	month	months	months	years	years	inflow/ (outflow)	amount
<i>Non-derivative assets</i>							
Cash and balances with Central Bank	25,535,406	1,385,800				26,921,206	26,920,830
Fixed income securities *	7,389,517	1,108,832	2,063,438	14,661,196		25,222,983	25,222,983
Shares and other variable income securities	1,077,425		2,931,074			4,008,499	4,008,499
Securities used for hedging	9,269,923		837,230	1,127,708		11,234,860	11,234,860
Loans to customers	2,215,155	3,485,082	18,206,773	6,157,758	2,572,075	32,636,844	30,348,828
Other assets	5,316,766	821,874	578,512	2,174,326		8,891,478	8,891,478
	50,804,192	6,801,588	24,617,027	24,120,987	2,572,075	108,915,870	106,627,478
<i>Derivative assets</i>							
Inflow	6,378,751	437,575		39,398		6,855,723	
Outflow	(6,115,007)	(209,391)		(472)		(6,324,870)	
	263,744	228,184	0	38,926	0	530,853	628,734
Financial liabilities by type							
<i>Non-derivative liabilities</i>							
Deposits from customers	(49,712,943)	(6,864,717)	(3,126,605)	(1,745,955)	(79,481)	(61,529,702)	61,367,640
Borrowings	(5,617,519)	(5,840,110)	(7,304,439)			(18,762,068)	18,647,770
Issued bills				(2,000,000)		(2,000,000)	1,983,418
Issued bonds				(3,468,277)	(230,702)	(3,698,978)	3,607,395
Subordinated liabilities				(437,733)	(2,412,849)	(2,850,583)	2,029,295
Short positions held for trading	(910,544)					(910,544)	910,544
Short positions used for hedging	(435,076)					(435,076)	435,076
Other liabilities	(4,542,380)	(750,158)	(689,685)	(602,144)		(6,584,367)	6,584,455
	(61,218,462)	(13,454,986)	(11,120,728)	(8,254,110)	(2,723,032)	(96,771,318)	95,565,592
<i>Derivative liabilities</i>							
Inflow	6,314,699	390,409	388,500			7,093,607	
Outflow	(6,812,599)	(433,028)	(400,325)			(7,645,951)	
	(497,900)	(42,619)	(11,825)	0	0	(552,344)	626,285
Unrecognised financial items							
<i>Loan commitments</i>							
Inflow	318,950	158,673	914,123	747,704		2,139,449	
Outflow	(2,097,732)					(2,097,732)	
<i>Financial guarantee contracts</i>							
Inflow	1,373	120,929	274,245	138,707	70,957	606,211	
Outflow	(606,211)					(606,211)	
	(2,383,620)	279,602	1,188,368	886,411	70,957	41,718	
Summary							
Non-derivative assets	50,804,192	6,801,588	24,617,027	24,120,987	2,572,075	108,915,870	
Derivative assets	263,744	228,184		38,926		530,853	
Non-derivative liabilities	(61,218,462)	(13,454,986)	(11,120,728)	(8,254,110)	(2,723,032)	(96,771,318)	
Derivative liabilities	(497,900)	(42,619)	(11,825)			(552,344)	
Net assets (liabilities) excluding unrecognised items	(10,648,426)	(6,467,833)	13,484,474	15,905,804	(150,957)	12,123,062	
Net unrecognised items	(2,383,620)	279,602	1,188,368	886,411	70,957	41,718	
Net assets (liabilities)	(13,032,046)	(6,188,231)	14,672,842	16,792,215	(79,999)	12,164,780	

* As mentioned in note 3, the Bank has reclassified a part of its fixed income securities as financial instruments measured at fair value through other comprehensive income. The maturity analysis for those financial instruments is based on their contractual cash flows. This results in a considerable increase in the amounts in the categories for 3-12 months and 1-5 years from year end 2019. However, the vast majority of the amount, which falls into the 1-5 years category, will mature in August 2021.

