Consolidated Financial Statements

31 December 2015

Kvika banki hf. • Borgartún 25 • 105 Reykjavík • Iceland • Reg. no. 540502-2930

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Endorsement and Statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the year 2015 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and additional Icelandic disclosure requirements where applicable. The Consolidated Financial Statements comprise Kvika and its subsidiaries (together the "Group").

Kvika banki hf. is a specialised bank focusing on asset management and capital markets. Kvika Asset Management has an established reputation and offers comprehensive solutions covering major asset classes, including fixed-income securities, equities, and real estate in both domestic and international markets. At the end of 2015, the Group had ISK 111 billion of assets under management.

According to the Consolidated Income Statement, loss in 2015 amounted to ISK 483 million. According to the Consolidated Statement of Financial Position, the Group's equity at the end of the year 2015 amounted to ISK 6,531 million. As at 31 December 2015, the Group's total assets amounted to ISK 61,614 million.

The Bank's Board of Directors proposes that the loss for the year 2015 will be moved to retained earnings and that the accumulated deficit at year end 2015 will be set off against the share premium account.

Share capital and shareholders

The Bank's issued share capital amounted to ISK 1,605 million as at 31 December 2015 (2014: ISK 1,171 million). At the end of the year the Bank held treasury shares with a nominal value of ISK 14 million (2014: ISK 1 million). The Bank's share capital was increased by nominal value of ISK 434 million during the year.

A program was launched during the year to sell bills issued by the Bank. Total amount of outstanding issued bills at year end amounted to ISK 4 billion. Further, the bank issued ISK 550 million of subordinated bond with a term of 10 years. By the end of the year, the bills and the subordinated bond were listed on the NASDAQ Iceland stock exchange.

The Bank had 72 shareholders at year-end (2014: 49), none of which held more than 10% of shares in the Bank (2014: 1). The ownership of the Bank is transparent and it is the only bank that is almost fully owned by private enities, such as pension funds, companies and individuals. The ten largest shareholders are as follows:

Shareholder	31.12.2015	31.12.2014
Lífeyrissjóður verslunarmanna	9.90%	9.74%
Varða Capital ehf.	7.99%	-
Sigla ehf.	7.55%	-
Títan B ehf.	7.23%	9.91%
Ingimundur hf.	6.86%	-
Mízar ehf.	6.86%	9.40%
Eignarhaldsfélagið Mata hf.	6.69%	-
Fagfjárfestasjóðurinn Norðurljós	5.99%	8.20%
Tryggingamiðstöðin hf.	3.74%	5.12%
Eignasafn Seðlabanka Íslands ehf.	3.18%	4.36%
	65.98%	46.73%

Further information about the shareholders of the Bank is provided in note 70.

A merger between Kvika and Straumur fjárfestingabanki hf.

In February 2015 Kvika (at the time MP banki hf.) and Straumur fjárfestingabanki hf. ("Straumur") disclosed a commencement of a formal merger process based on heads of terms mutually agreed by the two banks. This merger was approved by shareholders on 22 June 2015 and became effective on 29 June 2015. As disclosed in note 3, the consideration transferred to the previous owners of Straumur was in the form of shares in Kvika banki hf. The two banks were merged under the identification number and legal name of Kvika banki hf., which is the acquiring entity in the merger, and has assumed all rights and obligations of Straumur. The name of the Bank was changed to Kvika banki hf. in October. The headquarters of the Bank are located in Borgartun 25, Reykjavik. Kvika maintains its full bank license which supports various selective banking services for the clients of the Bank.

Since the merger substantial synergies have been achieved which will positively impact the Bank's profitability going forward. One off items relating to these synergies, such as costs relating to termination of employment agreements, significantly impact the results for the 2015. The total amount of one off merger costs which are expensed as administrative expenses is ISK 734 million, refer to note 8 for more information.

Strong operating results since the merger

The operations of the merged entities have been successfully integrated and the desired synergies have been achieved. This is reflected by the Group's operating results for the second half of 2015. The Group's results in the second half of 2015 adjusted for one off items is ISK 464 million and the annualised return on equity is 15.1%.

During 2015, the Group's capital adequacy ratio has increased substantially. The Capital Adequacy Ratio of the Group was 23.5% at the end of the period, compared with 17.4% at the end of the year 2014. The Bank's minimum regulatory capital requirement at year end was 11.8%. Consequently, the Bank is well placed to meet the additional capital requirements that will be imposed following the implementation of CRD IV during the next few years. The first regulatory capital buffer of 1% is introduced from 1 January 2016.

An emphasis is placed on maintaining a robust liquidity position. The liquidity level of the Group's assets is high and during the year the diversity of funding has been increased through term deposits, wholesale deposits and issuing of listed bills and subordinated debt. At year end, the Group's 30 day liquidity coverage ratio (LCR) was 199%, well above the minimum level of 80% in 2015 and the new minimum level of 90% becoming effective by 1 January 2016.

Endorsement and Statement
by the Board of Directors and the CEO

Risk management

The Bank is exposed to various types of risk in its operations. The Bank enforces a risk management framework which is further structured and outlined in the Bank's risk policy guide and rules on risk management. We refer to notes 43-56 on analysis of exposure to various types of risk.

Corporate Governance

The Board of Directors emphasizes good corporate governance and following accepted guidelines on corporate governance. The Board has laid down comprehensive rules in which the authority of the Board is defined and its scope of work in conjunction with the CEO. They cover e.g. order at meetings, competence of Board members to participate in individual decisions, confidentiality and information disclosure between the CEO and the Board. Majority of Board members are independent of the Bank and there are no executive directors on the Board. The Bank aims to promote gender equality and three out of seven board members and one out of two alternate board members are women.

