Íslandsbanki

Condensed Consolidated Interim Financial Statements

Third quarter 2018

Unaudited

440 4000

@islandsbanki

islandsbanki.is

Contents

Highlights

Íslandsbanki

Our profile

- A leader in financial services in Iceland, Íslandsbanki is a universal bank with total assets of ISK 1,163bn (about EUR 8.5bn) and a 25% - 50% market share across all domestic business segments.
- Building on over 140 years of servicing key industries, Íslandsbanki has developed specific expertise in tourism, seafood and energy related industries.
- Driven by the vision to be #1 for service, Íslandsbanki's relationship banking business model is propelled by three business divisions that manage and build relationships with the Bank's customers.
- Íslandsbanki has developed a wide range of online services such as the Íslandsbanki, Kreditkort and Kass apps, enabling customers to do their banking whenever and wherever. At the same time, the Bank continues to operate the most efficient branch network in Iceland through its strategically located 14 branches.
- In 2017, Íslandsbanki led the Icelandic Customer Satisfaction Index for banks for the fifth consecutive year and was named Bank of the Year in Iceland by the Banker. In July 2018, Euromoney selected Íslandsbanki as the best bank in Iceland.
- Íslandsbanki has a BBB+/A-2 rating from S&P Global Ratings and BBB/F3 from Fitch Ratings and is the only bank in Iceland rated by two international rating agencies.

Our Bank

14 branches

835 Number of FTE's for parent company at period end

78.000 APP users

Market Share[1]

32% individuals

36% SMEs

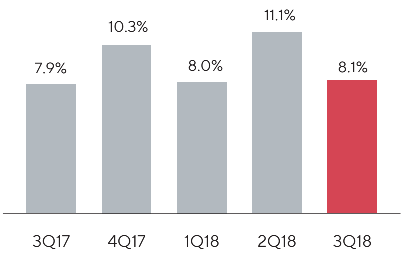
32% large companies

Credit Ratings

S&P Global Ratings **BBB+/A-2** Stable outlook

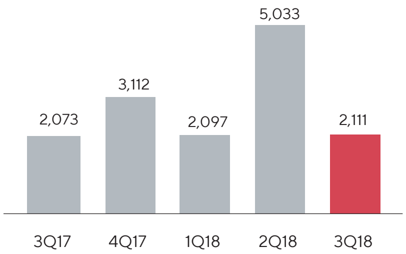
FitchRatings **BBB/F3** Stable outlook

ROE reg. operations CET1 16%[2]

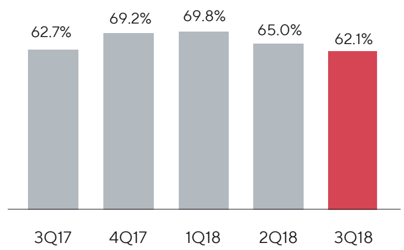


Profit after tax

(ISKm)

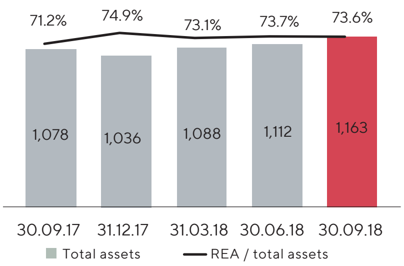


Cost / income ratio[3]



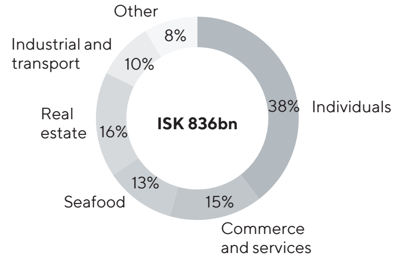
REA / total assets

(ISKbn)



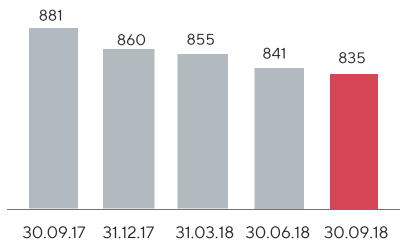
Loans to customers – sector split

As of 30.09.18



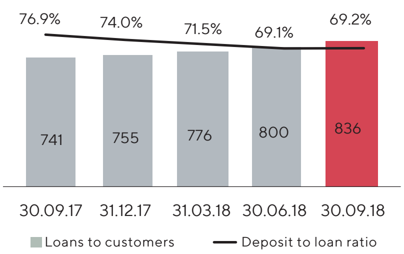
Number of FTE' s for Parent Company

Excluding seasonal employees

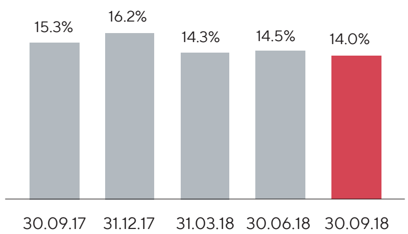


Loans to customers

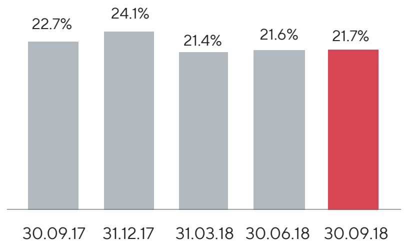
(ISKbn)



Leverage ratio



Total capital ratio



[1]Based on Gallup survey regarding primary bank.
[2]Earnings on regular income now includes profit from discontinued operations. The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%).
[3]The cost/income ratio for 3Q18 the parent company is 57.0%

Directors' Report

These are the condensed consolidated interim financial statements for the period 1 January to 30 September 2018 (“the interim financial statements”) of Íslandsbanki hf. (“the Bank” or “Íslandsbanki”) and its subsidiaries (together referred to as "the Group").

Operations in the reporting period

Íslandsbanki is a universal bank offering comprehensive financial services to households, corporations, and institutional investors in Iceland. The Group is one of Iceland's largest banking and financial services groups, with a strong domestic market share.

The profit from the Group's operations for the reporting period amounted to ISK 9,241 million, which corresponds to 7.1% annualised return on equity. At the end of the reporting period, the Group employed 1,075 full-time members of staff, including 835 within the Bank itself.

Net interest income rose by 4.3% between years, as strong balance sheet growth was somewhat offset by a lower interest rate environment. Net fee income was down by 13.5%, where a 6.5% combined growth for the Bank and Íslandssjóðir was offset by reduced activity in Borgun and Hringur, two subsidiaries of the Bank. Other income was about 1.3bn. Salary costs were up by 4.7% between years, as a result of reduced capitalisation of salaries in 2018 due to an investment in the Bank's core banking systems and collective wage increases, somewhat offset by a reduction in FTE's in the Bank. Other operating expenses grew by 4.2% between years.

Net impairments were positive by ISK 1.9 billion, similar number as for the first six months of the year as impairments in the third quarter were close to zero. Profit from discontinued operations amounted to ISK 920 million, mainly resulting from the sale of listed equities from a subsidiary of the Bank.

In September, the Bank launched its new core banking system for deposits and payments. This is a major milestone operationally, as this has been the Bank's largest infrastructure project in recent times. Overall, the implementation was successful, with limited negative impact on the Bank's customers.

The Group's loan book grew by 10.6% in the first nine months of 2018 on the back of strong demand in all lending units and across sectors. Net impairments for this year remain positive in spite of a small negative impairment in the third quarter.

Customer deposits increased by 7.3% during the first nine months of 2018 and the customer deposit-to-loan ratio was 72.8% at the end of the period, down from 75.1% at the end of 2017, as borrowings increased proportionally more than deposits in the period as a source of funding. The main increase in deposits came from individuals, corporates and pension funds.

In August, the Bank issued a Tier 2 subordinated debt instrument amounting to SEK 500 million. Placement of the transaction was focused towards investors across the Nordic region and was well recived by investors. Conditions in the global credit markets have deteriorated during the course of the first nine months of 2018, which has resulted in higher funding costs for the Bank in the international capital markets. This development is seen across jurisdictions as risk adversion seems to be increasing due to the potential for rate hikes in some of the major economies and more turmoil on the political front.

At the end of September, the Group was presented with the results of the annual SREP proecess conducted by the Icelandic Financial Supervisory Authority. The results included the updated capital requirement for the Group. The total capital requirement is now 18.8% of the risk exposure amount, down from 19.8% the year before. The lower capital requirement ratio is due to a reduction in the Group's market risk profile. However, the Icelandic Financial Stability Council announced in May that the countercyclical buffer will increase by 50 basis points, from 1.25% to 1.75%, as of May 2019, which will then bring the total capital requirement up to 19.3%. Based on the updated SREP results, the board of the Bank has approved an updated capital target. The new target entails a management buffer of 0.5-2.0%, where the upper limit has been raised from 1.5% to provide management with more flexibility in its capital management. The updated overall capital target is therefore 19.3-20.8%, from the previous target of 20.3-21.3%, and will become 19.8-21.3% with the higher countercyclical buffer from May 2019 onwards.

Outlook

As expected, the growth in the Icelandic economy is moderating. The Bank's Chief Economist forecasts 1.5% growth in 2019, down from 3.4% in 2018. The slowdown results from less growth in tourism and less residential construction. Growth is expected to pick up again in 2020.

Debt levels of households, corporates, and the public sector have come down substantially in the past few years, making all those different pillars of society more prepared for economic swings.

The Bank's balance sheet remains robust and the outlook favourable. There are exciting times ahead with regard to the development of digital services and plans have been made to roll out many new services on that front in the coming months.

Directors' Report

Statement by the Board of Directors and the CEO

The interim financial statements for the period 1 January to 30 September 2018 have been prepared on a going concern basis in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting as adopted by the European Union; the Act on Annual Accounts, no. 3/2006; the Act on Financial Undertakings, no. 161/2002; and rules on accounting for credit institutions, where applicable.

To the best of our knowledge, these interim financial statements provide a true and fair view of the Group's operating profits and cash flows in the reporting period and its financial position as of 30 September 2018.

The Board of Directors and the CEO have today discussed and approved the Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2018.

Kópavogur, 8 November 2018

Board of Directors:

Friðrik Sophusson, Chairman
Helga Valfells, Vice-Chairman
Anna Þórðardóttir
Auður Finnbogadóttir
Árni Stefánsson
Hallgrímur Snorrason
Heiðrún Jónsdóttir

Chief Executive Officer:

Birna Einarsdóttir

Consolidated Interim Income Statement

	Notes	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Interest income		45,044	42,025	15,707	13,406
Interest expense		(21,401)	(19,364)	(7,406)	(5,956)
Net interest income	10	23,643	22,661	8,301	7,450
Fee and commission income		14,280	15,643	5,044	5,117
Fee and commission expense		(5,531)	(5,525)	(2,105)	(1,812)
Net fee and commission income	11	8,749	10,118	2,939	3,305
Net financial expense	12	(325)	(975)	(420)	(1,084)
Net foreign exchange (loss) gain	13	(75)	446	(8)	76
Other operating income	14	1,664	506	64	291
Other net operating income		1,264	(23)	(364)	(717)
Total operating income		33,656	32,756	10,876	10,038
Salaries and related expenses	15	(11,453)	(10,936)	(3,501)	(3,168)
Other operating expenses	16	(8,732)	(8,377)	(2,962)	(2,879)
Contribution to the Depositors' and Investors' Guarantee Fund		(874)	(795)	(295)	(280)
Bank tax		(2,541)	(2,278)	(944)	(806)
Total operating expenses		(23,600)	(22,386)	(7,702)	(7,133)
Profit before net impairment on financial assets		10,056	10,370	3,174	2,905
Net impairment on financial assets	17	1,881	587	(53)	147
Profit before tax		11,937	10,957	3,121	3,052
Income tax expense	18	(3,616)	(3,335)	(1,136)	(1,072)
Profit for the period from continuing operations		8,321	7,622	1,985	1,980
Profit from discontinued operations, net of income tax	19	920	2,492	126	93
Profit for the period		9,241	10,114	2,111	2,073
Profit attributable to:					
Shareholders of Íslandsbanki hf.		9,520	10,401	2,199	2,017
Non-controlling interests		(279)	(287)	(88)	56
Profit for the period		9,241	10,114	2,111	2,073
Earnings per share from continuing operations					
Basic and diluted earnings per share attributable to the shareholders of Íslandsbanki hf.	20	0.86	0.79	0.21	0.19

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Comprehensive Income

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Profit for the period	9,241	10,114	2,111	2,073
Items that are or will be reclassified to profit or loss:				
Foreign currency translation differences for foreign operations	-	9	-	-
Items that will not be reclassified to profit or loss:				
Changes in fair value of financial assets and financial liabilities, net of tax ..	1,451	302	337	220
Other comprehensive income for the period, net of tax	1,451	311	337	220
Total comprehensive income for the period	10,692	10,425	2,448	2,293

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Financial Position

	Notes	30.9.2018	31.12.2017
Assets			
Cash and balances with Central Bank	21	156,251	189,045
Bonds and debt instruments	5	63,324	27,090
Shares and equity instruments	5	13,995	10,177
Derivatives	22	3,479	2,896
Loans to credit institutions	23	67,047	26,617
Loans to customers	24	835,582	755,175
Investments in associates	26	533	704
Property and equipment		5,079	7,128
Intangible assets		4,910	4,231
Other assets	28	11,205	9,993
Non-current assets and disposal groups held for sale	29	1,234	2,766
Total Assets		1,162,639	1,035,822
Liabilities			
Deposits from Central Bank and credit institutions	30	15,530	11,189
Deposits from customers	31	608,646	567,029
Derivative instruments and short positions	22	5,585	5,492
Debt issued and other borrowed funds	33	297,318	217,748
Subordinated loans	34	15,531	9,505
Tax liabilities		10,311	7,787
Other liabilities	36	35,014	35,947
Non-current liabilities and disposal groups held for sale		74	80
Total Liabilities		988,009	854,777
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		5,891	6,179
Retained earnings		101,280	107,387
Total equity attributable to the equity holders of Íslandsbanki hf.		172,171	178,566
Non-controlling interests		2,459	2,479
Total Equity		174,630	181,045
Total Liabilities and Equity		1,162,639	1,035,822

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity

	Share capital	Share premium	Restricted reserves	Fair value reserve	Liability credit reserve	Other reserves	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1.1.2017	10,000	55,000	1,673	(25)	-	2,491	105,563	174,702	4,223	178,925
Profit for the period							10,401	10,401	(287)	10,114
Dividends paid							(10,000)	(10,000)	(1,717)	(11,717)
Net change in fair value of AFS financial assets				192				192	110	302
Translation differences for foreign operations						9	14	23	(14)	9
Changes in non-controlling interests								-	186	186
Restricted due to capitalised development cost			1,167				(1,167)	-		-
Restricted due to fair value changes			97				(97)	-		-
Restricted due to subsidiaries and associates			570				(570)	-		-
Equity as at 30.9.2017	10,000	55,000	3,507	167	-	2,500	104,144	175,318	2,501	177,819
Equity as at 31.12.2017	10,000	55,000	3,440	239	-	2,500	107,387	178,566	2,479	181,045
Impact of adopting IFRS 9, see Note 3					(1,486)		(2,530)	(4,016)	6	(4,010)
Impact of adopting IFRS 15, see Note 3							(97)	(97)		(97)
Equity as at 1.1.2018	10,000	55,000	3,440	239	(1,486)	2,500	104,760	174,453	2,485	176,938
Profit for the period							9,520	9,520	(279)	9,241
Dividends paid							(13,000)	(13,000)		(13,000)
Net change in fair value of financial assets through OCI				446				446	253	699
Net change in fair value of financial liabilities					812		(60)	752		752
Restricted due to capitalised development cost			363				(363)	-		-
Restricted due to fair value changes			(91)				91	-		-
Restricted due to subsidiaries and associates			(332)				332	-		-
Equity as at 30.9.2018	10,000	55,000	3,380	685	(674)	2,500	101,280	172,171	2,459	174,630

Dividends:

The Annual General Meeting ("AGM") for the operating year 2017 was held on 22 March 2018. At the AGM shareholders approved the Board's proposal to pay dividends to shareholders amounting to ISK 13,000 million which is equivalent to ISK 1.30 per share (2017: ISK 1.00 per share). The dividends were paid on 28 March 2018.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

	Notes	2018 1.1-30.9	2017 1.1-30.9
Cash flows from operating activities:			
Profit for the period		9,241	10,114
Non-cash items included in profit for the period		10,263	8,699
Changes in operating assets and liabilities		(105,461)	(48,315)
Dividends received		75	36
Income tax and bank tax paid		(2,834)	(1,003)
Net cash used in operating activities		(88,716)	(30,469)
Net investment in subsidiaries and associated companies		3,220	(36)
Proceeds from sale of property and equipment		15	5
Purchase of property and equipment		(107)	(1,196)
Purchase of intangible assets		(597)	(1,546)
Net cash provided by (used in) investing activities		2,531	(2,773)
Proceeds from borrowings		107,097	37,933
Repayment of borrowings		(34,655)	(17,847)
Dividends paid		(13,000)	(2,449)
Dividends paid non-controlling interests		-	(2,148)
Net cash provided by financing activities		59,442	15,489
Net decrease in cash and cash equivalents		(26,743)	(17,753)
Effects of foreign exchange rate changes		(143)	(86)
Cash and cash equivalents at the beginning of the period		187,438	240,263
Cash and cash equivalents at the end of the period		160,552	222,424

Reconciliation of cash and cash equivalents:			
Cash on hand	21	2,062	3,143
Cash balances with Central Bank	21	154,189	211,111
Bank accounts	23	19,768	25,644
Mandatory reserve and special restricted balances with Central Bank	21	(15,467)	(17,474)
Cash and cash equivalents at the end of the period		160,552	222,424

The Group has prepared its consolidated interim statement of cash flows using the indirect method. The statement is based on the net profit after tax for the period and shows the cash flows from operating, investing and financing activities and the increase or decrease in cash and cash equivalents during the period.