Notes to the Condensed Interim Consolidated Financial Statements

42. Liquidity risk (cont.)

31.12.2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Financial assets by type							
<i>Non-derivative assets</i>							
Cash and balances with Central Bank	25,773,296	968,800				26,742,096	26,818,231
Fixed income securities	7,902,293	102,999	91,876			8,097,169	8,097,169
Shares and other variable income securities	1,528,914		2,130,294			3,659,208	3,659,208
Securities used for hedging	24,274,769					24,274,769	24,274,769
Loans to customers	3,066,655	6,490,086	14,211,455	6,443,200	984,383	31,195,778	30,105,643
Other assets	1,629,388	535,529	517,497	2,141,163		4,823,577	4,823,577
	64,175,315	8,097,414	16,951,122	8,584,364	984,383	98,792,597	97,778,596
<i>Derivative assets</i>							
Inflow	10,272,921		205,885	37,050		10,515,855	
Outflow	(9,515,478)		(2,658)	(1,210)		(9,519,347)	
	757,442	0	203,226	35,840	0	996,508	1,259,833
Financial liabilities by type							
<i>Non-derivative liabilities</i>							
Deposits from customers	(38,047,222)	(8,851,313)	(2,813,005)	(1,905,846)	(122,169)	(51,739,556)	51,479,732
Borrowings	(2,419,498)	(7,505,617)	(12,417,607)			(22,342,722)	22,058,747
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,945,306
Issued bonds	(40,079)	(636,625)	(2,209,392)	(1,671,961)		(4,558,057)	4,261,308
Subordinated liabilities			(123,396)	(493,584)	(2,250,952)	(2,867,933)	1,999,530
Short positions held for trading	(1,239,916)					(1,239,916)	1,239,916
Other liabilities	(955,774)	(917,995)	(973,396)	(549,800)		(3,396,965)	3,396,965
	(42,702,489)	(19,911,550)	(20,536,797)	(4,621,191)	(2,373,122)	(90,145,149)	88,381,503
<i>Derivative liabilities</i>							
Inflow	15,612,704		339,575			15,952,279	
Outflow	(16,645,233)		(349,300)			(16,994,533)	
	(1,032,529)	0	(9,725)	0	0	(1,042,254)	1,282,341
Unrecognised financial items by type							
<i>Loan commitments</i>							
Inflow	212,618	442,930	2,307,256	776,847		3,739,651	
Outflow	(3,667,615)					(3,667,615)	
<i>Financial guarantee contracts</i>							
Inflow	103,265	63,000	222,017	417,808	33,840	839,930	
Outflow	(839,930)					(839,930)	
	(4,191,662)	505,930	2,529,273	1,194,655	33,840	72,036	
Summary							
Non-derivative assets	64,175,315	8,097,414	16,951,122	8,584,364	984,383	98,792,597	
Derivative assets	757,442		203,226	35,840		996,508	
Non-derivative liabilities	(42,702,489)	(19,911,550)	(20,536,797)	(4,621,191)	(2,373,122)	(90,145,149)	
Derivative liabilities	(1,032,529)		(9,725)			(1,042,254)	
Net assets (liabilities) excluding unrecognised items	21,197,739	(11,814,136)	(3,392,173)	3,999,012	(1,388,739)	8,601,702	
Net unrecognised items	(4,191,662)	505,930	2,529,273	1,194,655	33,840	72,036	
Net assets (liabilities)	17,006,077	(11,308,207)	(862,901)	5,193,667	(1,354,899)	8,673,738	

Maturity analysis of financial assets and financial liabilities is based on contractual cash flows or, in the case of held for trading securities, expected cash flows. If an amount receivable or payable is not fixed, e.g. for inflation indexed assets and liabilities, the maturity analysis uses estimates based on current conditions.

Cash flows relating to unrecognised balance sheet items (unused loan commitments and financial guarantee contracts) are presented separately from financial assets and financial liabilities. Both contractual outflows and inflows are shown, to fully reflect the nature of these items.

It should be noted that the Group's expected cash flows sometimes vary considerably from the contractual cash flows, most significantly in that demand deposits from customers are expected to remain stable or increase in the long term. In this case the presentation used reflects the worst case scenario from the Group's perspective. Furthermore, the analysis does not consider any measures that could be taken to convert long-term assets to cash through sale.

Notes to the Condensed Interim Consolidated Financial Statements

43. Market risk

a. Definition

Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk. Notes 44-49 relate to market risk exposure.

b. Management

The Group has a strict policy on controlling market risk and to keep the exposure within set limits. The risk management unit monitors market risk limits on a daily basis and reports regularly to the ALCO committee and to the CEO.

44. Interest rate risk

a. Definition

The Group's exposure to interest rate risk is twofold. On the one hand, the Group has a proprietary portfolio of bonds, where market rates affect prices and any fluctuations are recognised in the income statement. On the other hand, the Group has mismatch in assets and liabilities with fixed interest terms. These include loans and swap contracts for securities on the asset side and borrowings and deposits on the liability side. This mismatch does not create an immediate effect on the income statement but nevertheless affects the Group's economic value.

Proprietary positions which are subject to interest rate risk fall under the scope of the Group's market risk management.

b. Management

The Group takes measures to minimise interest rate risk by matching the interest rate profile and duration of assets with the Group's liabilities as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Group's earnings.