The Board determines compensation for the CEO. The Board of Directors has delegated certain tasks to two subcommittees, the Remuneration Committee and the Risk and Audit Committee. The Risk and Audit committee has 4 members and the Remuneration Committee has three members appointed by the Board, the majority of which is independent of the Bank.

More information about the Bank's Corporate Governance, including a signed statement, can be found on the Bank's website, www.kvika.is.

Statement by the Board of Directors and the CEO

To the best of our knowledge the Consolidated Financial Statements of Kvika banki hf. for the year 2015 comply with International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the Group's assets, liabilities and financial position as at 31 December 2015 and the financial performance of the Group and changes of cash flows for the year 2015.

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

The Board of Directors and the CEO of the Bank have today discussed the Consolidated Financial Statements for the year 2015, and confirm them by the means of their signatures.

Reykjavík, 3 March 2016.

Board of Directors

CEO

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of Kvika banki hf., which comprise the consolidated income statement, the consolidated statements of comprehensive income, the consolidated statement of financial position as at December 31, 2015 changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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

The Board of Directors and CEO are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Kvika banki hf. as at December 31, 2015, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 104, Paragraph 2 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the consolidated financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the consolidated financial statements.

Reykjavík, 3 March 2016.

KPMG ehf.

Sigurður Jónsson

Kvika Amounts are in ISK thousands

Consolidated Income Statement

For the year 2015

	Notes	2015	2014
Interest income		3,355,363	2,898,890
Interest expense		(2,231,278)	(1,596,869)
Net interest income	4	1,124,085	1,302,021
Fee and commission income	5	2,635,153	1,819,211
Fee and commission expense		(26,840)	(89,486)
Net fee and commission income		2,608,313	1,729,725
Net financial income	6, 7	350,383	180,312
Share in (loss) profit of associates, net of income tax	22	(1,998)	22,427
Negative goodwill	3	297,560	0
Other operating income		53,769	93,773
Other operating income		699,714	296,512
Net operating income		4,432,112	3,328,258
Administrative expenses	8-11	(3,945,176)	(3,070,796)
Impairment of loans and receivables	19	(215,797)	10,692
Profit from assets held for sale	29, 101	3	14,531
Profit before taxes		271,142	282,685
Income tax	12	(730,616)	52,438
Special tax on financial institutions	13	(23,409)	(109)
(Loss) profit for the year		(482,882)	335,014

	Notes	2015	2014
Attributable to the shareholders of Kvika banki hf.		(510,844)	312,441
Attributable to non-controlling interest	21	27,962	22,573
(Loss) profit for the year		(482,882)	335,014

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Comprehensive Income
For the year 2015

	Notes	2015	2014
(Loss) profit for the year		(482,882)	335,014
Available for sale financial assets			
Fair value changes		0	4,677
Reclassified to profit and loss on sale of securities		0	(3)
Translation of foreign operations			
Exchange difference on translation of foreign operations		(3,028)	(32,263)
Reclassified to profit and loss on sale of subsidiaries		0	16,824
Other comprehensive income that are or may be reclassified to profit and loss, net of tax		(3,028)	(10,765)
Total comprehensive (loss) income for the year		(485,911)	324,249

	Notes	2015	2014
Attributable to the shareholders of Kvika banki hf.		(513,872)	301,676
Attributable to non-controlling interest		27,962	22,573
Total comprehensive (loss) income for the year		(485,911)	324,249

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Financial Position

As at 31 December 2015

Assets	Notes	31.12.2015	31.12.2014
Cash and cash equivalents	14	19,916,973	12,970,418
Receivables from Central Bank		0	98,832
Fixed income securities	15	4,649,103	4,196,330
Shares and other variable income securities	16	3,006,042	790,723
Securities used for hedging	17	11,057,833	6,856,641
Loans to customers	18, 19	21,592,738	22,287,138
Derivatives	20	327,993	233,685
Intangible assets	25	45,924	248,766
Property and equipment	26	76,749	74,873
Deferred tax assets	27	106,557	578,080
Other assets	19, 28	748,032	718,188
Assets classified as held for sale	29	85,813	290,651
Total assets		61,613,757	49,344,327
Liabilities			
Deposits from customers	30	30,544,407	26,764,581
Deposits from credit institutions		714,134	2,711,342
Borrowings	31	15,220,126	9,854,731
Issued bills	32	3,908,480	0
Subordinated liabilities	33	562,339	0
Short positions held for trading	34	783,662	2,988,256
Short positions used for hedging	35	1,024,390	249,158
Derivatives	20	987,486	154,196
Current tax liabilities	27	22,864	13,589
Deferred tax liabilities	27	3,982	3,973
Other liabilities	36	1,310,733	1,007,996
Total liabilities		55,082,604	43,747,821
Equity			
Share capital	37	1,590,644	1,170,000
Share premium		850,445	9,069
Option reserve		3,228	4,541
Warrants reserve	38	11,070	11,070
Deficit reduction reserve	110	3,850,917	3,850,917
Other reserves		(13,687)	(10,659)
Retained earnings		0	288,853
Total equity attributable to the shareholders of Kvika banki hf.		6,292,617	5,323,792
Non-controlling interest		238,537	272,714
Total equity		6,531,154	5,596,506
Total liabilities and equity		61,613,757	49,344,327