Interest received from 1 January to 30 September 2018 amounted to ISK 43,085 million (2017: ISK 44,132 million) and interest paid in the same period 2018 amounted to ISK 16,227 million (2017: ISK 17,474 million). Interest paid is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

Non-cash items included in profit for the period:	2018 1.1-30.9	2017 1.1-30.9
Depreciation and impairment	484	501
Amortisation of intangible assets	219	141
Share of loss (gain) of associates	34	(42)
Accrued interest and fair value changes on debt issued and subordinated loans	7,296	5,231
Net impairment on financial assets	(1,943)	587
Foreign exchange loss (gain)	75	(446)
Net gain on sale of subsidiary, property and equipment	(1,557)	(288)
Unrealised fair value loss (gain) recognised in profit or loss	387	(106)
Net profit on non-current assets classified as held for sale	(920)	(2,492)
Bank tax	2,541	2,278
Income tax	3,616	3,335
Other changes	31	-
Non-cash items included in profit for the period	10,263	8,699
Changes in operating assets and liabilities:		
Mandatory reserve and special restricted balances with Central Bank	2,099	29,719
Loans and receivables to credit institutions	(33,237)	(7,135)
Loans and receivables to customers	(76,661)	(51,605)
Trading assets	(37,626)	(16,709)
Other operating assets	(766)	(4,035)
Non-current assets and liabilities held for sale	2,464	2,708
Deposits with credit institutions and Central Bank	4,182	7,607
Deposits from customers	37,840	(6,601)
Trading financial liabilities	8	(93)
Derivatives	(2,540)	(851)
Other operating liabilities	(1,224)	(1,320)
Changes in operating assets and liabilities	(105,461)	(48,315)

Non-cash transactions 2018
During the period the Group did not have any non-cash transactions.

Non-cash transactions 2017
a) The Bank paid dividends amounting to ISK 10,000 million. Thereof are non-cash transactions amounting to ISK 7,551 million which were paid with a government bond.

b) The Bank's debt securities of ISK 12,083 million were paid during the period by issuing bonds. The transaction had no cash effect on the Group.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Condensed Consolidated Interim Financial Statements

1. Corporate information

Íslandsbanki hf., the parent company, was incorporated on 8 October 2008 and is a limited liability company domiciled in Iceland. The condensed consolidated interim financial statements for the third quarter of 2018 ("the interim financial statements") comprise the financial statements of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries together referred to as "the Group".

The interim financial statements were authorised for issue by the Board of Directors of Íslandsbanki hf. on 8 November 2018.

2. Basis of preparation

The interim financial statements have been prepared in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002 and rules on accounting for credit institutions.

The interim financial statements do not include all the information required for annual financial statements and should be read in conjunction with the audited consolidated financial statements of the Group for the year ended 31 December 2017, as well as the unaudited Pillar 3 Report for the year ended 31 December 2017. Both are available on the Bank's website: www.islandsbanki.is.

On 1 January 2018 the Group implemented IFRS 9 - Financial Instruments and IFRS 15 - Revenue from Contracts with Customers. The impact of the implementation of IFRS 9 and IFRS 15 on the opening balance sheet at 1 January 2018 is disclosed in Note 3.

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Therefore, the interim financial statements have been prepared on a going concern basis.

The interim financial statements have been prepared on an historical cost basis except for the following items in the statement of financial position: bonds and debt instruments which are measured at fair value, shares and equity instruments which are measured at fair value, derivative financial instruments which are measured at fair value, non-current assets and disposal groups classified as held for sale which are measured at the lower of its carrying amount and fair value less costs to sell and certain debt securities which are measured at fair value. Recognised financial liabilities designated as hedged items in qualifying fair value hedge relationships are measured at amortised cost adjusted for changes in fair value attributable to the risk being hedged.

The interim financial statements are presented in Icelandic króna (ISK), which is the functional currency of Íslandsbanki hf. All amounts presented in ISK have been rounded to the nearest million, except when otherwise indicated.

Important accounting estimates and judgements

The preparation of the interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the interim financial statements, and income and expenses recognised during the reporting period.

Estimates made by management are based on historical experience and other assumptions that are believed to be reasonable.

Key areas where management has made difficult, complex or subjective judgements, include those relating to the allowance for credit losses (see Note 3), the fair value of financial instruments, including derivatives and derecognition of financial assets and liabilities. While management makes its best estimates and assumptions, actual results could differ from these estimates and assumptions.

3. Changes to accounting policies

The accounting policies in the interim financial statements are consistent with those applied in the Group's audited consolidated financial statements for the year ended 31 December 2017, except for changes to the accounting for financial instruments resulting from the adoption of IFRS 9, and the accounting for revenue from contracts with customers resulting from the adoption of IFRS 15. Those changes are described below.

IFRS 9 – Financial Instruments

The Group adopted a new IFRS standard, IFRS 9 - Financial Instruments, which replaced IAS 39 as of 1 January 2018. As a result of the application of IFRS 9, the Group changed its accounting policies in the areas outlined below, and these new policies were applicable from 1 January 2018. As permitted by the transition provisions of IFRS 9, the Group elected not to restate comparative period information; accordingly, all comparative period information is presented in accordance with previous accounting policies, as described in the Group's audited consolidated financial statements for the year ended 31 December 2017. Adjustments to carrying amounts of financial assets and financial liabilities at the date of initial application were recognised in equity as of 1 January 2018. New or amended interim disclosures have been provided for the current period, where applicable, and comparative period disclosures are consistent with those made in the prior year.

3. Cont'd

Classification and measurement

Financial assets

Financial assets are classified into one of three measurement categories, i.e. measured subsequently at amortised cost, measured subsequently at fair value through other comprehensive income or measured subsequently at fair value through profit or loss. The measurement basis of individual financial assets is determined based on an assessment of the cash flow characteristics of the assets and the business models under which they are managed.

Reclassification between measurement categories is required if the objective of the business model in which the financial assets are held changes after initial recognition and if the change is significant to the Group's operations.

The business models

The business models are determined by the Group's key management personnel in the way that assets are managed and their performance is reported to them. The Group determines its business models at a level that reflects the way groups of financial assets are managed together to achieve a particular business objective. This condition is not an instrument-by-instrument approach to classification, but is determined at a higher level of aggregation. The Group's business models fall into the following three categories: Held to collect, Held to collect and for sale, and Other fair value business models, where assets are held for trading or managed on a fair value basis and are neither Held to collect nor Held to collect and for sale.

Solely payments of principal and interest (SPPI)

Financial assets held within the business models Held to collect and Held to collect and for sale, are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest. SPPI payments are those which are consistent with a basic lending arrangement. Principal is the fair value of the financial asset at initial recognition and changes over the life of the financial asset, for example if there are repayments of principal. Interest relates to basic lending returns, including compensation for the time value of money and credit risk associated with the principal amount outstanding over a period of time. Interest can also include consideration for other basic lending risks (e.g. liquidity risk) and costs (e.g. servicing or administrative costs), as well as a profit margin that is consistent with a basic lending arrangement.

Where the contractual terms introduce exposure to risk or variability of cash flows that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets at amortised cost

A financial asset is classified as being subsequently measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest and the asset is held within a business model whose objective is to collect contractual cash flows, i.e. Held to collect.

Financial assets at amortised cost are measured using the effective interest method. Amortised cost is calculated by taking into account the amount at which the assets are measured at initial recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums on acquisition and fees and costs that are an integral part of the effective interest rate), and minus any reduction for impairment. Accrued interest is included in the carrying amount of the financial asset in the statement of financial position.

Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

3. Cont'd

Financial assets at fair value through other comprehensive income (FVOCI)

Shares and equity instruments at FVOCI

For shares and equity instruments that are not held for trading, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses, including any related foreign exchange component, in other comprehensive income rather than profit or loss. This election is made on an instrument-by-instrument basis. Shares and equity instruments at FVOCI are not subject to an impairment assessment. Dividends are to be presented in profit or loss, as long as they represent a return on investment. On derecognition there is no recycling of fair value gains and losses to profit or loss.

Bonds and debt instruments at FVOCI

During the period the Group did not classify any bonds and debt instruments at FVOCI.

Financial assets at fair value through profit or loss (FVTPL)

Financial assets classified at fair value through profit or loss are all other financial assets which are not classified at amortised cost or at fair value through other comprehensive income. This includes financial assets classified mandatorily at fair value through profit or loss and financial assets which are irrevocably designated by the Group at initial recognition as at fair value through profit or loss that would otherwise meet the requirements to be measured at amortised cost or at FVOCI. The Group designates financial assets as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. During the period the Group did not classify any financial assets as designated at fair value through profit or loss.

Financial assets at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised immediately in profit or loss. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest earned, which is recognised in the line item "Interest income" and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)".

Financial liabilities

Financial liabilities designated as at fair value through profit or loss

Financial liabilities designated as at fair value through profit or loss are recognised at fair value and changes in fair value attributable to changes in the credit risk of those liabilities are recognised in other comprehensive income and are not subsequently reclassified to profit or loss. The remaining fair value changes are included in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised as "Interest expense" on an accrual basis and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

The Group calculates the fair value attributable to changes in credit risk as the difference between the changes in fair value of the financial liability and the amount of changes in fair value attributable to changes in market interest rates. The change in fair value attributable to changes in market interest rates on financial liabilities is calculated by discounting contractual cash flows at the end of the period with the discount rate of the appropriate market interest rate.

Upon initial recognition, the Group determines if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change is presented in profit or loss. This is not applicable for the Group during the period.

Hedge accounting

The Group has elected to continue to apply the hedge accounting principles under IAS 39 instead of those under IFRS 9. The policy for hedge accounting is described in Note 76.9 in the Group's audited consolidated financial statements for the year ended 31 December 2017.

3. Cont'd

Impairment

The adoption of IFRS 9 has had a significant impact on the Group's impairment methodology. The two main reasons for this impact are, firstly, that the impairment model of IFRS 9 is forward-looking as opposed to the incurred loss model of IAS 39 and, secondly, that impairment under IFRS 9 should reflect a probability weighted average of possible outcomes in contrast to IAS 39 where the single most likely outcome was accounted for. In addition, the expected credit loss model in IFRS 9 employs a dual measurement approach, under which the loss allowance for expected credit losses (ECL) is measured at each reporting date as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk (SICR) of the financial instrument since initial recognition. To satisfy the provisions of the IFRS 9 standard, a significant amount of modelling must be involved. The models which the Group uses for the calculation of the impairment amount are developed according to the Group's modelling framework. This framework imposes structure on the initial model development work, the model documentation including educational material as needed for users, the approval process for models, the implementation of models and the lifetime support for models, including validation and back-testing. The Group's impairment process, which encompasses all the steps needed to derive the appropriate impairment allowance for each accounting period, is documented and approved by the All Risk Committee.

Stage assignment

At each reporting date, all assets subject to the impairment methodology must be divided into three groups, termed "Stages", reflecting the extent of credit deterioration since initial recognition. This division then has an effect on how the impairment is measured and how interest is recognised.

Stage 1 – All assets that have not experienced a SICR are assigned to Stage 1. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from credit events occurring within 12 months of the reporting date (12-month ECL). Interest is recognised on the gross carrying amount of the assets.

Stage 2 – Assets that the Group determines to have experienced a SICR, but are not credit-impaired, are classified as Stage 2. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from all credit events occurring within the expected lifetime of the assets (lifetime ECL). Interest is recognised on the gross carrying amount of the assets.

Stage 3 – This Stage is for assets which are credit-impaired according to the Group's assessment. These assets are therefore experiencing an ongoing credit event. Thus, the 12-month ECL and lifetime ECL are the same amount and this amount is recognised as impairment allowance. For assets in this Stage, interest is recognised on the carrying amount of assets, net of impairment allowance.

The Group's definition of being credit-impaired is on a customer level, rather than on the level of an individual asset. According to the definition, a customer is credit-impaired when either of the following holds:
a) The Group assesses that it is unlikely that the customer can service all of their commitments to the Group in accordance with the terms of the agreements without recourse to default provisions in the agreements.
b) The customer is more than 90 days past due on any of their commitments.

The assessment in point a) is made based on a defined set of triggers, which includes serious breach of covenants, serious registrations on an internal watchlist, initiation of serious collection actions and serious external credit related information.

Furthermore, there is a defined set of conditions which must be satisfied so that customers that have been assessed as being credit-impaired are no longer subject to this assessment. This includes probation periods and a view to the future outlook of the customer.

The Group's definition of a SICR is on the level of an individual asset. The Group assesses that there has been a significant increase in credit risk of an asset if the probability of a credit impairment event, i.e. transfer to Stage 3, occurring over the lifetime of the asset has increased significantly from the origination of the assets. For this purpose, origination does not refer to any modification events which have not resulted in derecognition of the asset. The assessment is based on a defined set of triggers. This includes, as a backstop, the trigger that the asset is more than thirty days past due. Other triggers are internal assessments of outlook, events such as forbearance events which are less severe than a credit event, external credit related information and a significant deterioration in risk assessment compared with the risk assessment done in relation to the origination of the asset. The definition of SICR depends only on the probability of a credit event occurring, it does not take into account collateralisation or any other information related to the expected loss arising from the event.

The Group does not employ the low credit risk exemption in the Stage assignment process. In alignment with its operating procedures, the Group has chosen as its accounting policy to measure the impairment allowance for lease receivables at an amount equal to the lifetime ECL only for those assets which have a SICR or are credit-impaired. For other lease receivables the impairment allowance is equal to the 12-month ECL.

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

Expected credit loss (ECL)

The ECL for each asset is calculated using models for the probability of a credit impairment event occurring (PD), the loss percentage expected in case of such an event (LGD) and the outstanding amount at the time of the event (EAD). In its simplest form the ECL can be calculated as the product of these factors, however, for several reasons, the actual formula must be more complicated than this.

The Group uses the standardised approach for regulatory capital purposes but has used PD models and LGD models for risk management purposes for several years. These models have been adapted for IFRS 9 purposes. For EAD, and for LGD to a certain extent, new models have been developed.

The PD models are either fully automated statistical models, expert models or hybrid. For the models with a component involving expert input there is a process in place to ensure proper review of the model outcome and periodic reassessment of obligors. The inputs into the models include demographic variables, information from financial statements and past payment behaviour, among other variables.