45. Interest rate risk associated with trading portfolios

a. Breakdown

The breakdown of financial assets and liabilities in trading portfolios by the earlier of interest repricing time or maturity is specified as follows:

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	
						30.6.2020
Fixed income securities			955,451	3,691,020	1,886,403	6,532,874
Short positions - fixed income securities				(314,897)	(595,647)	(910,544)
Net imbalance	0	0	955,451	3,376,123	1,290,756	5,622,330
						31.12.2019
Fixed income securities		2,832,280	22,712	2,533,636	2,708,542	8,097,169
Short positions - fixed income securities				(1,137,103)	(102,813)	(1,239,916)
Net imbalance	0	2,832,280	22,712	1,396,533	2,605,729	6,857,253

b. Sensitivity analysis

The Group performs monthly sensitivity analysis on financial assets and liabilities in trading portfolios that are subject to interest rate risk. The sensitivity analysis assumes a shift in the yield curves for all currencies. A parallel shift in yield curves would have the following impact on the Group's pre-tax profit and equity, assuming all other risk factors remain constant:

	Shift in basis points	Downward	30.6.2020 Upward	Downward	31.12.2019 Upward
Indexed	50	110,934	(110,934)	117,650	(117,650)
Non-indexed	100	100,496	(100,496)	64,121	(64,121)
Total		211,430	(211,430)	181,771	(181,771)

Notes to the Condensed Interim Consolidated Financial Statements

46. Interest rate risk associated with non-trading portfolios

a. Breakdown

The breakdown of financial assets and liabilities in non-trading portfolios by the earlier of interest repricing time or maturity is specified as follows:

30.6.2020

Financial assets	Up to 1	1-3	3-12	1-5	Over 5	Total
	month	months	months	years	years	
Cash and balances with Central Bank	23,041,098	3,879,732				26,920,830
Fixed income securities		997,168	1,972,693	15,720,249		18,690,109
Loans to customers	24,234,056	1,084,421	3,079,196	752,689	1,198,465	30,348,828
Financial assets excluding derivatives	47,275,154	5,961,321	5,051,889	16,472,938	1,198,465	75,959,767
Effect of derivatives	12,608,799	2,173,961		600,000		15,382,761
Total	59,883,954	8,135,282	5,051,889	17,072,938	1,198,465	91,342,528
Financial liabilities	Up to 1	1-3	3-12	1-5	Over 5	Total
	month	months	months	years	years	
Deposits from customers	61,367,636					61,367,636
Borrowings	5,911,699	5,013,465	7,216,499	506,107		18,647,770
Issued bills			1,983,418			1,983,418
Issued bonds	33,183	66,317	2,121,848	1,386,047		3,607,395
Subordinated liabilities		1,170,050	61,082	798,163		2,029,295
Financial liabilities excluding derivatives	67,312,518	6,249,832	11,382,847	2,690,317	0	87,635,514
Effect of derivatives	2,100,991					2,100,991
Total	69,413,509	6,249,832	11,382,847	2,690,317	0	89,736,505
Total interest repricing gap	(9,529,556)	1,885,450	(6,330,958)	14,382,620	1,198,465	1,606,022

31.12.2019

Financial assets	Up to 1	1-3	3-12	1-5	Over 5	Total
	month	months	months	years	years	
Cash and balances with Central Bank	23,861,681	2,956,550				26,818,231
Loans to customers	23,951,507	1,148,549	3,010,619	647,975	1,346,993	30,105,643
Financial assets excluding derivatives	47,813,188	4,105,100	3,010,619	647,975	1,346,993	56,923,874
Effect of derivatives	27,334,633		2,500,000	600,000		30,434,633
Total	75,147,821	4,105,100	5,510,619	1,247,975	1,346,993	87,358,507
Financial liabilities	Up to 1	1-3	3-12	1-5	Over 5	Total
	month	months	months	years	years	
Deposits from customers	51,479,732					51,479,732
Borrowings	2,417,672	7,463,302	12,177,773			22,058,747
Issued bills		1,982,430	1,962,876			3,945,306
Issued bonds	39,974	633,194	2,124,611	1,463,529		4,261,308
Subordinated liabilities			1,184,146	815,383		1,999,530
Financial liabilities excluding derivatives	53,937,378	10,078,925	17,449,406	2,278,912	0	83,744,622
Effect of derivatives	3,104,224					3,104,224
Total	57,041,603	10,078,925	17,449,406	2,278,912	0	86,848,846
Total interest repricing gap	18,106,219	(5,973,826)	(11,938,788)	(1,030,938)	1,346,993	509,660

b. Sensitivity analysis

The Group performs monthly sensitivity analysis on financial assets and liabilities in non-trading portfolios subject to interest rate risk. The sensitivity analysis assumes a shift in the yield curves for all currencies. A parallel shift in yield curves would have the following impact on the Group's pre-tax profit and equity, assuming all other risk factors remain constant:

Currency	Shift in basis points	30.6.2020			31.12.2019	
		Downward	Upward	Downward	Upward	
ISK, indexed	50	3,628	(7,870)	26,255	(24,900)	
ISK, non-indexed	100	137,485	(126,627)	(85,240)	78,636	
Other currencies	20	(579)	(699)	(1,141)	175	
Total		140,534	(135,196)	(60,126)	53,912	

Notes to the Condensed Interim Consolidated Financial Statements

47. Exposure towards changes in the CPI

a. Definition

Exposure towards changes in CPI is the risk that fluctuations in the Icelandic Consumer Price Index (CPI) will affect the balance and cash flow of indexed financial instruments.