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2015

1 January 2015 to 31 December 2015	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Equity instrument reserve	Trans-lation reserve	Fair value reserve	(Accumulated deficit)/ Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2015		1,170,000	9,069	4,541	11,070	3,850,917	0	(10,659)	(0)	288,853	5,323,792	272,714	5,596,506
Loss for the year										(510,844)	(510,844)	27,962	(482,882)
Available for sale financial assets													
Fair value changes											0		0
Reclassified to profit and loss on sale of securities											0		0
Translation of foreign operations													
Exchange difference on translation of foreign operations								(3,028)			(3,028)		(3,028)
Reclassified to profit and loss on sale of subsidiaries								0			0		0
Total comprehensive loss for the year		0	0	0	0	0	0	(3,028)	0	(510,844)	(513,872)	27,962	(485,911)
Accumulated deficit set off against the share premium account			(221,991)							221,991			
Transactions with owners of the Bank													
Capital increase	37	433,799	1,083,468								1,517,268		1,517,268
Acquisition of non-controlling interest via merger	21										0	290,844	290,844
Treasury shares acquired via merger	37	(228,724)	(568,067)								(796,791)		(796,791)
Treasury shares held by the Bank before the merger and delivered to shareholders via merger	3, 37	800	3,200								4,000		4,000
Treasury shares delivered to shareholders via merger	3, 37	228,724	568,067								796,791		796,791
Purchased treasury shares		(13,956)	(23,301)								(37,257)		(37,257)
Share-based payment transactions	69			(1,314)							(1,314)		(1,314)
Other transactions													
Dividend paid to non-controlling interest by subsidiary											0	(6,600)	(6,600)
Acquisition of non-controlling interest via purchase												(67,462)	(67,462)
Sale of non-controlling interest												(278,921)	(278,921)
Equity as at 31 December 2015		1,590,644	850,445	3,228	11,070	3,850,917	0	(13,687)	(0)	(0)	6,292,617	238,537	6,531,154

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2014

1 January 2014 to 31 December 2014	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Equity instrument reserve	Trans-lation reserve	Fair value reserve	(Accumulated deficit)/ Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2014		5,850,000	8,088	2,388	0	0	23,482	4,780	(5,842)	(851,402)	5,031,493	5,274	5,036,767
Profit for the year										312,441	312,441	22,573	335,014
Available for sale financial assets													
Fair value changes									5,846	(1,169)	4,677		4,677
Reclassified to profit and loss on sale of securities									(4)	1	(3)		(3)
Translation of foreign operations													
Exchange difference on translation of foreign operations								(32,263)			(32,263)		(32,263)
Reclassified to profit and loss on sale of subsidiaries								16,824			16,824		16,824
Total comprehensive income for the year		0	0	0	0	0	0	(15,439)	5,842	311,273	301,676	22,573	324,249
Transactions with owners of the Bank													
Reduction in share capital		(4,680,000)				3,850,917				828,983	(100)		(100)
Treasury shares acquired		(25,000)	2,500								(22,500)		(22,500)
Equity instrument converted to equity		25,000	(1,518)				(23,482)				0		0
Share-based payment transactions	69			2,154							2,154		2,154
Warrants issued					11,070						11,070		11,070
Other transactions													
Acquisition of a subsidiary with a non-controlling interest											0	249,817	249,817
Dividend paid by subsidiary to non-controlling interest											0	(4,950)	(4,950)
Equity as at 31 December 2014		1,170,000	9,069	4,541	11,070	3,850,917	0	(10,659)	(0)	288,853	5,323,792	272,714	5,596,506

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Cash Flows
For the year 2015

Cash flows from operating activities	Notes	2015	2014
(Loss) profit for the year		(482,882)	335,014
Adjustments for:			
Indexation and exchange rate difference		(240,183)	(182,035)
Share in loss (profit) of associates, net of income tax	22	1,998	(22,427)
Depreciation and amortisation	25, 26	260,876	95,129
Net interest income	4	(1,124,085)	(1,302,021)
Impairment of loans and receivables	19	215,797	(10,692)
Income tax	12	730,616	(52,438)
Negatvie goodwill	3	(297,560)	0
Other adjustments		(1,638)	6,766
		(937,062)	(1,132,704)
Changes in:			
Receivables from Central Bank		98,832	4,411,671
Fixed income securities		(405,167)	208,958
Shares and other variable income securities		(2,215,319)	273,953
Securities used for hedging		1,883,065	(3,992,011)
Loans to customers		1,774,974	4,939,678
Derivatives - assets		171,311	270,656
Other financial assets		0	3,505
Deferred tax assets		(26,999)	217,283
Other assets		1,911,222	39,657
Deposits from customers		(6,012,708)	(8,324,679)
Deposits from credit institutions		(1,997,208)	365,220
Short positions		(2,318,185)	(4,429,314)
Derivatives - liabilities		478,953	(29,913)
Other financial liabilities		0	(15,439)
Other liabilities		(553,723)	(835,716)
		(8,148,015)	(8,029,196)
Interest received		3,307,367	2,785,506
Interest paid		(2,152,462)	(1,584,180)
Net cash to operating activities		(6,993,110)	(6,827,870)
Cash flows from investing activities			
Cash and cash equivalent acquired in business combination		4,324,080	425,472
Acquisition of intangible assets	25	(7,688)	(1,635)
Acquisition of property and equipment	26	(46,934)	(24,584)
Acquisition of non-controlling interest		(62,139)	
Proceeds from the sale of property and equipment		4,334	7,102
Proceeds from the sale (acquisition) of assets classified as held for sale	29, 101	204,838	14,886
Net cash from investing activities		4,416,492	421,241
Cash flows from financing activities			
Proceeds from borrowings		119,250,102	87,055,931
Repayment of borrowings		(113,996,895)	(85,528,616)
Issued bills		3,835,772	0
Subordinated liabilities		556,622	0
Dividend paid by subsidiary to non-controlling interest		0	(4,950)
Treasury share transactions		(37,257)	982
Sale of warrants		0	11,070
Net cash from financing activities		9,608,344	1,534,417
Net increase (decrease) in cash and cash equivalents		7,031,726	(4,872,212)
Cash and cash equivalents at the beginning of the year	14	12,970,418	17,795,993
Effects of exchange rate fluctuations on cash and cash equivalents held		(85,171)	46,637
Cash and cash equivalents at the end of the year	14	19,916,973	12,970,418
Investing and financing activites not affecting cash flows			
Changes in loans to customers		0	670,000
Acquisition of assets classified as held for sale		0	(670,000)