The effects of the economy on the PD is accounted for through the use of scaling factors which map through-the-cycle PD values to point-in-time PD values. The Group has a model to predict these scaling factors based on economic forecasts. The economic forecasts used are provided at least quarterly by the Group's Chief Economist and approved by the All Risk Committee. The Group uses several economic scenarios which have different scaling factors in order to represent the whole range of possible future economic developments. The actual impairment allowance is the weighted average of the ECL in these different scenarios.

The LGD model considers several scenarios for how a facility may develop once a credit event has occurred. One possibility is that the facility cures without a loss. If not, the recoveries may be based on the seizing of collateral and to estimate such recoveries it is appropriate to consider several scenarios for the development of the value of the collateral. Finally, there may be recoveries even though a formal collateral is not in place. These different recovery scenarios are weighted differently depending on the economic scenario under consideration. This leads to a non-linear interaction and thus a difference between the probability weighted average ECL and the ECL in the most likely scenario.

For EAD it is necessary to account for expected prepayments on term loans and for the expected utilisation of commitments such as credit cards, overdrafts, financial guarantees and credit lines. The expected lifetime of agreements may also extend beyond the contractual lifetime for contracts which are generally extended.

Write-off policy

The Group writes off a financial asset, either partially or in full, when there is no realistic prospect of recovery. Where financial assets are secured, write-off is generally after receipt of any proceeds from the realisation of security. In subsequent periods, any recoveries of amounts previously written off are credited to the provision for credit losses in the consolidated interim income statement.

The impairment process

In the Group's impairment framework, the Stage assignment and ECL for each financial asset is calculated from the aforementioned models. The outcome is reviewed by the business units and they can propose changes if they provide sufficient supporting material. The impairment and any proposals for changes are reviewed by the Impairment Council appointed by the All Risk Committee and the impairment allowance is approved by the All Risk Committee on a quarterly basis.

The principle of materiality applies to the above discussion on impairment, whereby exceptions related to non-materiality and immaterial adjustments are not discussed.

Impact of adoption of IFRS 9

The IFRS 9 transition reduced shareholders' equity by ISK 4,010 million in total net of tax at 1 January 2018, thereof ISK 2,484 million is due to changes in impairments and ISK 1,526 million due to reclassification of debt securities. The CET1 capital ratio reduced by 25 basis points.

3. Cont'd

Transition of financial assets and financial liabilities

The following table summarises the day one impact of the implementation of IFRS 9 showing the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Group's financial assets and financial liabilities.

At 1 January 2018	Classification IAS 39	Classification IFRS 9	Closing balance IAS 39	Reclassi-fication	Remeasure-ment	Opening balance IFRS 9
Cash and balances with Central Bank	Loans & receivables	Amortised cost	189,045	-	-	189,045
Listed bonds and debt instruments	Held for trading	Mandatorily at FVTPL	24,716	-	-	24,716
Listed bonds and debt instruments	Designated as at FVTPL*	Mandatorily at FVTPL	373	-	-	373
Unlisted bonds and debt instruments	Designated as at FVTPL*	Mandatorily at FVTPL	2,001	-	-	2,001
Listed shares and equity instruments	Held for trading	Mandatorily at FVTPL	5,108	-	-	5,108
Listed shares and equity instruments	Designated as at FVTPL	Mandatorily at FVTPL	1,645	-	-	1,645
Unlisted shares and equity instruments	Designated as at FVTPL	Mandatorily at FVTPL	2,188	-	-	2,188
Unlisted shares and equity instruments	Available for sale	Fair value through OCI	1,236	-	-	1,236
Derivatives	Held for trading	Mandatorily at FVTPL	2,891	5	-	2,896
Derivatives	Held for hedging	Held for hedging**	5	(5)	-	-
Loans to credit institutions	Loans & receivables	Amortised cost	26,617	-	(39)	26,578
Loans to customers	Loans & receivables	Amortised cost	755,175	-	(2,706)	752,469
Other financial assets	Loans & receivables	Amortised cost	9,847	-	(3)	9,844
Total financial assets			1,020,847	-	(2,748)	1,018,099
Deposits from CB and credit institutions	Amortised cost	Amortised cost	11,189	-	-	11,189
Deposits from customers	Amortised cost	Amortised cost	567,029	-	-	567,029
Derivative instruments and short positions	Held for trading	Mandatorily at FVTPL	5,071	421	-	5,492
Derivative instruments and short positions	Held for hedging	Held for hedging**	421	(421)	-	-
Debt issued and other borrowed funds	Designated as at FVTPL	Designated as at FVTPL***	-	82,655	1,908	84,563
Debt issued and other borrowed funds	Amortised cost	Amortised cost	217,748	(82,655)	-	135,093
Subordinated loans	Amortised cost	Amortised cost	9,505	-	-	9,505
Other financial liabilities	Amortised cost	Amortised cost	10,467	-	-	10,467
Total financial liabilities			821,430	-	1,908	823,338

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

*At the date of initial application of IFRS 9 the Group reclassified certain bonds and debt instruments from designated as at FVTPL to mandatorily at FVTPL. These bonds and debt instruments are managed and evaluated on a fair value basis and are therefore to be mandatorily measured at fair value through profit or loss. No bonds and debt instruments are classified as designated at fair value through profit or loss or at fair value through OCI.

**IFRS 9 includes new hedge accounting rules, which align hedge accounting more closely with risk management. IFRS 9 includes an accounting policy choice to defer the adoption of IFRS 9 hedge accounting and to continue with IAS 39 hedge accounting. The Group has decided to exercise this accounting policy choice. On 1 January 2018 the Group discontinued applying hedge accounting for certain euro denominated debt securities and interest rate swaps.

***At the date of initial application of IFRS 9 the Group changed the classification of certain debt securities to being designated as at fair value through profit or loss. The impact of this change on 1 January 2018 was ISK 1,908 million.

Allowance for credit losses

The following table is a comparison of impairment allowances determined in accordance with IAS 39 and IAS 37 to the corresponding impairment allowance determined in accordance with IFRS 9 as at 1 January 2018.

	Collectively assessed	Individually assessed	Total	Transition adjustments	Stage 1	Stage 2	Stage 3	Total
Loans at amortised cost*	1,729	8,662	10,391	2,745	2,741	1,244	9,151	13,136
Other assets at amortised cost	-	47	47	3	6	2	42	50
Off-balance sheet loan commitments and financial guarantees	-	64	64	610	467	101	106	674
Total allowance for credit losses	1,729	8,773	10,502	3,358	3,214	1,347	9,299	13,860

*Loans at amortised cost includes Loans to customers and Loans to credit institutions.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

IFRS 15 – Revenue from Contracts with Customers

IFRS 15 – Revenue from contracts with customers became effective on 1 January 2018 and replaced various IFRS standards and interpretations on revenue recognition related to sale of goods and services. IFRS 15 establishes a single comprehensive framework for accounting for revenue arising from sale of goods and services through contracts which fall under its scope. IFRS 15 does not apply to revenue arising from financial instruments but it applies to fees charged by the Group which are not part of the effective interest rate of a financial instrument.

The Group adopted IFRS 15 by applying the cumulative effect method, under which the effect of initial adoption was recognised in equity on 1 January 2018 and comparative information was not restated. The Group recognised ISK 97.4 million as a decrease in retained earnings at 1 January 2018 due to the adoption of IFRS 15. This change is due to the change in revenue recognition for insurance broker commissions, whereas the transaction price now reflects a refund liability due to contractual provisions in the contract with the insurance provider, which is the principal in the transaction, and a related refund asset due to commissions paid by the Group to sale agents. Apart from this change the adoption of IFRS 15 did not result in changes to the timing or amount of revenue recognition. However, the Group changed the presentation in the consolidated income statement of insurance and wholesale annual fees related to credit cards, whereas they were presented as an expense in the line item "Fee and commission expense" before 1 January 2018 but they are presented as a deduction from revenue in the line item "Fee and commission income" from 1 January 2018. This change in presentation has no effect on the net fee and commission income.

4. Operating segments

The Bank announced changes to its organisational structure in 2017. The purpose of the changes is to adapt the Bank's organisational structure to customers' changed needs and provide them with better banking services. The changes have not been fully implemented. Currently, Retail Banking and Corporate & Investment Banking serve the customers. Wealth Management and Markets no longer operate as separate segments but have been incorporated into the existing segments. At present, Retail Banking is comprised of Personal Banking and Business Banking, however once the organisational changes have been fully implemented the two new segments will replace Retail Banking. The Bank will then have three income-generating units: Personal Banking, Business Banking and Corporate & Investment Banking.

The increase in deposits in Corporate & Investment Banking in the third quarter is mainly due to a transfer of deposits from other segments, reflecting further implementation of the changes in the organisational structure.

Comparative amounts have not been adjusted.

The Group is currently organised into four main operating segments:

Retail Banking
Personal Banking provides comprehensive financial services to individuals, such as lending, savings and payments; and Business Banking provides wide-ranging financial services to small- and medium-sized enterprises. Comprehensive consultancy services are conducted by experienced advisors located throughout the branches. Business Banking operates Ergo, the asset based financing unit of the Bank. Personal Banking operates Kreditkort, a specialised brand in the credit card sector and Kass, a mobile payments platform.

Corporate & Investment Banking
Corporate & Investment Banking provides universal banking services to large companies, municipalities, institutional investors and affluent individuals. The experienced team members provide customised products and services to customers including lending and advisory, risk management, brokerage and private banking services. The division is sector-focused, building and maintaining relationships with key customer segments within Iceland. Outside of Iceland, Íslandsbanki has a special focus on the North Atlantic seafood industry, leveraging its expertise in the domestic market and global contacts.

Treasury
Treasury is responsible for funding the Bank's operations and for managing the internal pricing framework. Treasury is also responsible for the Bank's balance sheet management and for the relations with investors, financial institutions, stock exchanges and rating agencies.

Proprietary Trading and Subsidiaries
Proprietary Trading and Subsidiaries include equity and debt investments in the trading book and banking book as well as the impact of subsidiaries and associates. For further information regarding subsidiaries and associates see Note 26 and Note 27.

Cost centres comprise Head Office (Human Resources, Communications, Strategy & Marketing and Legal), Finance, Operations & IT, Risk Management, Group Internal Audit, and Compliance.

The accounting policies for the reportable segments are in line with the Group's accounting policies. The Group operates mainly in the Icelandic market.

Following is an overview showing the Group's performance with a breakdown by operating segments.

Notes to the Condensed Consolidated Interim Financial Statements

4. Cont'd

1 January to 30 September 2018 **Operations**	Retail Banking	Corporate & Investment Banking	Treasury	Proprietary Trading & Subsidiaries	Cost centres & eliminations	Total
Net interest income	14,727	5,490	2,975	651	(200)	23,643
Net fee and commission income	4,482	2,353	(137)	2,096	(45)	8,749
Other operating income	40	265	(192)	2,007	(856)	1,264
Total operating income	19,249	8,108	2,646	4,754	(1,101)	33,656
Salaries and related expenses	(3,510)	(1,184)	(122)	(2,071)	(4,566)	(11,453)
Other operating expenses	(2,608)	(489)	(239)	(1,643)	(3,753)	(8,732)
Deposit Guarantee Fund and bank tax	(792)	(85)	(2,538)	-	-	(3,415)
Net impairment on financial assets	1,550	501	(97)	(71)	(2)	1,881
Profit (loss) before cost allocation & tax	13,889	6,851	(350)	969	(9,422)	11,937
Net segment revenue from external customers	21,935	12,273	(4,813)	5,162	(901)	33,656
Of which fee and commission income	5,625	2,563	(104)	8,438	(2,242)	14,280
Net segment revenue from other segments	(2,686)	(4,165)	7,459	(408)	(200)	-
At 30 September 2018						
Loans to customers	509,073	321,307	165	5,037	-	835,582
Other assets	3,685	1,883	271,326	56,487	(6,324)	327,057
Total segment assets	512,758	323,190	271,491	61,524	(6,324)	1,162,639
Deposits from customers	433,735	125,171	54,682	-	(4,942)	608,646
Other liabilities	4,937	3,498	346,969	29,841	(5,882)	379,363
Total segment liabilities	438,672	128,669	401,651	29,841	(10,824)	988,009
Allocated equity	58,883	52,065	50,084	19,296	(5,698)	174,630
Risk exposure amount	417,426	359,696	28,383	51,725	(2,078)	855,152

The individual segment balance sheet positions are with external customers, and exclude internal transactions thus explaining the differences in total assets and total liabilities and equity.

1 January to 30 September 2017 **Operations**	Retail Banking	Corporate & Investment Banking	Treasury	Subsidiaries & Equity Investments	Cost Centres & eliminations	Total
Net interest income	14,916	4,456	2,859	621	(191)	22,661
Net fee and commission income	4,353	2,324	(116)	3,544	13	10,118
Other operating income	15	206	(334)	3,529	(3,439)	(23)
Total operating income	19,284	6,986	2,409	7,694	(3,617)	32,756
Salaries and related expenses	(3,450)	(1,355)	(148)	(1,969)	(4,014)	(10,936)
Other operating expenses	(2,724)	(323)	(170)	(1,737)	(3,423)	(8,377)
Deposit Guarantee Fund and bank tax	(770)	(17)	(2,286)	-	-	(3,073)
Net loan impairment	(64)	563	9	(22)	101	587
Profit (loss) before cost allocation & tax	12,276	5,854	(186)	3,966	(10,953)	10,957
Net segment revenue from external customers	17,479	12,088	(1,744)	8,352	(3,419)	32,756
Net segment revenue from other segments	1,805	(5,102)	4,153	(658)	(198)	-
At 30 September 2017						
Loans to customers	468,027	267,125	791	5,432	5	741,380
Other assets	4,818	3,238	266,996	70,525	(9,334)	336,243
Total segment assets	472,845	270,363	267,787	75,957	(9,329)	1,077,623
Deposits from customers	491,495	14,890	85,294	-	(4,757)	586,922
Other liabilities	6,386	3,958	268,348	33,258	932	312,882
Total segment liabilities	497,881	18,848	353,642	33,258	(3,825)	899,804
Allocated equity	38,398	40,849	76,222	32,884	(10,534)	177,819
Risk exposure amount	390,727	306,136	15,891	50,128	4,654	767,536

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

5. Classification of financial assets and financial liabilities

At 30 September 2018

	Notes	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Fair value through OCI	Amortised cost	Total carrying amount
Cash and balances with Central Bank	21	-	-	-	-	156,251	156,251
Listed bonds and debt instruments		61,809	-	-	-	-	61,809
Unlisted bonds and debt instruments		1,515	-	-	-	-	1,515
Listed shares and equity instruments		9,651	-	-	-	-	9,651
Unlisted shares and equity instruments		2,405	-	-	1,939	-	4,344
Derivatives	22	3,278	201	-	-	-	3,479
Loans to credit institutions	23	-	-	-	-	67,047	67,047
Loans to customers	24	-	-	-	-	835,582	835,582
Other financial assets		-	-	-	-	10,641	10,641
Total financial assets		78,658	201	-	1,939	1,069,521	1,150,319
Deposits from CB and credit institutions	30	-	-	-	-	15,530	15,530
Deposits from customers	31	-	-	-	-	608,646	608,646
Derivative instruments and short positions	22	5,585	-	-	-	-	5,585
Debt issued and other borrowed funds	33	-	38,854	65,918	-	192,546	297,318
Subordinated loans	34	-	-	-	-	15,531	15,531
Other financial liabilities		-	-	-	-	33,423	33,423
Total financial liabilities		5,585	38,854	65,918	-	865,676	976,033

At 31 December 2017

	Held for trading	Held for hedging	Designated as at FVTPL	Loans & receivables	Available for sale	Liabilities at amortised cost	Total carrying amount
Cash and balances with Central Bank	-	-	-	189,045	-	-	189,045
Listed bonds and debt instruments	24,716	-	373	-	-	-	25,089
Unlisted bonds and debt instruments	-	-	2,001	-	-	-	2,001
Listed shares and equity instruments	5,108	-	1,645	-	-	-	6,753
Unlisted shares and equity instruments	-	-	2,188	-	1,236	-	3,424
Derivatives	2,891	5	-	-	-	-	2,896
Loans to credit institutions	-	-	-	26,617	-	-	26,617
Loans to customers	-	-	-	755,175	-	-	755,175
Other financial assets	-	-	-	9,847	-	-	9,847
Total financial assets	32,715	5	6,207	980,684	1,236	-	1,020,847
Deposits from CB and credit institutions	-	-	-	-	-	11,189	11,189
Deposits from customers	-	-	-	-	-	567,029	567,029
Derivative instruments and short positions	5,071	421	-	-	-	-	5,492
Debt issued and other borrowed funds	-	-	-	-	-	217,748	217,748
Subordinated loans	-	-	-	-	-	9,505	9,505
Other financial liabilities	-	-	-	-	-	10,467	10,467
Total financial liabilities	5,071	421	-	-	-	815,938	821,430

Amounts are in ISK million

6. Fair value information for financial instruments

Financial instruments carried at fair value

The fair value of a financial instrument is the transaction price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where a market price is not readily available, the Group applies valuation techniques based on estimates and assumptions that are consistent with that which market participants would use in setting a price for the financial instrument.