The Group is exposed to inflation indexation of assets and liabilities denominated in ISK. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in CPI are recognised in the income statement.

b. Management

The Group controls its indexation risk through derivatives contracts and sales and purchases of indexed bonds, mostly government bonds, and thus keeps its exposure to the CPI within the limits set by the ALCO committee.

c. Balance of CPI linked assets and liabilities

The net balance of CPI linked assets and liabilities is specified as follows:

	30.6.2020	31.12.2019
Assets	9,583,722	10,676,860
Liabilities	(8,276,898)	(7,620,546)
Total	1,306,824	3,056,314

d. Sensitivity to changes in CPI

Given the net balance of CPI linked assets and liabilities, a 1% change in the CPI would, with other things constant, result in the following changes to the Group's pre-tax profit.

	30.6.2020		31.12.2019	
	-1%	1%	-1%	1%
Government bonds	(10,401)	10,401	(11,095)	11,095
Other fixed income securities	(10,814)	10,814	(25,248)	25,248
Loans to customers	(53,622)	53,622	(39,425)	39,425
Derivatives	(21,000)	21,000	(31,000)	31,000
Short positions	9,863	(9,863)	3,737	(3,737)
Deposits	54,906	(54,906)	54,469	(54,469)
Subordinated debt	18,000	(18,000)	18,000	(18,000)
	(13,068)	13,068	(30,563)	30,563

The effect on equity would be the same.

48. Currency risk

a. Definition

Currency risk arises when financial instruments are not denominated in the functional currency of the respective Group entity and can affect both the Group's income statement and statement of financial position. A part of the Group's financial assets and liabilities is denominated in foreign currencies.

b. Management

Currency positions are monitored by risk management and reported to the ALCO committee. Any mismatch between assets and liabilities in each currency is monitored closely and managed within limits.

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 30 June 2020 and 31 December 2019 the Group's position in foreign currencies was within those limits.

c. Exchange rates

The following exchange rates have been used by the Group in the preparation of these financial statements:

	Closing 30.6.2020	Average 6m 2020	Closing 31.12.2019	Average 6m 2019
EUR/ISK	155.4	148.1	135.8	137.0
USD/ISK	138.6	134.4	121.1	121.3
GBP/ISK	170.2	169.3	159.4	156.9

Notes to the Condensed Interim Consolidated Financial Statements

48. Currency risk (cont.)

d. Breakdown of financial assets and financial liabilities denominated in foreign currencies

30.6.2020

Financial assets

	EUR	USD	GBP	SEK	Other currencies	Total
Cash and balances with Central Bank	2,158,366	4,275,395	272,393	206,500	967,466	7,880,119
Fixed income securities	0		205,219			205,219
Shares and other variable income securities	8,078	207,326	1,166,581	1		1,381,985
Securities used for hedging	207,181	52,884				260,066
Loans to customers	616,512	121,439	1,013,245	334,440		2,085,636
Other assets	830,489	1,741,487	360,926	31,080	12,699	2,976,681
Financial assets excluding derivatives	3,820,626	6,398,531	3,018,364	572,021	980,164	14,789,706
Derivatives	1,542,352	1,113,532	20,522		0	2,676,405
Total	5,362,978	7,512,062	3,038,886	572,021	980,164	17,466,111

Financial liabilities

	EUR	USD	GBP	SEK	Other currencies	Total
Deposits from customers	4,472,862	6,789,146	677,124	176,742	944,420	13,060,293
Borrowings	45,780					45,780
Issued bonds		352,233				352,233
Other liabilities	459,907	204,942	291,191	30,595	53,869	1,040,503
Financial liabilities excluding derivatives	4,978,549	7,346,321	968,315	207,337	998,288	14,498,810
Derivatives		76,975	1,787,205	296,000		2,160,180
Total	4,978,549	7,423,296	2,755,520	503,337	998,288	16,658,989

Net currency position

	EUR	USD	GBP	SEK	Other currencies	Total
Financial assets	5,362,978	7,512,062	3,038,886	572,021	980,164	17,466,111
Financial liabilities	(4,978,549)	(7,423,296)	(2,755,520)	(503,337)	(998,288)	(16,658,989)
Financial guarantee contracts	77,700					77,700
Total	462,129	88,767	283,366	68,684	(18,124)	884,822