Investing and financing activites not affecting cash flows due to a merger, refer to note 3.

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

General information

Income statement

Statement of Financial Position

Risk management

Risk management (cont.)

Segment information

Other information

Significant accounting policies

Notes to the Consolidated Financial Statements

General information

1. Reporting entity

Kvika banki hf. (the Bank or Kvika), previously MP banki hf., is a limited liability company incorporated and domiciled in Iceland, with registered offices at Borgartún 25, Reykjavík. The Bank operates as an bank based on Act No. 161/2002, on Financial Undertakings, and is supervised by the Financial Supervisory Authority of Iceland.

The Consolidated Financial Statements for the year ended 31 December 2015 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). The Group is primarily involved in investment and corporate banking, capital markets, asset management and fund management.

The Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 3 March 2016.

2. Basis of preparation

a. Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union. The Consolidated Financial Statements are also prepared in accordance with Icelandic laws on financial statements and regulations on presentation and contents of financial statements.

b. Basis of measurement

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

- Fixed income securities are measured at fair value
- Shares and other variable income securities are measured at fair value
- Securities used for hedging which are measured at fair value
- Derivatives which are measured at fair value
- Short positions which are measured at fair value
- Assets classified as held for sale are measured at the lower of cost or fair value less cost to sell

A breakdown of the accounting classification of financial assets and financial liabilities is provided in note 59.

c. Functional and presentation currency

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

The Group's assets and liabilities which are denominated in other currency than ISK are translated to ISK using the exchange rate as at the end of day 31 December 2015.

d. Going concern

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

e. Estimates and judgements

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

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

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

Information about areas of estimation uncertainty and critical judgements made by management in applying accounting policies that can have a significant effect on the amounts recognised in the Consolidated Financial Statements is provided in note 112.

f. Relevance and importance of notes to the reader

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

3. Merger between Kvika banki hf. and Straumur fjárfestingabanki hf.

On 29 June 2015, the Bank took over all assets, liabilities and operations of Straumur fjárfestingabanki hf. ("Straumur") in accordance with the decision of the board of directors in both banks and the approval of shareholder meetings. The activities and operations of both banks have been integrated into that of the Bank.

The consideration transferred, to the previous owners of Straumur, was in the form of shares in Kvika banki hf. with a nominal value of ISK 663,323,468. The Bank issued new shares with a nominal amount of ISK 433,799,468. The remaining shares transferred, with a nominal amount of ISK 229,524,000, were own shares held by the Bank. Based on the estimated fair value of the consideration transferred, the acquisition price of Straumur was ISK 2,321 million.

The following table summarises the recognised amounts of assets and liabilities acquired by the Group at the date of the merger. Assets acquired from Straumur and its subsidiaries were recognised at the fair value amount of ISK 16,053 million. The liabilities assumed from Straumur and its subsidiaries were recognised at the fair value amount of ISK 13,434 million.

Identifiable assets acquired and liabilities assumed

Assets	Fair value
Cash and cash equivalents	3,337,432
Receivables from Central Bank	1,070,000
Fixed income securities	636,586
Shares and other variable income securities	1,006,543
Securities used for hedging	4,755,195
Loans to customers	1,338,470
Derivatives	265,619
Goodwill	544,925
Property and equipment	112,815
Deferred tax asset	290,204
Other assets	2,694,999
Total	16,052,788
Borrowings	10,517,468
Short positions used for trading	888,824
Derivatives	354,338
Other liabilities	1,365,751
Total	13,126,381
Non-controlling interest	307,589
Total identifiable net assets	2,618,818
Negative goodwill	(297,560)
Acquisition price	2,321,258

As the merger took place very close to the end of June 2015, the effects of the merger on the operations of the Bank for the first six months of the year are limited. If the merger had occurred on 1 January 2015, it is estimated that consolidated income would have been ISK 5,447 million and consolidated loss for the year would have been ISK 377 million.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Income statement

4. Net interest income

Interest income is specified as follows:

	2015	2014
Cash and cash equivalents	883,356	645,699
Fixed income securities	0	37,576
Derivatives	646,483	285,221
Loans to customers	1,812,841	1,903,677
Other interest income	12,682	26,717
Total	3,355,363	2,898,890

Interest expense is specified as follows:

	2015	2014
Deposits from customers	1,053,606	918,899
Deposits from credit institutions	109,789	114,771
Borrowings	1,000,411	481,734
Other interest expense	67,472	81,464
Total	2,231,278	1,596,869

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 2,709 thousand (2014: ISK 2,614 thousand). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 2,231 thousand (2014: ISK 1,597 thousand).