The table below shows financial instruments carried at fair value at 30 September 2018 categorised into three levels of fair value hierarchy that reflect the type of inputs used in making the fair value measurements. The different levels have been defined as follows:

Level 1: Inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Group can access at the measurement date.

Level 2: Inputs other than the quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs that are unobservable, e.g. internal assumptions.

At 30 September 2018

	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	61,810	66	1,448	63,324
Shares and equity instruments	9,192	120	4,683	13,995
Derivative instruments	-	3,479	-	3,479
Total financial assets	71,002	3,665	6,131	80,798
Short positions	279	-	-	279
Derivative instruments	-	5,306	-	5,306
Debt issued and other borrowed funds designated as at FVTPL	65,918	-	-	65,918
Total financial liabilities	66,197	5,306	-	71,503

At 31 December 2017

	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	25,132	130	1,828	27,090
Shares and equity instruments	6,714	90	3,373	10,177
Derivative instruments	-	2,896	-	2,896
Total financial assets	31,846	3,116	5,201	40,163
Short positions	270	-	-	270
Derivative instruments	-	5,222	-	5,222
Total financial liabilities	270	5,222	-	5,492

Reconciliation of financial instruments categorised into Level 3:	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2018	1,828	3,373
Purchases	-	744
Net loss on financial instruments recognised in profit or loss	(457)	(138)
Net gain on financial instruments recognised in other comprehensive income	-	704
Other	77	-
Fair value at 30 September 2018	1,448	4,683

Financial Statements third quarter 2018 22 Amounts are in ISK million

6. Cont'd

	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2017	1,872	2,072
Purchases	13	578
Sales	(10)	(2)
Net (loss) gain on financial instruments recognised in profit or loss	(48)	126
Net gain on financial instruments recognised in other comprehensive income	-	417
Transfers from Level 1 or 2	-	206
Other	1	(24)
Fair value at 31 December 2017	1,828	3,373

The responsibility for the valuation of the fair value of financial instruments lies with the relevant business units. Each quarter, the business units present a valuation report to the Investment Committee for approval. The report and its assumptions are reviewed by Risk Management.

Where applicable, fair values are determined using quoted prices in active markets for identical assets and liabilities. In other cases, where there is no active market, the fair value is estimated using valuation techniques such as net present value and discounted cash flow models; comparison with similar instruments for which observable market data exists; net asset value (NAV) for investment fund units or expected recovery for distressed bonds. These valuation techniques are based on various assumptions and inputs such as risk-free rate, expected revenue growth and credit and liquidity spreads. In some cases, where significant inputs into these models are not observable, expert judgement and estimation for these inputs are required.

Level 1 financial assets and financial liabilities contain actively traded bonds and equities that are listed either domestically or abroad.

Level 2 assets and liabilities contain domestic bonds, equities as well as derivatives. For interest rate derivatives contracts such as interest rate swaps (IRS) and cross-currency interest rate swaps (CIRS) the Group calculates the net present value of estimated future cash flows based on yield curves with key inputs such as interest swap rates and forward-rate agreements (FRAs) rates. Foreign-currency forwards and foreign-currency swaps are valued using the FX spot rate adjusted for forward pricing points that can be obtained from market sources. These products are classified as Level 2. Bond forwards and equity forwards are also classified as Level 2 as they are valued using standard models with key inputs observed from stock prices, estimated dividend rates and funding rates.

Level 3 assets contain primarily unlisted and illiquid equities and bonds. Unlisted equities and bonds are initially recorded at their transaction price but are revalued each quarter based on the models as described above. At 30 September 2018 the Group's Level 3 equities amounted to ISK 4,683 million. These include shares in five professional investment funds and investment companies investing in unlisted equities and specialised investments in Iceland totalling ISK 1,659 million; and Series C preferred shares in Visa Inc., amounting to ISK 1,939 million, which are subject to selling restrictions for a period of up to 10 years and under certain conditions may have to be recalled.

The Group's Level 3 bonds amounted to ISK 1,448 million. The majority of the amount in Level 3 bonds is estimated by discounting cash flow where the yield is the contractual currency's base rate with a premium that is decided by expert judgement on projected risk and financing cost.

7. Financial instruments not carried at fair value

Assets

The fair value of “Loans to customers” may differ from their net carrying amount because the interest rates they carry may not reflect the interest rates that similar new loans would carry. The fair value is estimated by subtracting from or adding to the net carrying amount of the loans the discounted interest rate difference calculated from the reporting date until the next interest reset or maturity, whichever comes first. Since the interest rate difference is estimated using internal models these assets are classified as Level 3.

After the adoption of IFRS 9, the credit deterioration for “Loans to customers” is reflected in the net carrying amount. Therefore, credit deterioration does not create a difference between the fair value and the net carrying amount.

For “Cash and balances with Central Bank”, “Loans to credit institutions” and “Other financial assets” the fair value is adequately approximated by the carrying amount as they are short term in nature. They are thus classified as Level 2.

Amounts are in ISK million

7. Cont'd

Liabilities

The fair value of a financial liability with a demand feature, such as a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Most deposits are on demand or carry floating interest rates and as such their carrying amount is considered a good approximation of their fair value. The fair value for longer term fixed rate deposits is calculated with a duration approach, using the difference in each liability's current interest rate from the rate that a similar deposit would carry today. All deposits are classified as Level 2 based on the use of observable market interest rates to estimate the fair value.

Observed market value is used for the fair value of "Debt issued and other borrowed funds" where it is available. Issued bonds and bills with quoted market prices are classified as Level 1. If there is no quoted market price the fair value of the debt is valued in the same manner as deposits if it carries a fixed rate. If the debt carries a floating rate its fair value is estimated by comparing the margin with the Bank's current funding premium on similar debt. These liabilities are classified as Level 2. The funding premium is based on the interest margin on the Bank's issued papers including covered bonds, commercial papers as well as foreign currency denominated bonds.

Other financial liabilities mainly include unsettled securities transactions and liabilities to retailers for credit card provisions and they are classified as Level 2 since their value is not observable from active market prices. Due to the short-term nature of these liabilities their carrying amount is considered a good approximation of their fair value.

The following tables show the fair value measurement and classification of the Group's assets and liabilities not carried at fair value. The different levels are defined in Note 6.

At 30 September 2018	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	156,251	-	156,251	156,251
Loans to credit institutions	-	67,047	-	67,047	67,047
Loans to customers	-	-	837,703	837,703	835,582
Other financial assets	-	10,641	-	10,641	10,641
Total financial assets	-	233,939	837,703	1,071,642	1,069,521
Deposits from Central Bank and credit institutions	-	15,554	-	15,554	15,530
Deposits from customers	-	608,808	-	608,808	608,646
Debt issued and other borrowed funds	144,001	89,198	-	233,199	231,400
Subordinated loans	15,484	-	-	15,484	15,531
Other financial liabilities	-	33,423	-	33,423	33,423
Total financial liabilities	159,485	746,983	-	906,468	904,530

At 31 December 2017	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	189,045	-	189,045	189,045
Loans to credit institutions	-	26,617	-	26,617	26,617
Loans to customers	-	-	759,526	759,526	755,175
Other financial assets	-	9,847	-	9,847	9,847
Total financial assets	-	225,509	759,526	985,035	980,684
Deposits from Central Bank and credit institutions	-	11,192	-	11,192	11,189
Deposits from customers	-	567,235	-	567,235	567,029
Debt issued and other borrowed funds	119,819	104,482	-	224,301	217,748
Subordinated loans	9,457	-	-	9,457	9,505
Other financial liabilities	-	10,467	-	10,467	10,467
Total financial liabilities	129,276	693,376	-	822,652	815,938

Financial Statements third quarter 2018 24 Amounts are in ISK million

8. Offsetting financial assets and financial liabilities

The tables below show reconciliation to the net amounts of financial assets and financial liabilities, which are subject to offsetting, enforceable master netting agreements and similar agreements.

Financial assets	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 30 September 2018	Financial assets before netting	Netting with financial liabilities	Net financial assets	Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Derivatives	3,479	-	3,479	(1,251)	(1,412)	(275)	541	-	3,479
Total assets	3,479	-	3,479	(1,251)	(1,412)	(275)	541	-	3,479
At 31 December 2017									
Reverse repurchase agreements	618	-	618	(270)	-	-	348	-	618
Derivatives	2,896	-	2,896	(733)	(1,482)	(9)	672	-	2,896
Total assets	3,514	-	3,514	(1,003)	(1,482)	(9)	1,020	-	3,514

Financial liabilities	Financial liabilities subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 30 September 2018	Financial liabilities before netting	Netting with financial assets	Net financial liabilities	Financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total financial liabilities recognised in the balance sheet
Derivative instruments and short positions	5,306	-	5,306	(1,251)	(65)	-	3,990	279	5,585
At 31 December 2017									
Derivative instruments and short positions	5,492	-	5,492	(733)	(492)	-	4,267	-	5,492

9. Quarterly statements

	2018 Q3	2018 Q2	2018 Q1	2017 Q4	2017 Q3
Net interest income	8,301	7,602	7,740	7,338	7,450
Net fee and commission income	2,939	3,032	2,778	3,632	3,305
Net financial (expense) income	(420)	378	(283)	260	(1,084)
Net foreign exchange (loss) gain	(8)	(57)	(10)	81	76
Other operating income	64	1,587	13	122	291
Salaries and related expenses	(3,501)	(4,026)	(3,926)	(4,297)	(3,168)
Other operating expenses	(2,962)	(2,846)	(2,924)	(3,358)	(2,879)
Contribution to the Depositors' and Investors' Guarantee Fund	(295)	(287)	(292)	(288)	(280)
Bank tax	(944)	(812)	(785)	(614)	(806)
Net impairment on financial assets	(53)	1,846	88	969	147
Profit before tax	3,121	6,417	2,399	3,845	3,052
Income tax expense	(1,136)	(1,465)	(1,015)	(816)	(1,072)
Profit for the period from continuing operations	1,985	4,952	1,384	3,029	1,980
Profit from discontinued operations, net of income tax	126	81	713	83	93
Profit for the period	2,111	5,033	2,097	3,112	2,073

Amounts are in ISK million

10. Net interest income

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Cash and balances with Central Bank*	5,676	8,256	1,629	2,543
Loans at amortised cost*	37,941	33,707	13,565	10,710
Financial assets mandatorily at fair value through profit or loss	1,327	-	500	-
Financial assets designated as at fair value through profit or loss	-	39	-	6
Financial assets held for trading	-	(77)	-	117
Other assets	100	100	13	30
Total interest income	45,044	42,025	15,707	13,406
Deposits from credit institutions and Central Bank*	(303)	(118)	(97)	(37)
Deposits from customers*	(12,150)	(13,540)	(4,192)	(4,035)
Debt issued and other borrowed funds at fair value through profit or loss	(713)	-	(133)	-
Debt issued and other borrowed funds at amortised cost*	(6,357)	(5,690)	(2,399)	(1,881)
Subordinated loans*	(89)	-	(18)	-
Other financial liabilities	(1,765)	-	(561)	-
Other interest expense	(24)	(16)	(6)	(3)
Total interest expense	(21,401)	(19,364)	(7,406)	(5,956)
Net interest income	23,643	22,661	8,301	7,450

*Interest calculated using the effective interest rate method.

11. Net fee and commission income

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Asset management	1,529	1,438	498	436
Investment banking and brokerage	1,682	1,643	634	566
Payment processing	8,822	10,054	3,186	3,296
Loans and guarantees	1,131	1,088	362	359
Other fee and commission income	1,116	1,420	364	460
Total fee and commission income	14,280	15,643	5,044	5,117
Brokerage	(209)	(97)	(79)	(33)
Clearing and settlement	(5,314)	(5,412)	(2,025)	(1,773)
Other commission expenses	(8)	(16)	(1)	(6)
Total commission expenses	(5,531)	(5,525)	(2,105)	(1,812)
Net fee and commission income	8,749	10,118	2,939	3,305

12. Net financial expense

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Net loss on financial assets and liabilities held for trading	-	(1,082)	-	(995)
Net gain (loss) on financial assets designated as at fair value through profit or loss	-	65	-	(87)
Net loss on financial assets and liabilities mandatorily at FVTPL	(171)	-	(447)	-
Net (loss) gain on financial liabilities designated as at FVTPL	(137)	-	25	-
Net (loss) gain on fair value hedges	(17)	42	2	(2)
Net financial expense	(325)	(975)	(420)	(1,084)

Amounts are in ISK million

13. Net foreign exchange (loss) gain

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Cash and balances with Central Bank	(143)	(95)	(36)	32
Financial assets held for trading	-	2,859	-	2,635
Financial assets designated as at fair value through profit or loss	-	(78)	-	37
Financial assets mandatorily at fair value through profit or loss	19	-	2,130	-
Loans at amortised cost	8,819	1,976	8,779	6,443
Other assets	128	179	105	287
Net foreign exchange gain for assets	8,823	4,841	10,978	9,434
Deposits	(3,935)	509	(3,727)	(2,196)
Debt issued and other borrowed funds designated as at FVTPL	(1,551)	-	(2,400)	-
Debt issued and other borrowed funds at amortised cost	(3,022)	(4,909)	(3,907)	(6,986)
Subordinated loans	(228)	-	(865)	-
Other liabilities	(162)	5	(87)	(176)
Net foreign exchange loss for liabilities	(8,898)	(4,395)	(10,986)	(9,358)
Net foreign exchange (loss) gain	(75)	446	(8)	76

14. Other operating income

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Share of (loss) profit of associates, net of income tax	(34)	102	-	-
Net gain (loss) from sale of subsidiaries and associates*	1,529	(60)	-	(60)
Legal cost and fees	62	77	18	19
Rental income	28	29	9	9
Gain from sale of buildings	2	288	1	287
Other net operating income	77	70	36	36
Other operating income	1,664	506	64	291

*In the second quarter of 2018 the Group sold a subsidiary, which owned land in Reykjavík.

15. Salaries and related expenses

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Salaries	8,793	8,878	2,672	2,547
Contributions to pension funds	1,316	1,265	411	373
Social security charges and financial activities tax*	1,287	1,305	416	394
Other	65	63	6	(2)
Capitalisation of internal staff costs in software development	(8)	(575)	(4)	(144)
Salaries and related expenses	11,453	10,936	3,501	3,168

*Financial activities tax calculated on salaries is 5.5% (2017: 5.5%).