31.12.2019

Financial assets

	EUR	USD	GBP	CAD	Other currencies	Total
Cash and balances with Central Bank	726,348	277,004	195,341	322,278	665,077	2,186,049
Fixed income securities	543,483	2,413,067				2,956,550
Shares and other variable income securities		181,624	1,020,161		1	1,201,786
Securities used for hedging	1,297,948					1,297,948
Loans to customers	444,945	106,074	863,985		16,616	1,431,619
Other assets	946,260	181,361	299,735		57,397	1,484,753
Financial assets excluding derivatives	3,958,984	3,159,129	2,379,222	322,278	739,091	10,558,704
Derivatives	1,319,461	888,608	19,221			2,227,290
Total	5,278,445	4,047,737	2,398,443	322,278	739,091	12,785,994

Financial liabilities

	EUR	USD	GBP	CAD	Other currencies	Total
Deposits from customers	3,526,958	3,459,182	690,839	294,344	670,179	8,641,502
Borrowings	40,079					40,079
Issued bonds		301,738				301,738
Other liabilities	1,498,474	136,045	42,103		1,264	1,677,887
Financial liabilities excluding derivatives	5,065,512	3,896,965	732,942	294,344	671,443	10,661,206
Derivatives	165,895	78,811	1,594,200			1,838,907
Total	5,231,407	3,975,777	2,327,142	294,344	671,443	12,500,113

Net currency position

	EUR	USD	GBP	CAD	Other currencies	Total
Financial assets	5,278,445	4,047,737	2,398,443	322,278	739,091	12,785,994
Financial liabilities	(5,231,407)	(3,975,777)	(2,327,142)	(294,344)	(671,443)	(12,500,113)
Financial guarantee contracts	67,915					67,915
Total	114,953	71,960	71,301	27,935	67,648	353,796

Notes to the Condensed Interim Consolidated Financial Statements

48. Currency risk (cont.)

e. Sensitivity to currency risk

Given the net currency position, a 10% change in the value of the ISK would, with other things constant, result in the following changes to the Group's pre-tax profit.

Assets and liabilities denominated in foreign currencies	30.6.2020		31.12.2019	
	-10%	+10%	-10%	+10%
EUR	46,213	(46,213)	11,495	(11,495)
USD	8,877	(8,877)	7,196	(7,196)
GBP	28,337	(28,337)	7,130	(7,130)
SEK	6,868	(6,868)	1,842	(1,842)
CAD	(3,061)	3,061	2,793	(2,793)
Other currencies	1,248	(1,248)	4,923	(4,923)
Total	88,482	(88,482)	35,380	(35,380)

The effect on equity would be the same.

49. Other price risk

Other price risk arises from changes in the market prices of shares and other variable income securities in the Group's portfolio. The Group directly holds listed and unlisted shares and other variable income securities, while also gaining exposure to listed shares through portfolio options trading. The table below shows the Group's net exposure, including delta-adjusted options exposure.

	30.6.2020			31.12.2019		
	Average	Max	Exposure	Average	Max	Exposure
Listed shares	1,105,316	1,486,961	875,274	927,255	1,352,589	1,271,325
Unlisted shares	2,358,354	2,454,804	2,077,091	1,657,393	1,863,076	1,694,493
Unlisted unit shares	807,194	1,198,469	1,056,133	773,771	998,994	693,390
Total			4,008,499			3,659,208

50. Operational risk

a. Definition

Operational risk is the risk of direct or indirect loss from inadequate or failed internal processes or systems, from human error or external events that affect the Group's reputation and operational earnings.

b. Management

The individual business units within the Group are primarily responsible for managing their respective operational risk. The risk management unit is furthermore responsible for identifying, monitoring and reporting the Group's operational risk. Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management unit monitors operational risk by tracking loss events, quality deficiencies, potential risk indicators and other early-warning signals. The unit takes an active role in internal control and quality management.

Notes to the Condensed Interim Consolidated Financial Statements

Financial assets and financial liabilities

51. Accounting classification of financial assets and financial liabilities

The accounting classification of financial assets and financial liabilities is specified as follows:

30.6.2020				
Financial assets	Amortised cost	Fair value through OCI	Mandatorily at fair value through P/L	Total carrying amount
Cash and balances with Central Bank	26,920,830			26,920,830
Fixed income securities		17,630,038	7,592,945	25,222,983
Shares and other variable income securities			4,008,499	4,008,499
Securities used for hedging			11,234,860	11,234,860
Loans to customers	27,316,351		3,032,476	30,348,828
Derivatives			628,734	628,734
Other assets	8,535,022		356,456	8,891,478
Total	62,772,204	17,630,038	26,853,970	107,256,212
Financial liabilities	Amortised cost	Fair value through OCI	Mandatorily at fair value through P/L	Total carrying amount
Deposits from customers	61,367,640			61,367,640
Borrowings	18,647,770			18,647,770
Issued bills	1,983,418			1,983,418
Issued bonds	3,607,395			3,607,395
Subordinated liabilities	2,029,295			2,029,295
Short positions held for trading			910,544	910,544
Short positions used for hedging			435,076	435,076
Derivatives			626,285	626,285
Other liabilities	6,009,228		575,227	6,584,455
Total	93,644,745	0	2,547,131	96,191,877
31.12.2019				
Financial assets	Amortised cost	Fair value through OCI	Mandatorily at fair value through P/L	Total carrying amount
Cash and balances with Central Bank	26,818,231			26,818,231
Fixed income securities			8,097,169	8,097,169
Shares and other variable income securities			3,659,208	3,659,208
Securities used for hedging			24,274,769	24,274,769
Loans to customers	27,758,981		2,346,662	30,105,643
Derivatives			1,259,833	1,259,833
Other assets	4,823,577			4,823,577
Total	59,400,789	0	39,637,640	99,038,429
Financial liabilities	Amortised cost	Fair value through OCI	Mandatorily at fair value through P/L	Total carrying amount
Deposits from customers	51,479,732			51,479,732
Borrowings	22,058,747			22,058,747
Issued bills	3,945,306			3,945,306
Issued bonds	4,261,308			4,261,308
Subordinated liabilities	1,999,530			1,999,530
Short positions held for trading			1,239,916	1,239,916
Short positions used for hedging				0
Derivatives			1,282,341	1,282,341
Other liabilities	2,901,973		494,991	3,396,965
Total	86,646,596	0	3,017,248	89,663,844

Notes to the Condensed Interim Consolidated Financial Statements

52. Financial assets and financial liabilities measured at fair value

a. Fair value hierarchy

The fair value of financial assets and liabilities that are traded in active markets are based on quoted market prices. For other financial instruments the Bank determines fair value using various valuation techniques. IFRS 13 specifies a fair value hierarchy based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources whereas unobservable inputs reflect the Bank's market assumptions. These two types of inputs result in the following fair value hierarchy:

- Level 1
Inputs are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2
Inputs are not quoted market prices but are observable either directly, i.e. as prices, or indirectly, i.e. derived from prices. This category includes financial instruments valued using quoted prices in active markets for similar instruments, quoted prices for similar or identical instruments in markets that are considered less than active and other instruments which are valued using techniques which rely primarily on inputs that are directly or indirectly observable from market data.
- Level 3
Inputs are not observable or unobservable inputs have a significant effect on the valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments are required to reflect the differences between the instruments.

b. Valuation process

The Bank's ALCO committee is responsible for fair value measurements of financial assets and financial liabilities classified as level 2 or level 3 instruments. The valuation is carried out by personnel from Risk and Treasury and is revised at least quarterly, or when there are indications of significant changes in the underlying inputs.

c. Valuation techniques

The Group uses widely recognised valuation techniques, including net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist, Black-Scholes and other valuation models.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Group calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

For more complex instruments, the Group uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase in fair value, indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and no later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value in the statement of financial position.

Notes to the Condensed Interim Consolidated Financial Statements

52. Financial assets and financial liabilities measured at fair value (cont.)

d. Fair value hierarchy classification

The fair value of financial assets and financial liabilities measured at fair value in the statement of financial position is classified into the fair value hierarchy as follows:

30.6.2020

Financial assets	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Fixed income securities	7,392,146		200,799	7,592,945
Shares and other variable income securities	1,626,211	163,329	2,218,958	4,008,499
Securities used for hedging	11,234,860			11,234,860
Loans to customers			3,032,476	3,032,476
Derivatives		628,734		628,734
Other assets			356,456	356,456
Measured at fair value through other comprehensive income				
Fixed income securities	17,630,038			17,630,038
Total	37,883,255	792,063	5,808,690	44,484,008

Financial liabilities	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	910,544			910,544
Short positions used for hedging	435,076			435,076
Derivatives		626,285		626,285
Other liabilities			575,227	575,227
Total	1,345,620	626,285	575,227	2,547,131

Transfers of fixed income securities from Level 1 to level 3 amounted to ISK 199 million during the period

31.12.2019

Financial assets	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Fixed income securities	8,095,688		1,480	8,097,169
Shares and other variable income securities	1,665,665	227,472	1,766,071	3,659,208
Securities used for hedging	24,195,355	79,414		24,274,769
Loans to customers			2,346,662	2,346,662
Derivatives		1,259,833		1,259,833
Total	33,956,707	1,566,719	4,114,214	39,637,640
Financial liabilities				
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	1,239,916			1,239,916
Short positions used for hedging				0
Derivatives		1,282,341		1,282,341
Other liabilities			494,991	494,991
Total	1,239,916	1,282,341	494,991	3,017,248

Transfers from Level 3 to Level 1 amounted to ISK 360 million during the year due to listing of a company on Nasdaq First North Growth Market.