5. Fee and commission income

Fee and commission income is specified as follows:

	2015	2014
Banking	301,415	346,322
Capital Markets	763,971	582,564
Asset Management	1,043,161	584,591
Other	526,605	305,734
Total	2,635,153	1,819,211

6. Net financial income

Net financial income is specified as follows:

	2015	2014
Financial assets held for trading		
Fixed income securities	151,081	(88,419)
Shares and other variable income securities	410,862	58,398
Derivatives	(77,857)	28,075
Financial assets designated at fair value through profit or loss		
Fixed income securities	8,358	10,704
Shares and other variable income securities	(151,485)	(24,095)
Available for sale financial assets		
Fixed income securities	0	3
Net gain on disposal of subsidiaries	0	175,791
Foreign currency exchange difference	9,425	19,855
Total	350,383	180,312

7. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	2015	2014
Gain (loss) on financial instruments at fair value through profit and loss	4,340	(69,698)
Gain on other financial instruments	5,086	89,553
Total	9,425	19,855
Change in the ISK trade index during the year	+7.9%	-1.3%

Note 56 provides information about the development of foreign exchange rates against the Icelandic krona.

Notes to the Consolidated Financial Statements

8. Administrative expenses

Administrative expenses are specified as follows:

	2015	2014
Salaries and related expenses	2,192,807	1,769,230
Other operating expenses	1,431,503	1,134,827
Depositors' and Investors' Guarantee Fund contributions	59,990	71,610
Depreciation and amortisation	260,876	95,129
Total	3,945,176	3,070,796

ISK 280 million of one off merger costs related to termination of employment contracts are included in salaries and related expenses in the table above. Additionally, ISK 285 million in other one off merger costs are included in other operating expenses in the table. Furthermore, ISK 169 million of the ISK 261 million in depreciation and amortization are one off costs which relate to intangible assets and equipment which have been discontinued following the merger. Refer to notes 25-26 for more information on depreciation and amortization.

9. Salaries and related expenses

Salaries and related expenses are specified as follows:

	2015	2014
Salaries	1,664,407	1,377,250
Performance based payments excluding share-based payments	12,069	0
Share-based payment expenses	(1,314)	2,154
Pension fund contributions	259,019	203,730
Tax on financial activity	107,021	90,534
Other salary related expenses	151,605	95,562
Total	2,192,807	1,769,230
Average number of full time employees during the year	81	98
Total number of full time employees at year-end	86	75

The figures for 2014 do not include employees of Straumur fjárfestingabanki hf. ("Straumur"). At the beginning of 2015, Straumur had 34 full time employees and Kvika and its subsidiaries had 75, or 109 in total. The total number of full time employees at year end 2015 is considerably lower than this figure.

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2014: 5.50%).

10. Employment terms of the board of directors and management

Salaries and benefits paid to the Board of Directors, the CEO and Managing Directors of the Bank for their work for companies within the Group, and their shareholding in the Bank, are specified as follows:

			31.12.2015			31.12.2014
	Salaries and benefits	Number of shares	Warrants and options	Salaries and benefits	Number of shares	Warrants and options
Sigurður Atli Jónsson, CEO	49,094	10,000	17,300	42,141	10,000	17,300
Þorsteinn Pálsson, Chairman of the Board	11,387	0	0	6,600	0	0
Finnur Reyr Stefánsson, Deputy Chairman of the Board	2,145	90,576	0	0	0	0
Inga Björg Hjaltadóttir, Board member	6,049	0	0	3,300	0	0
Skúli Mogensen, Board member	5,593	116,060	0	3,240	116,060	0
Þórunn Pálsdóttir, Board member	2,145	0	0	0	0	0
Kristín Guðmundsdóttir, Board member	2,586	737	0	0	0	0
Jónas Hagan Guðmundsson, Board member	2,106	32,040	0	0	0	0
Hanna Katrín Friðriksson, alternate Board member	4,470	0	0	4,156	0	0
Ármann Fr. Ármannsson, alternate Board member	0	110	0	0	0	0
Magnús Bjarnason, former Board member *	1,930	0	0	0	0	0
Mario Espinosa, former Board member	0	0	0	2,700	0	0
Vilmundur Jósefsson, former alternate Board member	3,680	4,000	0	3,300	4,000	0
Ástríður Þórðardóttir, former alternate Board member	3,032	0	0	2,332	0	0
Managing Directors (2015: 5, 2014: 4)	183,596	8,650	30,000	134,766	0	57,300
Total	277,813	262,172	47,300	202,535	130,060	74,600

* Magnús Bjarnason became a Managing Director in mid year 2015. Salaries and benefits which he has received in that position, as well as shareholdings, warrants and options, if applicable, are included in the line Managing Directors in the table above.

Notes to the Consolidated Financial Statements

10. Employment terms of the board of directors and management (cont.)

Salaries and benefits are substantially all short-term employee benefits.

Figures for shares, share options and warrants are in thousands and include shares held by companies owned by or under the control of the respective parties as at 31 December 2015 and 31 December 2014. If the holdings are held indirectly through companies, then only the pro rata ownership of the aforementioned persons has been included.