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

16. Other operating expenses

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Professional services	3,939	3,618	1,364	1,264
Real estate and fixtures	2,546	2,205	837	764
Depreciation and amortisation	702	642	261	220
Other administrative expenses	1,545	1,912	500	631
Other operating expenses	8,732	8,377	2,962	2,879

17. Net impairment on financial assets

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Allowance for expected credit losses, on-balance sheet items	918	-	35	-
Allowance for expected credit losses, off-balance sheet items	(48)	-	(88)	-
Specific impairment	-	796	-	228
Collective impairment	-	303	-	141
Impairment changes due to court rulings	1,011	(737)	-	(341)
Impairment reversal due to revised estimated future cash flows	-	225	-	119
Net impairment on financial assets	1,881	587	(53)	147

18. Income tax expense

Income tax is recognised based on applicable tax rates and tax laws. The income tax rate for legal entities in 2018 is 20% (2017: 20%). Special financial activities tax is calculated as 6% of taxable profits exceeding ISK 1 billion in accordance with the Act on Financial Activities Tax no. 165/2011. The effective income tax rate in the Group's income statement for the third quarter of 2018 is 30.3% (2017: 30.4%).

Income tax recognised in the income statement is specified as follows:	2018 1.1-30.9	2017 1.1-30.9
Current tax expense excluding discontinued operations	2,960	2,385
Special financial activities tax	813	613
Difference in prior year's imposed and calculated income tax	(6)	(22)
Changes in temporary differences due to deferred tax assets and deferred tax liabilities	(151)	359
Total	3,616	3,335

The effective income tax rate is specified as follows:	2018 1.1-30.9		2017 1.1-30.9	
Profit before tax	11,937		10,957	
20% income tax calculated on the profit for the period	2,387	20.0%	2,191	20.0%
Special financial activities tax	813	6.8%	613	5.6%
(Income) expenses not subject to tax	(108)	(0.9%)	40	0.4%
Non-deductible expenses	509	4.3%	461	4.2%
Other differences	15	0.1%	30	0.2%
Income tax expense	3,616	30.3%	3,335	30.4%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

19. Profit from discontinued operations

	2018 1.1-30.9	2017 1.1-30.9	2018 1.7-30.9	2017 1.7-30.9
Net profit from sales of foreclosed mortgages	73	234	34	45
Net share of profit from disposal groups held for sale	847	360	92	48
Net profit from sale of subsidiaries	-	1,898	-	-
Profit from discontinued operations, net of income tax	920	2,492	126	93

20. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2018 1.1-30.9	2017 1.1-30.9	2018 1.1-30.9	2017 1.1-30.9
Profit attributable to equity holders of the Bank	8,600	7,909	9,520	10,401
Weighted average number of outstanding shares for the period	10,000	10,000	10,000	10,000
Basic earnings per share	0.86	0.79	0.95	1.04

There were no instruments at the end of the period that could potentially dilute basic earnings per share (2017: none).

21. Cash and balances with Central Bank

	30.9.2018	31.12.2017
Cash on hand	2,062	1,976
Balances with Central Bank	138,722	169,503
Balances with Central Bank assets subject to special restrictions*	2,963	4,593
Included in cash and cash equivalents	143,747	176,072
Mandatory reserve deposits with Central Bank**	12,504	12,973
Cash and balances with Central Bank	156,251	189,045

*Offshore króna assets and onshore króna assets, as defined in Act no. 37/2016 and rules no. 490/2016.

**The Monetary Policy Committee of the Central Bank of Iceland has decided to change the arrangements for credit institutions' minimum reserve requirements so as to divide the reserve requirement into two parts: a fixed 1% reserve requirement bearing no interest, and a 1% reserve requirement of the type that has been in place, currently bearing 4% interest. The objective of these changes is to reduce the cost to the Central Bank in relation to foreign cash reserves. The new rules on minimum reserve requirements no. 585/2018 took effect on 21 June 2018.

Financial Statements third quarter 2018 29 Amounts are in ISK million

22. Derivative instruments and short positions

At 30 September 2018	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	786	95,650	2,818	137,246
Cross-currency interest rate swaps	842	55,393	1,681	40,455
Equity forwards	765	6,349	39	667
Foreign exchange forwards	282	10,910	207	11,224
Foreign exchange swaps	698	29,779	531	29,101
Bond forwards	106	12,993	30	5,960
Derivatives	3,479	211,074	5,306	224,653
Short positions in listed bonds	-	-	279	-
Total	3,479	211,074	5,585	224,653

At 31 December 2017	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	724	77,754	2,687	120,284
Cross-currency interest rate swaps	613	33,023	1,924	29,512
Equity forwards	217	1,669	99	1,846
Equity options	19	152	-	-
Foreign exchange forwards	211	7,263	117	5,992
Foreign exchange swaps	1,095	19,100	325	24,813
Bond forwards	17	2,444	70	7,430
Derivatives	2,896	141,405	5,222	189,877
Short positions in listed bonds	-	-	270	-
Total	2,896	141,405	5,492	189,877

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. The Group carries relatively low indirect exposure due to margin trading with clients and the Group holds collaterals for possible losses. Other derivatives in the Group held for trading or for other purposes are insignificant.

Short positions are in Icelandic Government bonds and institutions with government guarantees. As a primary dealer the Group has access to securities lending facilities provided by the Central Bank and the Housing Financing Fund. Majority of the securities lending facilities have a maturity of less than a year.

The Group applies hedge accounting only with respect to certain EUR denominated interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR denominated bonds (see Note 33) arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. The total fair value of the interest rate swaps at the end of September 2018 was positive and amounted to ISK 201 million. Their total notional amount at the end of September 2018 was ISK 38,610 million. At the beginning of 2018 Íslandsbanki derecognised certain EUR denominated interest rate swaps as hedging instruments and classified them as mandatorily at fair value through profit and loss due to changes in classification of certain EUR denominated bonds. The notional amount of those interest rate swaps was ISK 62,525 million at the end of 2017.

Amounts are in ISK million

23. Loans to credit institutions

	30.9.2018	31.12.2017
Money market loans	47,279	10,658
Bank accounts	19,768	15,959
Loans to credit institutions	67,047	26,617

24. Loans to customers

At 30 September 2018	Gross carrying amount			ECL allowance			Net carrying amount
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	
Individuals	303,586	5,623	8,257	(1,064)	(234)	(1,677)	314,491
Commerce and services	118,675	3,488	5,277	(626)	(161)	(3,029)	123,624
Construction	28,802	2,191	359	(196)	(202)	(41)	30,913
Energy	6,702	736	-	(18)	(13)	-	7,407
Financial services	220	-	-	-	-	-	220
Industrial and transportation	79,826	2,389	3,822	(373)	(41)	(774)	84,849
Investment companies	16,641	2,924	632	(186)	(60)	(419)	19,532
Public sector and non-profit organisations	11,790	20	23	(12)	(1)	(1)	11,819
Real estate	134,076	1,748	1,890	(501)	(77)	(349)	136,787
Seafood	94,287	11,590	629	(105)	(66)	(395)	105,940
Loans to customers	794,605	30,709	20,889	(3,081)	(855)	(6,685)	835,582

At 31 December 2017	Gross amount	Specific impairment allowance	Loans less impairment allowance
Individuals	301,502	(2,152)	299,350
Commerce and services	115,128	(2,984)	112,144
Construction	25,816	(1,019)	24,797
Energy	7,109	-	7,109
Financial services	26	-	26
Industrial and transportation	71,258	(1,297)	69,961
Investment companies	20,138	(412)	19,726
Public sector and non-profit organisations	11,871	-	11,871
Real estate	127,323	(256)	127,067
Seafood	85,395	(542)	84,853
Loans to customers before collective impairment allowance	765,566	(8,662)	756,904
Collective impairment allowance			(1,729)
Loans to customers			755,175

Amounts are in ISK million

25. Expected credit loss

Loans to customers

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	2,701	1,244	9,151	13,096
Transfer to Stage 1	2,096	(1,250)	(846)	-
Transfer to Stage 2	(476)	1,641	(1,165)	-
Transfer to Stage 3	(109)	(1,039)	1,148	-
Net remeasurement of loss allowance	(1,222)	173	(638)	(1,687)
New financial assets originated or purchased	817	255	804	1,876
Derecognitions and maturities	(725)	(166)	(328)	(1,219)
Write-offs	(1)	(3)	(2,086)	(2,090)
Recoveries of amounts previously written off	-	-	191	191
Changes in models/risk parameters	-	-	-	-
Foreign exchange	-	-	65	65
Unwinding of interests	-	-	389	389
At 30 September 2018	3,081	855	6,685	10,621

	Stage 1	Stage 2	Stage 3	Total
Cash and balances with Central Bank	62	-	-	62
Loans to credit institutions	65	-	-	65
Loans to customers	3,081	855	6,685	10,621
Other financial assets	5	4	67	76
Off-balance sheet loan commitments and financial guarantees	434	116	172	722
At 30 September 2018	3,647	975	6,924	11,546

Changes in the provision for impairment losses for loans to customers according to IAS 39:	Specific impairment allowance	Collective impairment allowance	Total
At 1 January 2017	11,472	2,049	13,521
Amounts written-off	(5,905)	(3)	(5,908)
Recoveries of amounts previously written-off	617	-	617
Charged to the income statement	2,478	(317)	2,161
At 31 December 2017	8,662	1,729	10,391

26. Investments in associates

	2018 1.1-30.9	2017 1.1-31.12
Investments in associates at the beginning of the year	704	450
Additions during the period	-	36
Sales of shares in associates	(39)	-
Transfers	(80)	-
Share of results	(34)	142
Dividends paid	(18)	(25)
Impairment	-	(60)
Other	-	161
Investments in associates	533	704

Amounts are in ISK million

27. Investments in subsidiaries

Significant subsidiaries:

		30.9.2018	31.12.2017
Borgun hf., a payment acquirer and issuing processor, Ármúli 30, 108 Reykjavík	Iceland	63.5%	63.5%
Íslandssjóðir hf., an investment fund management company, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
IS Þróunarsjóðurinn Langbrók, a professional investment fund, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
Hringur-eignarhaldsfélag ehf., a holding company, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%
Allianz Ísland hf., an insurance agent, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%

Other non-significant subsidiaries:
During the third quarter the Group gained control over its associate B-Payment Szolgáltato Zrt and its three subsidiaries, thereby making them subsidiaries of the Group.

In addition Íslandsbanki has control over 17 other subsidiaries.

28. Other assets

	30.9.2018	31.12.2017
Receivables	7,651	6,736
Unsettled securities transactions	2,148	2,620
Accruals	411	205
Prepaid expenses	464	215
Deferred tax assets	235	4
Other assets	296	213
Other assets	11,205	9,993

29. Non-current assets and disposal groups held for sale

	30.9.2018	31.12.2017
Repossessed collateral	1,031	1,224
Assets of disposal groups classified as held for sale	203	1,542
Total	1,234	2,766

Land and property	1,008	1,194
Industrial equipment and vehicles	23	30
Repossessed collateral	1,031	1,224

30. Deposits from Central Bank and credit institutions

	30.9.2018	31.12.2017
Repurchase agreements with Central Bank	32	92
Deposits from credit institutions	15,498	11,097
Deposits from Central Bank and credit institutions	15,530	11,189

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

31. Deposits from customers

	30.9.2018	31.12.2017
Demand deposits*	542,765	479,590
Time deposits	65,881	87,439
Deposits from customers	608,646	567,029

*Demand deposits include deposits with maturity of up to 3 months.

Deposits from customers specified by owners:

	30.9.2018		31.12.2017	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	9,426	2%	6,071	1%
Municipalities	7,871	1%	7,054	1%
Companies	317,432	52%	290,405	51%
Individuals	273,917	45%	263,499	47%
Deposits from customers	608,646	100%	567,029	100%

32. Pledged assets

	30.9.2018	31.12.2017
Financial assets pledged as collateral against liabilities	182,015	149,663
Financial assets pledged as collateral in foreign banks	1,007	908
Financial assets pledged as collateral in repurchase agreements	736	618
Pledged assets against liabilities	183,758	151,189

The Group has pledged assets against the issuance of covered bonds under Icelandic law, which are pledged on a pool of consumer mortgage loans. The underlying cover pool must withstand a weekly stress test.

The Group has also pledged cash in foreign banks and financial institutions, mainly as collateral for trades under ISDA agreements to hedge market risk.

The comparative amount in the line item "Financial assets pledged as collateral against liabilities" at 31.12.2017 has been increased by ISK 4,800 million for comparison with 30.09.2018 to take into consideration assets pledged as collateral to the Central Bank of Iceland to secure settlement in the Icelandic cash clearing systems.

Amounts are in ISK million

33. Debt issued and other borrowed funds

	Issued	Maturity	Maturity type	Terms of interest	30.9.2018	31.12.2017
Covered bond in ISK	2014-2017	2019	At maturity	Fixed, 6.93%	10,240	10,120
Covered bond in ISK	2015-2018	2023	At maturity	Fixed, 6.40%	8,334	7,469
Covered bond in ISK - CPI-linked	2012-2014	2019	At maturity	Fixed, 2.84%	8,785	8,666
Covered bond in ISK - CPI-linked	2014-2015	2020	At maturity	Fixed, 3.47%	4,241	4,117
Covered bond in ISK - CPI-linked	2015-2017	2022	At maturity	Fixed, 2.98%	17,686	17,467
Covered bond in ISK - CPI-linked	2012-2018	2024	At maturity	Fixed, 3.45%	32,603	21,963
Covered bond in ISK - CPI-linked	2015-2018	2026	At maturity	Fixed, 3.37%	26,943	24,049
Covered bond in ISK - CPI-linked	2017-2018	2030	At maturity	Fixed, 3.00%	23,815	15,089
Covered bonds					132,647	108,940
Senior unsecured bond in EUR*	2015-2016	2018	At maturity	Fixed, 2.88%	-	19,004
Senior unsecured bond in NOK	2015	2018	At maturity	Floating, NIBOR + 2.60%	6,844	6,391
Senior unsecured bond in SEK	2015	2019	At maturity	Floating, STIBOR + 3.10%	7,528	7,660
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.38%	386	375
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.40%	2,574	2,500
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.50%	1,288	1,253
Senior unsecured bond in EUR*	2016	2020	At maturity	Fixed, 1.75%	65,918	63,651
Senior unsecured bond in SEK	2018	2019	At maturity	Floating, STIBOR + 0.34%	1,252	-
Senior unsecured bond in SEK	2018	2021	At maturity	Floating, STIBOR + 0.60%	1,250	-
Senior unsecured bond in SEK	2018	2021	At maturity	Floating, STIBOR + 0.74%	1,256	-
Senior unsecured bond in SEK	2018	2022	At maturity	Floating, STIBOR + 0.80%	12,472	-
Senior unsecured bond in SEK	2018	2020	At maturity	Floating, STIBOR + 0.32%	3,125	-
Senior unsecured bond in SEK	2018	2021	At maturity	Floating, STIBOR + 1.00%	13,205	-
Senior unsecured bond in EUR**	2018	2024	At maturity	Fixed, 1.13%	38,854	-
Bonds issued					155,952	100,834
Bills issued					8,282	7,538
Other debt securities					437	436
Other borrowed funds					8,719	7,974
Debt issued and other borrowed funds					297,318	217,748

*At the date of initial application of IFRS 9 the Group changed the classification of certain debt securities to being designated as at fair value through profit or loss. The impact of this change on 1.1.2018 amounted to ISK 1,908 million. At 30 September 2018 the total carrying amount of the bond issuance amounted to ISK 65,918 million and included in the amount are fair value changes amounting to ISK 1,082 million. The carrying amount of the debt securities designated as at fair value through profit or loss at 30 September 2018 was ISK 1,568 million higher than the contractual amount due at maturity.

**The Group applies hedge accounting to this bond issuance and uses certain EUR denominated interest rate swaps as hedging instruments (see Note 22). The interest rate swaps are hedging the exposure of the Group's changes in the fair value of this fixed-rate EUR denominated bond arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. At 30 September 2018 the total carrying amount of the bond issuance amounted to ISK 38,854 million and included in the amount are fair value changes amounting to ISK 111 million.

Íslandsbanki did not repurchase own senior or covered bonds during the period.

The covered bond amounts do not contain the bonds reserved for securities lending.