Notes to the Condensed Interim Consolidated Financial Statements

52. Financial assets and financial liabilities measured at fair value (cont.)

e. Reconciliation of changes in Level 3 fair value measurements

	Fixed income securities	Shares and other var. income securities	Loans to customers	Other assets	Other liabilities	Total
30.6.2020						
Balance as at 31 December 2019	1,480	1,766,071	2,346,662		(494,991)	3,619,222
Total gains and losses in profit or loss	(18)	161,610	84,257		(251,520)	(5,670)
Additions		291,277	641,986	356,456		1,289,719
Repayments			(40,429)		171,284	130,855
Disposals						0
Transfers in (out) of Level 3	199,337					199,337
Balance as at 30 June 2020	200,799	2,218,958	3,032,476	356,456	(575,227)	5,233,463
	Fixed income securities	Shares and other var. income securities	Loans to customers	Other assets	Other liabilities	Total
31.12.2019						
Balance as at 31 December 2018	134,944	864,180	2,160,522			3,159,646
Reclassification into Level 3 in accordance with IFRS 9			150,865			150,865
Total gains and losses in profit or loss	(133,463)	212,897	95,505		447,463	622,401
Additions		1,652,385	592,385			2,244,770
Repayments			(652,615)		1,599,864	947,249
Acquisition of subsidiary		928,327			(2,542,318)	(1,613,991)
Disposals		(1,531,253)				(1,531,253)
Transfers in (out) Level 3		(360,466)				(360,466)
Balance as at 31 December 2019	1,480	1,766,071	2,346,662	0	(494,991)	3,619,222

f. Fair value measurements for Level 3 financial assets and liabilities

Level 3 assets consist primarily of illiquid, unlisted bonds, shares and share certificates and loans measured at fair value. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2020:

Asset class	Method	Significant unobservable input	Range	Book value
Unlisted bonds	Expected recovery	Value of assets	0-95%	200,799
Unlisted variable income securities	Market price	Recent trades	-	2,218,958
Loans to customers	Expert model	Value of assets and collateral	-	3,032,476
Total				5,452,234
Asset class	Method	Significant unobservable input	Range	Book value
Unlisted bonds	Expected recovery	Value of assets	0-5%	1,480
Unlisted variable income securities	Market price	Recent trades	-	1,766,071
Loan to customers	Expert model	Value of assets and collateral	-	2,346,662
Total				4,114,214

Given the methods used, the possible range of the significant unobservable inputs is wide. When determining the values used the Group considers the financial strength of the entity in question, recent trades if any and multipliers for comparable instruments.

g. The effect of unobservable inputs in Level 3 fair value measurements

The Group believes its estimates represent appropriate approximations of fair value and that the use of different valuation methodologies and reasonable changes in assumptions or unobservable inputs would not significantly change the estimates.

A 10% change in the estimates would have the following effect on profit before taxes:

	+10%	-10%
Shares and other variable income securities	221,896	(221,896)
Loans to customers	303,248	(303,248)
Total	525,143	(525,143)

Notes to the Condensed Interim Consolidated Financial Statements

Segment information

53. Business segments

Segment reporting is based on the same principles and structure as internal reporting to senior management and the Board of Directors. Segment performance is evaluated on profit before cost allocation and tax.

Reportable segments

The Group defines five reportable segments which reflect the reporting structure of the Bank.

- Corporate Banking
Corporate Banking offers various forms of banking services and related advisory services, in addition to providing specialised lending services.
- Corporate Finance
Corporate Finance provides its customers with impartial and independent advice concerning purchases, sales and mergers and acquisitions of companies.
- Capital Markets
Capital Markets offers securities and foreign currency brokerage, derivatives brokerage and forward contracts to clients, which include institutional investors, corporates and high net worth individuals.
- Proprietary Trading and Treasury
Proprietary Trading and Treasury provide market making services to its clients as well as providing the Bank with treasury services.
- Asset Management
Products and services offered include asset management involving both domestic and foreign assets, private banking, and private pension plans.

Information about other divisions of the Bank, e.g. non-revenue generating divisions, is presented under the heading Support functions and eliminations.