The Bank has defined two Managing Director as Key Employee, as defined in Act No. 161/2002 on Financial Undertakings. Furthermore the Bank has approved and published internal rules covering the qualification requirements, evaluation process and conduct of Key Employees, in accordance with requirements set forth by the Icelandic Financial Supervisory Authority.

The Bank has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. Further information about the remuneration policy is provided in notes 67-69.

11. Auditor's fees

Remuneration to the Group's auditors is specified as follows:

	2015	2014
Audit of annual accounts	27,507	27,751
Review of interim accounts	10,287	7,006
Other audit related services	5,131	7,950
Total	42,925	42,708
Thereof to the auditors of the Bank	38,774	39,222

12. Income tax

The Group will not pay income tax on its profit for 2015 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2014, the tax loss carry forward from Straumur fjárfestingabanki hf. amounted to ISK 154 billion and the tax loss carry forward from MP banki hf. amounted to ISK 6 billion. A substantial part of the deferred tax asset is utilisable until end of year 2018 and 2019. Management is of the opinion that the Group's operations in the years to come will result in taxable results which will be offset with the tax loss carry forward. The Group has therefore recognised a part of the tax loss carry forward as a deferred tax asset in the consolidated statement of financial position. The deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The deferred tax asset is reviewed at each reporting date.

Income tax is recognised based on the tax rates and tax laws enacted during the current year, according to which the domestic corporate income tax rate was 20.0% (2014: 20.0%)

Reconciliation of effective tax rate:

		2015		2014
Profit before income tax		271,142		282,685
Income tax using the domestic corporation tax rate	20.0%	(54,228)	20.0%	(56,515)
Effect of tax rates in foreign jurisdictions	0.0%	(0)	(0.0%)	23
Non-deductible expenses	0.5%	(1,375)	0.7%	(1,897)
Non-taxable income	(232.0%)	628,987	(52.5%)	148,419
Derecognition of previously recognised tax losses	324.4%	(879,479)	0.0%	0
Other changes	156.6%	(424,520)	13.3%	(37,592)
Effective income tax	269.5%	(730,616)	(18.5%)	52,438

Profit before tax amounts to ISK 271 million. Income tax amounts to ISK -731 million, resulting in an effective tax rate of 269.5%. This is substantially different from the Icelandic corporate tax rate of 20%, mainly due to non-taxable income from shares and revalueation of the deferred tax asset.

13. Special tax on financial institutions

According to Act No. 155/2010 on Special Tax on Financial Institutions, certain types of financial institutions, including banks, must pay annually a tax based on the carrying amount of their liabilities as determined for tax purposes in excess of ISK 50 billion at year-end. The tax rate is set at 0.376% (2014: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Statement of Financial Position

14. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	31.12.2015	31.12.2014
Deposits with the Central Bank of Iceland	15,676,543	8,643,487
Cash on hand	80,881	89,691
Balances with banks	3,476,080	3,678,258
Treasury bills	683,469	558,982
Total	19,916,973	12,970,418

15. Fixed income securities

Fixed income securities are specified as follows:

	31.12.2015	31.12.2014
Held for trading		
Listed government bonds and bonds with government guarantees	1,684,684	2,471,713
Listed treasury bills	73,865	84,637
Listed bonds	2,717,833	1,367,033
Unlisted bonds	148,833	0
Designated at fair value		
Unlisted bonds	23,886	272,946
Total	4,649,103	4,196,330

Further discussion about the accounting classification of financial assets is provided in notes 59-61.

16. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	31.12.2015	31.12.2014
Held for trading		
Listed shares	1,376,404	338,712
Listed unit shares	0	220
Unlisted shares	18,568	4,418
Unlisted unit shares	1,095,558	97,467
Designated at fair value		
Unlisted shares	509,033	287,082
Unlisted unit shares	6,480	62,825
Total	3,006,042	790,723

Further discussion about the accounting classification of financial assets is provided in notes 59-61.

17. Securities used for hedging

Securities used for hedging are specified as follows:

	31.12.2015	31.12.2014
Listed government bonds and bonds with government guarantees	1,325,364	3,675,958
Listed bonds	286,838	53,418
Listed shares	8,582,712	3,123,620
Unlisted unit shares	862,919	3,645
Total	11,057,833	6,856,641

Securities used for hedging are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 59-61.

18. Loans to customers

Loans to customers are specified as follows:

	31.12.2015	31.12.2014
Loans to customers, gross amount	22,007,487	22,577,554
Specific allowance for impairment losses	(208,880)	(108,761)
Collective allowance for impairment losses	(205,869)	(181,654)
Total	21,592,738	22,287,138

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

19. Allowance for impairment losses

Change in allowance for impairment losses is specified as follows:

a. Loans to customers

31.12.2015	Specific	Collective	Total
Balance as at 1 January 2015	108,761	181,654	290,415
Charge to the income statement for the year	180,050	24,215	204,265
Write-offs	(79,932)	0	(79,932)
Balance as at 31 December 2015	208,880	205,869	414,748

31.12.2014	Specific	Collective	Total
Balance as at 1 January 2014	294,306	210,587	504,893
Charge to the income statement for the year	58,712	1,345	60,057
Recoveries	(72,036)	0	(72,036)
Write-offs	(172,220)	0	(172,220)
Reclassification	0	(30,278)	(30,278)
Balance as at 31 December 2014	108,761	181,654	290,415

b. Other assets - accounts receivable

31.12.2015	Specific	Collective	Total
Balance as at 1 January 2015	0	3,053	3,053
Charge to the income statement for the year	10,912	620	11,532
Recoveries	(780)	0	(780)
Write-offs	0	1,327	1,327
Balance as at 31 December 2015	10,132	5,000	15,132