Financial Statements third quarter 2018 35 Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

34. Subordinated loans

	Issued	Maturity	Maturity type	Terms of interest	30.9.2018	31.12.2017
Loans which qualify as Tier 2 capital:						
Subordinated loans in SEK	2017	2027	At maturity	Floating, STIBOR + 2.0%	9,334	9,505
Subordinated loans in SEK*	2018	2028	At maturity	Floating, STIBOR + 2.5%	6,197	-
Subordinated loans					15,531	9,505

*The Group issued an SEK 500 million Tier 2 bond in the third quarter of 2018.

35. Changes in liabilities arising from financing activities

					Non-cash changes			
	31.12.2017	Reclassi-fication IFRS 9	1.1.2018	Cash flows	Accrued interest	Foreign exchange movement	Fair value changes	30.9.2018
Coverd bonds NIL	17,589	-	17,589	158	827	-	-	18,574
Coverd bonds CPI	91,351	-	91,351	18,223	4,499	-	-	114,073
Senior unsecured bonds FX	37,182	(19,003)	18,179	30,588	421	1,992	-	51,180
Senior unsecured bonds FX at fair value ...	-	82,655	82,655	(20,083)	713	1,551	1,082	65,918
Assets held to hedge long-term borrow.	63,652	(63,652)	-	37,406	308	1,029	111	38,854
Short-term borrowings	7,974	-	7,974	441	303	1	-	8,719
Subordinated loans	9,505	-	9,505	5,709	89	228	-	15,531
Total	227,253	-	227,253	72,442	7,160	4,801	1,193	312,849

			Non-cash changes				
	1.1.2017	Cash flows	Accrued interest	Foreign exchange movement	Fair value changes	Other	31.12.2017
Coverd bonds NIL	15,491	1,031	1,067	-	-	-	17,589
Coverd bonds CPI	48,733	27,170	3,365	-	-	12,083	91,351
Senior unsecured bonds FX	64,133	(30,854)	2,361	1,542	-	-	37,182
Other loans	17,207	(2,690)	-	-	-	(14,517)	-
Assets held to hedge long-term borrowings	61,125	(1,108)	665	3,071	(101)	-	63,652
Short-term borrowings	5,779	1,835	360	-	-	-	7,974
Subordinated loans	-	9,250	14	241	-	-	9,505
Total	212,468	4,634	7,832	4,854	(101)	(2,434)	227,253

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

36. Other liabilities

	30.9.2018	31.12.2017
Accruals	3,911	4,049
Liabilities to retailers for credit cards	24,031	23,878
Provision for effects of court rulings	112	1,811
Off-balance sheet loan commitments and financial guarantees	722	64
Withholding tax	650	1,596
Unsettled securities transactions	2,193	1,384
Deferred income	120	199
Sundry liabilities	3,275	2,966
Other liabilities	35,014	35,947

Reconciliation of off-balance sheet loan commitments and financial guarantees:

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	467	101	106	674
Transfer to Stage 1	90	(60)	(30)	-
Transfer to Stage 2	(20)	29	(9)	-
Transfer to Stage 3	(5)	(66)	71	-
Net remeasurement of loss allowance	(236)	25	(108)	(319)
New financial assets originated or purchased	307	96	158	561
Derecognitions and maturities	(169)	(9)	(16)	(194)
At 30 September 2018	434	116	172	722

37. Custody assets

	30.9.2018	31.12.2017
Custody assets - not managed by the Group	2,290,480	2,101,434

38. Related party

Íslandsbanki is wholly owned by the Icelandic Government, directly and through ISB Holding ehf., which is also wholly owned by the Icelandic Government. The shares are administered by the Icelandic State Financial Investments ("ISFI"). As a result, the Icelandic Government and the Icelandic State Financial Investments, and the members of the Board of Directors of ISFI are defined as related parties of the Group. The Group has applied the partial exemption for government-related entities, as described in IAS 24, and does not disclose those transactions in the related party note.

The Board of Directors of the parent company, key management personnel, close family members of individuals referred to herein and legal entities controlled by them, are defined as related parties. The Group's associates, and their key management personnel and legal entities controlled by them, are also defined as related parties.

The Group's products and services are offered to the Icelandic Government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from government-related entities under generally accepted commercial terms. Transactions with related parties were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

Cash and balances with the Central Bank are disclosed under Note 21 and Deposits from the Central Bank are disclosed under Note 30.

All loans to employees are provided on general business terms of the Group and the balances do not reflect collaterals held by the Group.

Amounts are in ISK million

38. Cont'd

At 30 September 2018	Assets	Liabilities	Net balance	Commitments & overdrafts
Shareholders with control over the Group	-	(105)	(105)	1
Board of Directors and key management personnel	386	(648)	(262)	85
Associated companies and other related parties	239	(614)	(375)	236
Balances with related parties	625	(1,367)	(742)	322

1 January - 30 September 2018	Interest income	Interest expense	Other income
Shareholders with control over the Group	-	(2)	-
Board of Directors and key management personnel	37	(6)	24
Associated companies and other related parties	12	(6)	2
Transactions with related parties	49	(14)	26

At 31 December 2017	Assets	Liabilities	Net balance	Commitments & overdrafts
Shareholders with control over the Group	-	(103)	(103)	1
Board of Directors and key management personnel	287	(415)	(128)	59
Associated companies and other related parties	330	(743)	(413)	232
Balances with related parties	617	(1,261)	(644)	292

1 January - 31 December 2017	Interest income	Interest expense	Other income
Shareholders with control over the Group	-	(3)	-
Board of Directors and key management personnel	16	(13)	-
Associated companies and other related parties	24	(25)	2
Transactions with related parties	40	(41)	2

No share option programmes were operated during the reporting period 1 January - 30 September 2018.

39. Contingencies

Provisions

Variable rate loan contracts

In September 2014, the Icelandic Consumer Agency published its decision on a matter regarding the terms of, and information relating to the granting of, a consumer mortgage contract with interest reset terms granted by the Group in 2005. The Consumer Agency found that the terms offered by the Group and its predecessors, regarding the method and conditions of resetting interest rates, did not fulfil the requirements of the law on consumer loans. The Supreme Court found in favour of the Consumer Agency in October 2017. Close to 1,600 customers were affected.

The Group had recognised a provision of ISK 800 million against the loss due to this ruling. On 30 September 2018 the Group had repaid ISK 688 million to affected customers. The Group expects to process the repayments to the few remaining customers in the fourth quarter of 2018.

Amounts are in ISK million

39. Cont'd

Contingent liabilities

Borgun hf.

Borgun hf. is a payment acquirer and issuing processor and a subsidiary of Íslandsbanki. Landsbankinn hf. sold its 31.2% stake in Borgun in late 2014. Since early 2016 Landsbankinn has been criticised (among others by the Icelandic National Audit Office) for not having foreseen in the process of the sale that Borgun was entitled to proceeds from the Visa Inc. takeover of Visa Europe. Landsbankinn's response to the criticism is that it considers that Borgun's management had not released information on all factors that could affect the value of Borgun during the sales process. In order to reclaim the alleged loss, Landsbankinn filed a lawsuit on 12 January 2017, claiming damages for having been deprived of the true value of the stake involved in the sale.

The plaintiff does not quantify the claim, but his estimate of the loss of profit is approximately ISK 1,930 million (by selling the shares in Borgun). Seeing that the conclusion of the case is uncertain and the financial effect cannot be estimated, the Group has not recognised a provision in relation to this matter. Due to proceedings involving the appointing of an independent evaluator the trial date has not been set.

Contingent assets

Settlement of the 2011 Byr acquisition

The Group acquired Byr hf. ("Byr"), a former savings bank, in 2011 from the Byr Winding-up Committee ("Committee") and the Icelandic Ministry of Finance and Economic Affairs ("Ministry"). According to standard practice, the Group retained the right to re-evaluate the fair value of the net assets acquired and to demand a refund if the fair value of the net assets was not in line with what was presented in Byr's financial statements. Based on this, the Group filed a claim amounting to ISK 6,943 million plus interest with the Committee in June 2013. The claim is filed as a priority claim, according to Article 110 of the Act on Bankruptcy no. 21/1991. The Committee rejected the claim with a letter dated 30 September 2013. At a creditors' meeting in December 2013 it was decided that the Committee would refer the dispute to the District Court of Reykjavík. A formal claim amounting to ISK 911 million plus interest was filed with the Ministry on 24 September 2014. Both claims have now been filed with the District Court of Reykjavík. Furthermore, at the request of the Group, the District Court has appointed two independent professionals to perform a formal evaluation of the Group's claim on the Ministry and the Committee. The Group expects the evaluation will be completed in the fourth quarter of 2018. Court proceedings are expected to commence once the evaluation has been completed and filed with the District Court. The Group has not recognised any revenues relating to this claim.

The District Court of Reykjavík confirmed the Composition Agreement of Byr Savings Bank on 8 January 2016. The Agreement includes reservations due to Íslandsbanki's claim and is not expected to impact the proceedings described above.

40. Events after the reporting period

No events have arisen after the reporting period that require amendments or additional disclosures in the interim financial statements for the third quarter 2018.

41. Risk management

Risk governance

Íslandsbanki is exposed to various risks and managing these risks is an integral part of the Bank's operations. More information about the Bank's risk management and risk assessment processes is available in the unaudited Pillar 3 Report. The Pillar 3 Report is available on the Bank's website: www.islandsbanki.is.

42. Credit risk

Credit risk is defined as current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any financial contract with the Group.

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. industrial sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

Credit risk arises principally from loans and advances to customers and other banks but also from balances with the Central Bank and off-balance sheet items such as financial guarantees, loan commitments and derivatives.

The Group has policies and procedures dedicated to accepting, measuring, and managing credit risk. The objective of the Group's credit risk management is to achieve an appropriate balance between risk and return and to minimise potential adverse effects of credit risk on the Group's financial performance.

A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations forms the basis for all credit decisions. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, groups of borrowers, countries and industry segments. The Group measures and consolidates its credit risk for each counterparty or group of connected clients in accordance with internal and external criteria of connection between parties.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in borrower's assets. The principal collateral types for loans are real properties, vehicles, equipment, vessels and securities. When applicable, other credit risk mitigants are employed.

43. Maximum credit exposure

The Group's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Group might have to pay out against financial guarantees and loan commitments, less provisions that have been made because of these items. The maximum credit exposure for a derivative contract is calculated by adding potential future credit exposure to the positive market value of the contract.

The industry breakdown shows the credit exposure by industry classification. The breakdown follows an internal industry classification which is based on the Icelandic ISAT2008 that derives from the European NACE Rev. 2 classification standard.

The Group's credit exposure, before taking account of any collateral held or other credit enhancements, is as follows:

Credit risk exposure

43. Cont'd

Maximum credit exposure at 30 September 2018

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	156,251	-	-	-	-	-	-	-	-	-	156,251
Bonds and debt instruments	-	47,731	-	-	381	12,666	1,647	63	775	61	-	63,324
Derivatives	8	-	146	-	1,658	4,678	391	910	-	552	427	8,770
Loans to credit institutions	-	-	-	-	-	67,047	-	-	-	-	-	67,047
Loans to customers:	314,491	-	123,624	30,913	7,407	220	84,849	19,532	11,819	136,787	105,940	835,582
Overdrafts	12,502	-	11,836	3,187	19	28	5,126	1,073	312	4,822	9,334	48,239
Credit cards	15,208	-	1,572	255	4	25	433	33	130	64	40	17,764
Mortgages	243,024	-	-	-	-	-	-	-	-	-	-	243,024
Capital leases	6,876	-	24,752	2,290	6	-	6,653	119	50	1,197	171	42,114
Other loans	36,881	-	85,464	25,181	7,378	167	72,637	18,307	11,327	130,704	96,395	484,441
Other financial assets	454	6	294	2	1	9,693	10	39	118	18	6	10,641
Off-balance sheet items:	34,252	-	24,031	19,967	9,360	9,900	19,985	4,415	4,625	15,492	9,928	151,955
Financial guarantees	1,503	-	5,388	4,445	12	1,169	2,565	149	5	1,021	513	16,770
Undrawn loan commitments	-	-	4,627	12,864	9,124	-	12,926	1,867	-	11,652	3,338	56,398
Undrawn overdrafts	9,392	-	9,980	1,971	204	8,611	3,462	2,261	3,971	2,610	5,934	48,396
Credit card commitments	23,357	-	4,036	687	20	120	1,032	138	649	209	143	30,391
Total maximum credit exposure	349,205	203,988	148,095	50,882	18,807	104,204	106,882	24,959	17,337	152,910	116,301	1,293,570

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

43. Cont'd

Maximum credit exposure at 31 December 2017

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	189,045	-	-	-	-	-	-	-	-	-	189,045
Bonds and debt instruments	-	14,716	-	-	-	9,644	1,613	95	1,022	-	-	27,090
Derivatives	2	-	212	-	1,562	2,381	296	1,465	1	206	196	6,321
Loans to credit institutions	-	-	-	-	-	26,617	-	-	-	-	-	26,617
Loans to customers:	299,350	-	112,144	24,797	7,109	26	69,961	19,726	11,871	127,067	84,853	756,904
Overdrafts	11,352	-	11,874	3,376	11	5	4,686	1,607	352	4,990	7,397	45,650
Credit cards	16,397	-	1,510	234	4	21	406	37	107	51	33	18,800
Mortgages	225,765	-	-	-	-	-	-	-	-	-	-	225,765
Capital leases	7,528	-	22,077	2,258	6	-	7,316	206	70	1,085	219	40,765
Other loans	38,308	-	76,683	18,929	7,088	-	57,553	17,876	11,342	120,941	77,204	425,924
Other financial assets	414	8	243	4	1	8,935	26	27	97	90	2	9,847
Off-balance sheet items:	38,017	1	30,269	14,909	9,646	4,640	17,050	3,774	4,875	20,404	10,304	153,889
Financial guarantees	1,607	-	5,936	4,466	13	1,169	2,389	59	4	1,006	543	17,192
Undrawn loan commitments	-	-	10,263	7,587	9,402	-	9,514	3,041	-	16,266	2,175	58,248
Undrawn overdrafts	9,977	-	9,707	2,164	201	3,351	4,044	531	4,129	2,886	7,436	44,426
Credit card commitments	26,433	1	4,363	692	30	120	1,103	143	742	246	150	34,023
Total maximum credit exposure	337,783	203,770	142,868	39,710	18,318	52,243	88,946	25,087	17,866	147,767	95,355	1,169,713

Amounts are in ISK million

44. Credit exposure covered by collateral

Collateral and other credit mitigants vary between types of obligors and credit facilities. Loans to credit institutions are usually unsecured. For loans to individuals the principal collateral taken is residential property against mortgages. In the case of corporate entities the Group takes a charge over assets such as real estate, vessels, cash and securities and as well as other collateral including accounts receivables, inventory, vehicles and equipment. Loans to government entities and to municipalities are more often than not unsecured. Derivative exposures are generally made under ISDA master agreements with Credit Support Annex or corresponding terms with pledged collateral in the form of cash and government bonds.

In some cases the Group uses guarantees as a credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not represent a reduction in maximum exposure to credit risk. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability. In the case of fishing vessels the associated fishing quota is included in the valuation. Collateral is allocated according to the gross carrying amount of loans and nominal off-balance sheet items, and is measured without including the effect of overcollateralisation. This means that if some loans have collateral values in excess of their gross carrying amount, then the excess is removed in order to reflect the Group's actual maximum exposure to credit risk. The total value of pledged assets can thus be higher than the cover indicates. The maximum credit risk exposure is measured on net carrying value basis, and therefore collateral allocation can in some instances be higher.

For capital leases the Group remains the owner of the leased object. In total ISK 35,614 million of the collateral are leased objects.

The following tables show the maximum exposure to credit risk by class of financial asset and collateral held against those exposures.