	Corporate Banking	Corporate Finance	Capital Markets	Proprietary trading and Treasury	Asset Management	Support functions and eliminations	Total
6m 2020							
Net interest income	780,836	(66)	120,300	(7,990)	(27,131)	1,802	867,751
Net fee and commission income	269,222	166,770	491,800	84,473	2,010,329	(8,950)	3,013,644
Net financial income	(77,354)	(0)	(2,636)	220,099	25,462	56,392	221,963
Share in profit of associates	(17,855)	0	0	0	6,456	0	(11,399)
Other operating income (expense)	78,788	0	12	1,053	26,028	(50,605)	55,276
Net operating income	1,033,638	166,704	609,476	297,635	2,041,143	(1,361)	4,147,236
Salaries and related expenses	(139,238)	(129,003)	(143,067)	(108,539)	(578,654)	(673,092)	(1,771,594)
Other operating expenses	(243,501)	(11,085)	(36,314)	(27,941)	(209,845)	(370,383)	(899,069)
Net impairment	(158,574)	(1,108)	0	0	(53,757)	4,649	(208,790)
Revaluation of investment properties	0	0	0	0	0	0	0
Revaluation of contingent consideration	0	0	0	0	(251,520)	0	(251,520)
Profit (loss) before cost allocation and tax	492,326	25,508	430,095	161,155	947,367	(1,040,187)	1,016,263
Net segment revenue from external customers	1,015,235	110,614	889,919	59,185	2,041,143	31,139	4,147,236
Net segment revenue from other segments	18,403	56,090	(280,443)	238,449	1	(32,500)	0
				Proprietary		Support	
	Corporate	Corporate	Capital	trading and	Asset	functions and	Total
	Banking	Finance	Markets	Treasury	Management	eliminations	
6m 2019							
Net interest income	767,939	(101)	101,553	59,769	(86,182)	2,731	845,709
Net fee and commission income	366,332	183,374	452,311	59,578	1,926,005	(75,374)	2,912,226
Net financial income	92,905	0	(2,103)	245,430	(5,588)	43,828	374,472
Share in profit of associates	(50,685)	0	0	0	23,275	0	(27,410)
Other operating income (expense)	35,313	0	(2)	1,566	17,759	5,799	60,435
Net operating income	1,211,804	183,273	551,759	366,343	1,875,270	(23,017)	4,165,433
Salaries and related expenses	(101,900)	(114,362)	(126,319)	(85,871)	(548,483)	(772,794)	(1,749,729)
Other operating expenses	(212,583)	(12,797)	(34,124)	(32,783)	(331,952)	(283,865)	(908,105)
Net impairment	43,241	(17,098)	0	0	(7,000)	3,000	22,143
Revaluation of contingent consideration	0	0	0	0	60,093	0	60,093
Profit (loss) before cost allocation and tax	940,562	39,016	391,316	247,689	1,047,928	(1,076,676)	1,589,835
Net segment revenue from external customers	829,866	152,590	1,327,323	(15,819)	1,866,990	4,483	4,165,433
Net segment revenue from other segments	381,938	30,683	(775,564)	382,162	8,280	(27,500)	0

Notes to the Condensed Interim Consolidated Financial Statements

Other information

54. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland to the amount of ISK 2.7 billion as at 30 June 2020 (2019: ISK 2.7 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 3.5 billion as at 30 June 2020 (2019: ISK 0.7 billion).

55. Related parties

a. Definition of related parties

The Group has a related party relationship with the board members of the Bank, the CEO of the Bank and key employees (together referred to as management), associates as disclosed in note 22, shareholders with significant influence over the Bank, close family members of individuals identified as related parties and entities under the control or joint control of related parties.

b. Arm's length

Transactions with related parties are carried out at arm's length and subject to an annual review by the Bank's internal auditor.

c. Effects on statement of financial position

	Loans & receivables	Deposits & payables
30.6.2020		
Management	0	173,826
Associates	0	0
Total	0	173,827
	Loans & receivables	Deposits & payables
31.12.2019		
Management	354	40,296
Associates	208,278	2,995,554
Total	208,632	3,035,851

d. Effects on income statement

	Interest income	Interest expense	Fees received	Fees paid
6m 2020				
Management	0	487	1,362	10,560
Associates	10,379	209	26,279	0
Total	10,379	696	27,641	10,560
	Interest income	Interest expense	Fees received	Fees paid
6m 2019				
Management	4,093	1,610	1,519	5,112
Associates	22	23,619	22,793	0
Total	4,115	25,229	24,313	5,112

56. Other matters

Legal proceedings

The Bank has been served with a written summons whereby owners of a certain real estate have made a claim of ca. ISK 316 million plus interest against Kvika and several other parties in solidum. Kvika has denied the claims of the plaintiffs and does not believe the matter to be of merit. Kvika is to submit its statement in this case on 9 September 2020.

57. Events after the reporting date

Letter of intent for the purchase of Netgíró hf.

In July 2020, the Bank signed a letter of intent for the purchase of 80% of the shares in Netgíró hf. At the signing of the letter of intent, the Bank owned around 20% share in Netgíró hf. and will therefore, if the purchase goes through, become the sole owner of the company. The purchase of Netgíró is in line with the bank's policy to use technological solutions to modernize financial services. Kvika has had a successful collaboration with Netgíró hf. in the past years, including financing of the company's claims. The purchase will enable the Bank to further strengthen the collaboration with the company which will lead to increased efficiency and optimization for both parties. Netgíró hf. currently operates in almost 3,000 local shops and over 68,000 individuals use the company's services.