31.12.2014	Specific	Collective	Total
Balance as at 1 January 2014	23,251	10,608	33,859
Charge to the income statement for the year	(2,958)	4,246	1,288
Write-offs	(20,294)	(11,800)	(32,094)
Balance as at 31 December 2014	0	3,053	3,053

20. Derivatives

Derivatives are specified as follows:

			31.12.2015			31.12.2014
	Notional	Assets	Liabilities	Notional	Assets	Liabilities
Interest rate derivatives	1,020,000	45,894		500,000	34,527	
Currency forwards	725,839	14,287	0			
Bond and equity total return swaps	1,691,601	267,811	884,545	10,098,940	176,084	134,275
Equity options	(400,590)		102,941	903,240	17,670	19,921
Bond options				405,200	5,405	
	3,036,851	327,993	987,486	11,907,380	233,685	154,196

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

21. Group entities

The main subsidiaries held directly or indirectly by the Group are listed in the table below. The number of subsidiaries increased due to the merger with Straumur fjárfestingabanki hf.

Entity	Nature of operations	Domicile	Share 31.12.2015	Share 31.12.2014
Ármúli fasteignir ehf.	Holding company	Iceland	100%	100%
Burðarás eignarhaldsfélag ehf.	Holding company	Iceland	100%	-
Burðaás PE GP ehf.	Dormant	Iceland	100%	-
Burðarás PE slhf.	Dormant	Iceland	100%	-
Fasteignastýring ehf.	Dormant	Iceland	100%	100%
Foss eignarhaldsfélag ehf.	Dormant	Iceland	100%	-
Foss 2 eignarhaldsfélag ehf.	Dormant	Iceland	100%	-
IB eignarhaldsfélag ehf.	Dormant	Iceland	100%	-
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Mánatún GP ehf.	Dormant	Iceland	100%	100%
Pivot ehf.	Holding company	Iceland	100%	-
Straumur eignarhaldsfélag ehf.	Dormant	Iceland	100%	-
Straumur Equites ehf.	Dormant	Iceland	100%	-
Straumur fjárfestingar hf.	Dormant	Iceland	100%	-
Straumur sjóðir hf.	Fund management	Iceland	100%	-
Íslensk eignastýring ehf.	Holding company	Iceland	79%	-
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	70%	70%
Teris	Holding company	Iceland	54%	54%
Heildun UAB	Dormant	Lithuania	100%	100%
Horn Florida Ltd.	Holding company	UK	100%	100%

When the merger with Straumur fjárfestingabanki hf. took place, Íslensk eignastýring ehf., a subsidiary of Pivot ehf., owned a majority stake in Íslensk verðbréf hf. Íslensk verðbréf hf. were therefore a part of the consolidated accounts of Straumur fjárfestingabanki hf. and its assets and liabilities were a part of the consolidated assets and liabilities that were merged with the Bank, as shown in note 3. The assets amounted to ISK 1,708 million and its liabilities amounted to ISK 875 million. In relation to Straumur fjárfestingabanki hf. Investment in Íslensk verðbréf hf., via Pivot ehf., the Group recognized goodwill amounting to ISK 545 million. Íslensk eignastýring ehf. sold all its shares in Íslensk verðbréf hf. before year-end 2015. This resulted in the company no longer being part of the Group and no goodwill being on the consolidated statement of financial position at year-end 2015.

22. Investment in associates

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

Entity	Nature of operations	Domicile	Share 31.12.2015	Share 31.12.2014
Londonderry Associates LLC	Holding company	USA	38%	38%

The Bank does not consider its associates material, neither individually nor as a group.

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

	31.12.2015	31.12.2014
Balance at the beginning of the year	0	309,021
Additions through a merger	29,052	0
Disposal of shares in associates	(27,054)	0
Reclassification	0	(331,448)
Share in (loss) profit of associates, net of income tax	(1,998)	22,427
Total	(0)	0

23. Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 73 Financial investments under control are presented in fixed income securities (2015: ISK 19,878 thousand, 2014: ISK 0) in the consolidated statement of financial position.

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

24. Unconsolidated structured entities

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

The nature and purpose of Investment funds is to generate fees from managing assets on behalf of third party investors. These vehicles are financed through the issuance of units to investors.

	31.12.2015	**31.12.2014**
Investments funds	41,917,800	24,336,200

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

	Carrying amount	
	31.12.2015	**31.12.2014**
Investments funds	1,691,393	101,400

The Group received management fees during the year:

	31.12.2015	**31.12.2014**
Investments funds	489,538	294,000

25. Intangible assets

Intangible assets are specified as follows:

31.12.2015	**Software**	**Goodwill**	**Other**	**Total**
Balance as at 1 January 2015	133,673	0	115,094	248,766
Acquisitions	7,688	57,425	0	65,113
Additions through a merger	4,328	544,925	0	549,253
Discontinued	(80,790)	0	(71,059)	(151,849)
Disposals	(4,328)	(602,350)	0	(606,678)
Amortisation	(40,267)	0	(18,415)	(58,682)
Balance as at 31 December 2015	20,304	0	25,620	45,924
Gross carrying amount	38,924	0	48,800	87,724
Accumulated amortization and impairment losses	(18,620)	0	(23,180)	(41,800)
Balance as at 31 December 2015	20,304	0	25,620	45,924