An overview of collateral held by the Group against credit exposure is shown below for exposures in Stages 1 and 2 (non credit-impaired) and exposures in Stage 3 (credit-impaired):

At 30 September 2018 **Collateral held against non credit-impaired exposures**	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral
Derivatives	8,770	-	-	2,834	-	-	2,834
Loans and commitments to customers:	972,723	537,915	85,907	6,361	49,308	65,863	745,354
Individuals	342,000	260,368	4	453	13,975	161	274,961
Commerce and services	145,193	54,586	658	250	26,990	24,770	107,254
Construction	50,539	29,136	-	427	1,841	4,100	35,504
Energy	16,767	3,657	-	370	-	86	4,113
Financial services	10,120	-	-	307	-	-	307
Industrial and transportation	101,734	34,505	10	90	5,993	14,898	55,496
Investment companies	23,718	8,036	26	3,119	80	8,411	19,672
Public sector and non-profit organisations	16,421	983	-	6	37	2	1,028
Real estate	150,605	133,141	-	1,313	220	1,125	135,799
Seafood	115,626	13,503	85,209	26	172	12,310	111,220
Total	981,493	537,915	85,907	9,195	49,308	65,863	748,188

Collateral held against credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral
Derivatives	-	-	-	-	-	-	-
Loans and commitments to customers:	14,814	10,128	2,508	158	377	415	13,586
Individuals	6,743	5,962	17	9	103	3	6,094
Commerce and services	2,462	1,662	184	1	106	213	2,166
Construction	341	257	-	-	14	22	293
Industrial and transportation	3,100	432	2,258	96	98	172	3,056
Investment companies	229	142	-	52	12	-	206
Public sector and non-profit organisations	23	12	-	-	-	-	12
Real estate	1,674	1,533	-	-	1	-	1,534
Seafood	242	128	49	-	43	5	225
Total	14,814	10,128	2,508	158	377	415	13,586

Amounts are in ISK million

44. Cont'd

At 31 December 2017	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Credit exposure covered by collateral
Derivatives	-	-	2,351	-	-	2,351
Loans and commitments to customers:	488,494	79,699	4,601	46,888	54,093	673,775
Individuals	251,052	22	501	13,127	172	264,874
Commerce and services	49,961	857	219	25,189	17,315	93,541
Construction	20,916	-	363	1,868	4,043	27,190
Energy	3,436	-	367	-	92	3,895
Financial services	-	-	166	-	-	166
Industrial and transportation	22,386	2,876	147	6,081	14,994	46,484
Investment companies	6,579	-	2,381	104	9,164	18,228
Public sector and non-profit organisations	881	-	10	53	5	949
Real estate	126,604	-	418	221	873	128,116
Seafood	6,679	75,944	29	245	7,435	90,332
Total	488,494	79,699	6,952	46,888	54,093	676,126

45. Credit quality of financial assets

The following table provides the gross carrying amount of loans and credit risk exposure on loan commitments and financial guarantees. Amounts are broken down by risk class and the method by which their respective credit loss allowances (ECL) are calculated, i.e. Stage 1, 2 and 3 as described in Note 3.

The Group uses internal rating models to assess the default probability of corporate and retail customers. The models assign each customer to one of ten risk classes. One risk class is for customers in default (risk class 10), and nine risk classes are for performing customers (risk classes 1-9). Risk classes are assigned on customer level and not facility level.

The rating of corporate customers is based on a company's most recent financial statement, together with a qualitative assessment of its management, market position and industry sector.

For retail customers the Group uses two different statistical rating models. One model is for individuals and another is for small companies with a total exposure to the Group of less than ISK 150 million. These models are behavioural scoring models and use information about a customer's payment history, amount of debt and deposits, and demographic variables to assess the probability that a customer will default on any of his obligations within 12 months of the rating assessment.

Risk classes 1-4 represent low risk, risk classes 5-6 moderate risk, risk classes 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers that are in default. Unrated are loans originating from subsidiaries of Íslandsbanki that do not have rating models, in addition to loans that are yet to be rated.

The same customer can have loans and off-balance sheet commitments in Stages 1 and 2 simultaneously, however, if a customer has an exposure in Stage 3 then all other loans and commitments are classified as Stage 3 as well.

The Group is in the process of implementing a new harmonised definition of default that encompasses four similar definitions previously in use, i.e. default according to Article 178 of the CRR (Capital Requirements Regulation), credit-impaired according to IFRS 9 (Stage 3), non-performing according to FINREP and Risk class 10 according to the Group's internal classification. The new definition is broader than each individual definition, in particular the previous definition of Risk class 10. Currently, ISK 6,871 million of the exposure in Stage 3 is attributable to the new definition and would otherwise not have been classified as Risk class 10.

Financial Statements third quarter 2018 44 Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

45. Cont'd

At 30 September 2018

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	216,242	64	-	216,306
Risk class 5-6	350,571	1,255	-	351,826
Risk class 7-8	185,516	19,290	-	204,806
Risk class 9	37,223	9,710	-	46,933
Risk class 10	-	-	20,807	20,807
Unrated	5,053	390	82	5,525
	794,605	30,709	20,889	846,203
ECL	(3,081)	(855)	(6,685)	(10,621)
Net carrying amount	791,524	29,854	14,204	835,582

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	68,276	31	-	68,307
Risk class 5-6	60,455	1,087	-	61,542
Risk class 7-8	17,826	1,528	-	19,354
Risk class 9	1,461	450	-	1,911
Risk class 10	-	-	782	782
Unrated	477	304	-	781
	148,495	3,400	782	152,677
ECL	(434)	(116)	(172)	(722)
Net carrying amount	148,061	3,284	610	151,955

At 31 December 2017	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
Loans to customers:							
Individuals	54,270	113,333	87,600	29,999	950	3,425	289,577
Commerce and services	21,236	64,388	18,353	2,686	108	1,434	108,205
Construction	591	9,206	12,299	888	325	-	23,309
Energy	3,193	3,062	854	-	-	-	7,109
Financial services	17	4	5	-	-	-	26
Industrial and transportation	24,940	22,181	15,420	3,430	2,816	19	68,806
Investment companies	1,214	6,109	11,470	534	9	-	19,336
Public sector and non-profit organisations	7,813	3,636	410	6	-	1	11,866
Real estate	35,534	55,614	29,396	2,455	321	33	123,353
Seafood	40,854	36,896	4,351	242	1	92	82,436
Total	189,662	314,429	180,158	40,240	4,530	5,004	734,023

46. Forbearance and write-offs

When restructuring or modification measures are believed to be more appropriate than collection procedures, the Group offers several debt relief measures and restructuring frameworks for customers in financial difficulties. These forbearance measures include temporary payment holidays, extension of loan terms, capitalisation of arrears and waiving of covenants.

From 1 January 2018, when a loan has been renegotiated or modified but not derecognised the Group also reassesses, after a certain trial period, whether the loan is still considered to have a significant increase in credit risk. The Group also considers whether the assets should be classified as Stage 3 credit-impaired.

Amounts are in ISK million

46. Cont'd

Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for a loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:
- All of the customer's facilities have to be considered performing; and
- The customer does not have any contract that is more than 30 days past due; and
- The probation period of two years has passed from the date the forborne contract was considered performing; and
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period.

The following table provides a summary of the Group's forborne assets.

At 30 September 2018

	Gross carrying amount of forborne assets			
	Stage 1	Stage 2	Stage 3	Total
Individuals	2,169	1,656	1,344	5,169
Companies	7,108	10,683	4,613	22,404
Total	9,277	12,339	5,957	27,573

	ECLs of forborne assets			
	Stage 1	Stage 2	Stage 3	Total
Individuals	(17)	(79)	(187)	(283)
Companies	(140)	(266)	(1,232)	(1,638)
Total	(157)	(345)	(1,419)	(1,921)

Gross carrying amount written off during the reporting period and still subject to enforcement activity:	Gross carrying amount
Individuals	580
Companies	312
Total	892

47. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by regulation no. 233/2017. The Group has internal criteria that define connections between clients. These criteria reflect the Group's interpretation of Article (1)(a) of the Act on Financial Undertakings no. 161/2002, where groups of connected clients are defined. Since the interim financial statements for the third quarter of the year are not audited, the profit for the third quarter is excluded from the capital base according to the Act on Financial Undertakings.

The exposure is evaluated both before and after credit risk mitigating effects. After mitigating effects, the Group currently has five large exposures, an increase of two since the last reporting date. No large exposure is above the maximum 25% single large exposure limit set by the law.

The following tables show the Group's large exposures as a percentage of the Group's capital base, before and after eligible credit risk mitigating effects.

		30.9.2018
Groups of connected clients	Before	After
Group 1	89%	0%
Group 2	12%	12%
Group 3	14%	12%
Group 4	12%	11%
Group 5	11%	11%

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

47. Cont'd

Groups of connected clients	31.12.2017 Before	After
Group 1	102%	0%
Group 2	11%	11%
Group 3	10%	10%

48. Liquidity risk

The Group defines liquidity risk as the risk of not being able to fund its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

The Group's main source of funding is customer deposits. Treasury is responsible for the Bank's funding and liquidity management in line with internal and regulatory limits and policies. Treasury manages the Bank's intraday liquidity. Risk Management, as the second line of defence, is responsible for independent reporting on the liquidity position to internal and external stakeholders and providing a holistic view on liquidity risk on a consolidated basis.

Key measures for the assessment of liquidity risk are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The Central Bank of Iceland, which is the main supervisory authority regarding liquidity risk, has incorporated the LCR and the NSFR based on the CRD IV standards into the rules on liquidity ratio and the rules on funding ratio in foreign currencies. In addition, the Group complies with the Financial Supervisory Authority's guidelines no. 2/2010 on best practices in liquidity management and liquidity coverage ratio rules no. 266/2017.

The following tables show the LCR and NSFR for the group at the end of September 2018 and at year-end 2017.

Net Stable Funding Ratio	30.9.2018	31.12.2017
For all currencies	117%	117%
Foreign currencies	159%	122%

Liquidity Coverage Ratio	30.9.2018	31.12.2017
For all currencies	164%	142%
Foreign currencies	270%	155%

	For all currencies		Foreign currencies	
At 30 September 2018	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1	189,411	189,411	39,483	39,483
Liquid assets level 2	2,801	733	2,801	733
Total liquid assets	192,212	190,144	42,284	40,216
Deposits	482,924	153,572	86,707	45,311
Debt issued	8,692	8,692	6,935	6,934
Other outflows	79,397	31,647	18,372	7,297
Total outflows	571,013	193,911	112,014	59,542
Short term deposits with other banks	63,256	61,268	60,210	58,266
Other inflows	34,640	16,908	10,296	4,905
Restrictions on inflows	-	-	-	(18,514)
Total inflows	97,896	78,176	70,506	44,657
Liquidity coverage ratio		164%		270%

Amounts are in ISK million

48. Cont'd

At 31 December 2017	For all currencies Unweighted	Weighted	Foreign currencies Unweighted	Weighted
Liquid assets level 1	179,299	179,299	12,444	12,444
Liquid assets level 2	2,092	672	2,027	672
Total liquid assets	181,391	179,971	14,471	13,116
Deposits	429,365	129,957	65,502	29,500
Debt issued	575	575	56	56
Other outflows	88,979	32,192	10,928	3,534
Total outflows	518,919	162,724	76,486	33,090
Short term deposits with other banks	25,356	23,766	25,271	23,766
Other inflows	27,545	12,079	1,365	861
Total inflows	52,901	35,845	26,636	24,627
Liquidity coverage ratio		142%		155%

The following tables show the contractual payments of principal and interest for the Group's financial liabilities. Thus, the total figures for each liability class are higher than the respective balance sheet amount. Cash flows for payments of unknown nature, such as for floating rate, CPI-linked or foreign currency denominated instruments, are based on internal yield curves and forecasts.

For dated financial liabilities the amounts are grouped into maturity buckets according to contractual maturities of principal and estimated contractual payments of interest. For demand deposits or other non-dated liabilities, the figures are grouped according to the first possible required payment date.

Maturity analysis 30 September 2018

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	15,530	4,663	5,879	-	5,381	-	-	15,923
Deposits from customers	608,646	439,961	105,369	25,599	26,169	32,261	-	629,359
Debt issued and other borrowed funds	297,318	393	13,462	37,773	138,173	145,138	-	334,939
Subordinated loans	15,531	-	66	268	2,239	19,799	-	22,372
Other financial liabilities	33,423	30,468	2,292	663	-	-	-	33,423
Total	970,448	475,485	127,068	64,303	171,962	197,198	-	1,036,016

Off-balance sheet liabilities show the amount of contractual obligations that the Group has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking into account the Group's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations all fall into the first time bucket since contractually, on a case-by-case basis, the Group could be required to fulfil these obligations instantaneously.

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	16,770	-	-	-	-	-	16,770
Undrawn loan commitments	56,398	-	-	-	-	-	56,398
Undrawn overdrafts	48,396	-	-	-	-	-	48,396
Credit card commitments	30,391	-	-	-	-	-	30,391
Total	151,955	-	-	-	-	-	151,955
Total non-derivative financial liabilities and off-balance sheet liabilities	627,440	127,068	64,303	171,962	197,198	-	1,187,971

Amounts are in ISK million

48. Cont'd

The table below shows the contractual cash flow of the Group's derivative liabilities, i.e. derivatives that have a negative and a positive carrying amount at the reporting date. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	57,565	29,506	53,699	1,771	-	142,541
Outflow	-	(58,172)	(30,451)	(57,086)	(1,943)	-	(147,652)
Total	-	(607)	(945)	(3,387)	(172)	-	(5,111)
Net settled derivatives	-	(71)	-	-	-	-	(71)
Total	-	(678)	(945)	(3,387)	(172)	-	(5,182)

Maturity classification of assets is based on contractual maturity. For bonds and debt instruments in the banking book the maturity classification is based on contractual maturity dates while for bonds and debt instruments held for trading the maturity classification is based on the estimated liquidation time of the asset.

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	156,251	37,342	118,909	-	-	-	-	156,251
Bonds and debt instruments	63,324	-	25,535	13,484	12,564	11,356	385	63,324
Shares and equity instruments	13,995	-	-	-	-	-	13,995	13,995
Loans to credit institutions	67,047	18,763	48,284	-	-	-	-	67,047
Loans to customers	835,582	3,890	102,112	78,580	266,219	384,781	-	835,582
Other financial assets	10,641	3,057	615	95	11	-	6,863	10,641
Total	1,146,840	63,052	295,455	92,159	278,794	396,137	21,243	1,146,840

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	57,050	22,267	77,126	327	-	156,770
Outflow	-	(56,077)	(21,929)	(74,072)	(343)	-	(152,421)
Total	-	973	338	3,054	(16)	-	4,349
Net settled derivatives	-	869	-	-	-	-	869
Total	-	1,842	338	3,054	(16)	-	5,218

The tables below show the comparative amounts for financial assets and financial liabilities at year-end 2017.

Maturity analysis 31 December 2017

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	270	270	-	-	-	-	-	270
Deposits from CB and credit institutions	11,189	6,104	3,078	-	2,246	-	-	11,428
Deposits from customers	567,029	388,943	92,487	51,156	25,109	29,080	-	586,775
Debt issued and other borrowed funds	217,748	436	3,222	36,568	132,831	79,152	-	252,209
Subordinated loans	9,505	-	36	138	1,257	12,356	-	13,787
Other financial liabilities	10,467	6,181	3,273	1,012	-	-	-	10,466
Total	816,208	401,934	102,096	88,874	161,443	120,588	-	874,935

Amounts are in ISK million

48. Cont'd

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	17,192	-	-	-	-	-	17,192
Undrawn loan commitments	58,248	-	-	-	-	-	58,248
Undrawn overdrafts	44,426	-	-	-	-	-	44,426
Credit card commitments	34,023	-	-	-	-	-	34,023
Total	153,889	-	-	-	-	-	153,889
Total non-derivative financial liabilities and off-balance sheet liabilities	555,823	102,096	88,874	161,443	120,588	-	1,028,824

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	23,143	48,265	43,880	5,115	-	120,403
Outflow	-	(23,558)	(48,108)	(47,170)	(5,631)	-	(124,467)
Total	-	(415)	157	(3,290)	(516)	-	(4,064)
Net settled derivatives	-	(170)	-	-	-	-	(170)
Total	-	(585)	157	(3,290)	(516)	-	(4,234)

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	189,045	31,396	153,098	-	-	4,551	-	189,045
Bonds and debt instruments	27,090	998	8,896	2,590	7,298	7,308	-	27,090
Shares and equity instruments	10,177	-	-	-	-	-	10,177	10,177
Loans to credit institutions	26,617	15,050	11,567	-	-	-	-	26,617
Loans to customers	755,175	4,172	77,809	84,286	220,524	370,113	-	756,904
Other financial assets	9,847	3,860	524	10	32	6	5,415	9,847
Total	1,017,951	55,476	251,894	86,886	227,854	381,978	15,592	1,019,680

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	25,982	52,964	30,231	813	-	109,990
Outflow	-	(24,827)	(51,416)	(28,728)	(880)	-	(105,851)
Total	-	1,155	1,548	1,503	(67)	-	4,139
Net settled derivatives	-	233	-	-	-	-	233
Total	-	1,388	1,548	1,503	(67)	-	4,372

As a part of managing liquidity risk, the Group holds a portfolio of liquid assets to meet unexpected outflow of funds or a temporary shortage in access to new funding. These assets are subject to strict criteria with respect to credit quality, liquidation time and price volatility. The table below shows the composition and amount of the Group's liquid assets.

Composition and amount of liquid assets	30.9.2018	31.12.2017
Cash and balances with Central Bank	139,049	183,834
Domestic bonds eligible as collateral against borrowing at Central Bank	11,141	3,654
Foreign government bonds	38,875	11,872
Loans to credit institutions	64,954	23,768
Total	254,019	223,128

Amounts are in ISK million

49. Deposits by LCR category

The Group's deposits are categorised by counterparty according to the Liquidity Coverage Ratio (LCR) standard. The groups are listed in order of estimated stability and the respective LCR outflow weight. Deposits are also classified as stable if the customer has an established business relationship with the Bank and is covered by an effective insurance scheme.

	Deposits maturing within 30 days					
At 30 September 2018	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	134,941	10%	61,348	5%	66,504	262,793
SMEs	65,483	10%	15,964	5%	6,589	88,036
Operational relationships	2,626	25%	-	5%	-	2,626
Corporations	71,903	40%	390	20%	22,881	95,174
Sovereigns, Central Bank and public sector entities	8,922	40%	238	20%	986	10,146
Financial institutions in composition	2,004	100%	-	-	-	2,004
Pension funds	52,765	100%	-	-	25,829	78,594
Domestic financial entities	27,514	100%	-	-	29,204	56,718
Foreign financial entities	3,009	100%	-	-	7,530	10,539
Other foreign entities	13,049	100%	1,693	25%	2,804	17,546
Total	382,216		79,633		162,327	624,176

At 31 December 2017						
Retail	118,964	10%	63,715	5%	68,808	251,487
SMEs	55,958	10%	15,024	5%	6,847	77,829
Operational relationships	1,694	25%	-	5%	-	1,694
Corporations	64,114	40%	321	20%	27,327	91,762
Sovereigns, Central Bank and public sector entities	7,083	40%	234	20%	1,513	8,830
Financial institutions in composition	2,947	100%	-	-	-	2,947
Pension funds	31,271	100%	-	-	28,466	59,737
Domestic financial entities	30,849	100%	-	-	26,979	57,828
Foreign financial entities	4,868	100%	-	-	4,353	9,221
Other foreign entities	8,718	100%	2,214	25%	5,951	16,883
Total	326,466		81,508		170,244	578,218

50. Market risk

The Group defines market risk as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, equity prices, commodity prices and foreign exchange rates.

Market risk within the Group can broadly be split into two categories, trading book and banking book. The trading book includes market risk exposures related, directly or indirectly, to the Group's short- and medium-term trading in securities, currencies and other capital market instruments and derivatives. All financial assets and liabilities in the trading portfolio are recognised at fair value and all resulting changes are immediately reflected in the income statement. The banking book includes market risk exposures related to securities held for long-term investment purposes, unlisted securities or holdings in subsidiaries or affiliates. A large part of the banking book market risk is due to mismatches in the composition of assets and liabilities, for example with respect to currencies, interest rates, CPI-indexation or other factors that can affect the Group's earnings or earnings volatility. These mismatches are reported to management and are subject to internal and regulatory limits.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

51. Interest rate risk

Interest rate risk is defined as the current or prospective risk to earnings or capital arising from adverse movements in interest rates.

Sensitivity measures like Basis Point Value (BPV) are used to measure and manage risk arising from its fixed income exposures. The BPV measures the effect of a 0.01 percentage point upward parallel shift in the yield curve on the fair value of these exposures.

52. Interest rate risk in the trading book

The fixed income trading unit invests mainly in government bonds, bonds issued by the Housing Financing Fund (HFF) which are guaranteed by the Icelandic Government, domestic municipality bonds and covered bonds issued by other Icelandic banks. Bonds and bills in the Group's liquidity portfolio are also categorised in the trading book. In the table below the total market value (MV) of long and short positions may not be the same as reported in Note 5 since netting between short and long positions is not applied here. Derivatives and securities used for hedging are excluded from the table.

Trading bonds and debt instruments, long positions		30.9.2018			31.12.2017	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,683	6.40	(1.08)	1,750	7.17	(1.25)
Non-indexed	40,352	0.29	(1.19)	14,148	0.51	(0.73)
Total	42,035	0.53	(2.27)	15,898	1.24	(1.98)

Trading bonds and debt instruments, short positions		30.9.2018			31.12.2017	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	-	-	-	-	-	-
Non-indexed	308	1.00	0.02	-	-	-
Total	308	1.00	0.02	-	-	-
Net position of trading bonds and debt instruments	41,727	0.53	(2.25)	15,898	1.24	(1.98)

53. Interest rate risk in the banking book

Interest rate risk in the banking book arises from the Group's core banking activities. The main source of this type of interest rate risk is the risk of loss from fluctuations in future cash flows or fair value of financial instruments as interest rates change over time, reflecting the fact that the Group's assets and liabilities are of different maturities and are priced relative to different interest rates.

The impact on the Group's interest rate risk in the banking book due to the Supreme Court ruling on 12 October 2017 regarding interest rate reset terms on consumer mortgage contracts was not considered in the year-end 2017 but is now taken into account. Part of the borrowers owing mortgage loans where the Group will not be able to reset interest rates have been asked to disclose their preferences with regards to refinancing and updating of the loan contracts. The number of remaining contracts is approximately 2,900 with a carrying amount of ISK 38 billion. In order to categorise those contracts in appropriate time buckets the Bank uses an internal model to estimate their expected time to maturity.

Amounts are in ISK million

53. Cont'd

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	153,347	2,904	-	-	-	-	156,251
Bonds and debt instruments	1,487	-	61	133	100	93	1,874
Loans to credit institutions	67,047	-	-	-	-	-	67,047
Loans to customers	572,178	19,651	42,438	155,102	7,841	38,372	835,582
Total	794,059	22,555	42,499	155,235	7,941	38,465	1,060,754
Off-balance sheet items	147,915	2,571	75,402	3,323	-	-	229,211
Effect of derivatives held for hedging	-	-	-	38,690	-	-	38,690

Liabilities	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Deposits from Central Bank and credit institutions	10,491	-	5,039	-	-	-	15,530
Deposits from customers	597,767	2,034	6,785	2,060	-	-	608,646
Debt issued and other borrowed funds	50,837	22,412	74,535	18,985	106,734	23,815	297,318
Subordinated loans	15,531	-	-	-	-	-	15,531
Total	674,626	24,446	86,359	21,045	106,734	23,815	937,025
Off-balance sheet items	143,275	5,349	52,357	26,765	766	-	228,512
Effect of derivatives held for hedging	38,634	-	-	-	-	-	38,634
Net interest gap on 30 September 2018	85,439	(4,669)	(20,815)	149,438	(99,559)	14,650	124,484

The following table displays assets and liabilities in the banking book according to the next interest rate reset date as of 31 December 2017. In the table below the total amount for loans to customers is shown before collective impairment allowance is subtracted and is therefore not the same as the total amount shown in the financial statements.

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	184,494	4,551	-	-	-	-	189,045
Bonds and debt instruments	1,805	129	-	348	19	72	2,373
Loans to credit institutions	26,617	-	-	-	-	-	26,617
Loans to customers	515,861	28,018	37,858	165,981	3,636	5,548	756,902
Total	728,777	32,698	37,858	166,329	3,655	5,620	974,937
Off-balance sheet items	81,929	49,681	521	5,847	-	-	137,978
Effect of derivatives held for hedging	-	-	-	62,463	-	-	62,463

Liabilities	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Deposits from Central Bank and credit institutions	9,158	-	2,031	-	-	-	11,189
Deposits from customers	548,921	8,090	789	8,488	741	-	567,029
Debt issued and other borrowed funds	16,886	24,518	22,539	85,236	53,481	15,089	217,749
Subordinated loans	9,505	-	-	-	-	-	9,505
Total	584,470	32,608	25,359	93,724	54,222	15,089	805,472
Off-balance sheet items	64,504	2,555	14,247	56,115	744	-	138,165
Effect of derivatives held for hedging	62,537	-	-	-	-	-	62,537
Net interest gap on 31 December 2017	99,195	47,216	(1,227)	84,800	(51,311)	(9,469)	169,204

Amounts are in ISK million

54. Currency risk

Currency risk is the risk that earnings or capital may be negatively affected from the fluctuations of foreign exchange rates, due to transactions in foreign currencies or due to a mismatch in the currency composition of assets or liabilities.

The analysis of the Group's foreign currency exposure presented below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off-balance sheet items that carry currency risk and are included in the total currency imbalance. The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements.

Currency analysis at 30 September 2018

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	206	119	68	20	5	30	32	52	26	50	608
Bonds and debt instruments	30,025	10,531	27	-	-	-	-	-	-	-	40,583
Shares and equity instruments	44	2,292	389	-	-	-	69	-	-	-	2,794
Loans to credit institutions	14,008	35,162	4,039	144	220	4,790	5,171	692	86	572	64,884
Loans to customers	105,735	28,242	2,021	919	3,170	1	4,411	586	6,105	41	151,231
Other assets	982	1,507	1,127	5	94	29	3	36	7	1,754	5,544
Total assets	151,000	77,853	7,671	1,088	3,489	4,850	9,686	1,366	6,224	2,417	265,644
Liabilities											
Deposits from credit institutions	5,494	479	79	-	88	-	16	-	-	-	6,156
Deposits from customers	28,073	41,834	3,585	317	510	950	3,290	2,314	390	56	81,319
Debt issued and other borrowed funds	109,395	-	-	-	-	40,088	6,844	-	-	-	156,327
Subordinated loans	-	-	-	-	-	15,531	-	-	-	-	15,531
Other liabilities	3,341	1,152	2,158	27	257	89	6	55	30	1,723	8,838
Total liabilities	146,303	43,465	5,822	344	855	56,658	10,156	2,369	420	1,779	268,171
Net on-balance sheet position	4,697	34,388	1,849	744	2,634	(51,808)	(470)	(1,003)	5,804	638	(2,527)
Net off-balance sheet position	(2,447)	(34,052)	(2,479)	(774)	(2,742)	51,798	128	1,121	(5,796)	(26)	4,731
Net position	2,250	336	(630)	(30)	(108)	(10)	(342)	118	8	612	2,204

Amounts are in ISK million

54. Cont'd

Currency analysis at 31 December 2017

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	238	124	78	19	5	39	30	60	26	39	658
Bonds and debt instruments	7,253	3,688	23	-	-	-	2,544	-	-	-	13,508
Shares and equity instruments	29	1,467	-	-	-	-	37	-	-	80	1,613
Loans to credit institutions	6,177	12,095	620	907	344	2,514	1,804	778	129	716	26,084
Loans to customers	92,179	19,693	2,287	1,220	3,198	3	4,791	673	4,166	47	128,257
Other assets	874	788	570	5	51	27	2	30	11	1,359	3,717
Total assets	106,750	37,855	3,578	2,151	3,598	2,583	9,208	1,541	4,332	2,241	173,837
Liabilities											
Deposits from credit institutions	5,216	378	-	4	4	-	-	-	-	-	5,602
Deposits from customers	22,546	24,405	4,468	190	336	703	2,683	2,452	358	22	58,163
Debt issued and other borrowed funds	87,166	-	-	-	-	7,660	6,391	-	-	-	101,217
Subordinated loans	-	-	-	-	-	9,505	-	-	-	-	9,505
Other liabilities	2,994	2,577	559	9	202	65	4	45	30	1,875	8,360
Total liabilities	117,922	27,360	5,027	203	542	17,933	9,078	2,497	388	1,897	182,847
Net on-balance sheet position	(11,172)	10,495	(1,449)	1,948	3,056	(15,350)	130	(956)	3,944	344	(9,010)
Net off-balance sheet position	11,492	(11,572)	1,466	(1,952)	(3,101)	15,390	(353)	1,022	(3,981)	(149)	8,262
Net position	320	(1,077)	17	(4)	(45)	40	(223)	66	(37)	195	(748)

Amounts are in ISK million

55. Derivatives

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. However, the Group is subject to indirect exposure through customers' margin trading. Margin trading is subject to continuous monitoring and collateral requirements. Other derivatives held for trading or for other purposes are insignificant.

56. Inflation risk

The Group is exposed to inflation risk since the value of CPI-linked assets exceeds CPI-linked liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI affect profit and loss.

Assets, CPI-linked	30.9.2018	31.12.2017
Bonds and debt instruments	2,514	2,442
Loans to customers	291,168	270,533
Off-balance sheet position	-	506
Total assets	293,682	273,481
Liabilities, CPI-linked		
Deposits from customers	93,693	92,077
Debt issued and other borrowed funds	114,116	91,351
Off-balance sheet position	70,178	62,569
Total liabilities	277,987	245,997
CPI imbalance	15,695	27,484

57. Capital management

The following table shows the capital base, risk exposure amount, the resulting capital ratios, and leverage for the Group at 30 September 2018 and 31 December 2017. In addition, the table shows the official capital ratios where the unaudited profit of the third quarter is excluded according to the Act on Financial Undertakings.

The Group's regulatory capital requirement is calculated according to CRD IV as implemented through Act no. 161/2002 on Financial Undertakings and regulation no. 233/2017 on prudential requirements for financial undertakings. Capital requirement calculations for credit risk and market risk are based on the standardised approach whereas the capital requirement calculations for operational risk are based on the basic indicator approach.

The Group aims at managing its capital position and the corresponding capital ratios above the overall regulatory capital requirement. According to the latest SREP report from the Financial Supervisory Authority, published in October 2018, the overall capital requirement is 18.8%. The Group's capital target includes a 0.5-2.0% management buffer on top of the overall capital requirement.

The minimum leverage ratio for Icelandic financial institutions is 3%.

Amounts are in ISK million

57. Cont'd

	30.9.2018	31.12.2017
CET1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	5,891	6,179
Retained earnings	101,280	107,387
Non-controlling interests	2,459	2,479
Fair value changes due to own credit standing	674	-
Tax assets	(235)	(4)
Intangible assets	(4,910)	(4,231)
Other regulatory adjustments	-	(1,285)
Total CET1 capital	170,159	175,525
Tier 2 capital		
Qualifying subordinated liabilities	15,531	9,505
General credit risk adjustments	-	1,729
Total capital base	185,690	186,759
Risk exposure amount		
- due to credit risk	758,774	682,525
- due to market risk	10,428	8,102
- due to credit valuation adjustment	2,619	1,534
- due to operational risk	83,331	83,331
Total risk exposure amount	855,152	775,492
Capital ratios		
CET1 ratio	19.9%	22.6%
Total capital ratio	21.7%	24.1%
Official Tier 1 ratio	19.7%	22.6%
Official capital ratio	21.5%	24.1%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,154,014	1,026,879
Off-balance sheet exposures	51,797	51,328
Derivative exposures	8,794	6,334
Leverage ratio total exposure measure	1,214,605	1,084,541
Tier 1 capital	170,159	175,525
Leverage ratio	14.0%	16.2%

Amounts are in ISK million

Íslandsbanki hf. Hagasmári 3 201 Kópavogur Iceland Reg.no 491008-0160