31.12.2014	**Software**	**Goodwill**	**Other**	**Total**
Balance as at 1 January 2014	171,519	0	133,509	305,028
Acquisitions	1,741	0	0	1,741
Amortisation	(39,582)	0	(18,415)	(57,997)
Translation difference	(5)	0	0	(5)
Balance as at 31 December 2014	133,673	0	115,094	248,766
Gross carrying amount	262,767	0	184,150	446,917
Accumulated amortization and impairment losses	(91,248)	0	(50,641)	(141,889)
Balance as at 1 January 2014	171,519	0	133,509	305,028
Gross carrying amount	264,508	0	184,150	448,658
Accumulated amortization and impairment losses	(130,835)	0	(69,056)	(199,892)
Balance as at 31 December 2014	133,673	0	115,094	248,766

The goodwill which the Group acquired through the merger with Straumur fjárfestingabanki hf. and through acquisitions during the year relates to investments in Íslensk verðbréf hf. Since the Group disposed of all its shares in Íslensk verðbréf hf. before year-end 2015 goodwill at year-end amounts to zero.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

26. Property and equipment

Property and equipment is specified as follows:

31.12.2015	Real estate	Other	Total
Balance as at 1 January 2015	0	74,873	74,873
Acquisitions	0	46,934	46,934
Additions through a merger	98,407	11,543	109,950
Discontinued	0	(17,122)	(17,122)
Disposals	(97,659)	(7,161)	(104,820)
Depreciation	(748)	(32,318)	(33,066)
Balance as at 31 December 2015	0	76,749	76,749
Gross carrying amount	0	197,507	197,507
Accumulated depreciation	0	(120,757)	(120,757)
Balance as at 31 December 2015	0	76,749	76,749

31.12.2014	Real estate	Other	Total
Balance as at 1 January 2014	0	99,465	99,465
Acquisitions	0	24,584	24,584
Disposals	0	(11,714)	(11,714)
Reclassified to assets classified as held for sale	0	(147)	(147)
Depreciation	0	(37,238)	(37,238)
Translation difference	0	(76)	(76)
Balance as at 31 December 2014	0	74,873	74,873
Gross carrying amount	0	196,484	196,484
Accumulated depreciation	0	(97,019)	(97,019)
Balance as at 1 January 2014	0	99,465	99,465
Gross carrying amount	0	194,207	194,207
Accumulated depreciation	0	(119,334)	(119,334)
Balance as at 31 December 2014	0	74,873	74,873

27. Deferred tax assets and liabilities

Change in deferred tax is specified as follows:

	31.12.2015	31.12.2014
Balance at the beginning of the year	574,107	613,443
Calculated income tax	0	52,438
Expensed income tax	(730,616)	0
Additions through a merger	236,466	0
Current income tax payable	22,864	13,589
Income tax recognized in other comprehensive income and equity	0	(1,168)
Other changes	(247)	(104,194)
Net	102,575	574,107
Deferred tax assets	106,557	578,080
Deferred tax liabilities	(3,982)	(3,973)
Net	102,575	574,107

The Group's deferred tax assets (liabilities) are attributable to the following items:

	31.12.2015	31.12.2014
Property and equipment	6,693	2,136
Intangible assets	6,853	(10,990)
Assets and liabilities denominated in foreign currencies	(5,380)	(2,558)
Other items	(796)	2,971
Tax losses carried forward	95,204	582,548
Total	102,575	574,107

At year end 2015, tax losses carried forward amount to ISK 160.4 billion, and are set to expire as follows:

	Losses
Tax losses 2009, expiring in 2019	193,520
Tax losses 2011, expiring in 2021	561,705
Tax losses 2012, expiring in 2022	640,623
Tax losses 2013, expiring in 2023	1,061,629
Tax losses 2014, expiring in 2024	415,621
Tax losses 2015, expiring in 2025	3,198,482
Tax losses acquired via merger with Straumur fjárfestingabanki hf., expiring 2018-2024	154,321,707
Total	160,393,287

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

28. Other assets

Other assets are specified as follows:

	31.12.2015	31.12.2014
Unsettled securities transactions	0	379,024
Accounts receivable	625,190	314,839
Sundry assets	122,842	24,325
Total	748,032	718,188

29. Assets classified as held for sale

The Group has classified certain assets as held for sale. The Group intends to dispose of the majority of these assets in 2016.

Assets classified as held for sale are specified as follows:

	31.12.2015	31.12.2014
Buildings and land	25,918	251,025
Unlisted shares	59,895	39,626
Total	85,813	290,651

Assets classified as held for sale include foreclosed assets as specified in note 47.

30. Deposits from customers

Deposits from customers are specified as follows:

	31.12.2015	31.12.2014
Demand deposits	22,697,505	19,848,388
Time deposits	7,846,902	6,916,193
Total	30,544,407	26,764,581

31. Borrowings

Borrowings are specified as follows:

	31.12.2015	31.12.2014
Loans from credit institutions	2,053	2,922
Money market deposits	15,218,074	9,851,810
Total	15,220,126	9,854,731

Money market deposits typically have a principal of ISK 5-200 million and maturity between 1 week and 3 months and pay fixed interest rates.

32. Issued bills

Issued bills are specified as follows:

	31.12.2015	31.12.2014
Issued bills	3,908,480	0
Total	3,908,480	0

33. Subordinated liabilities

Subordinated liabilities are specified as follows:

	Issued	Maturity	Maturity type	Terms of interest	31.12.2015	31.12.2014
Tier 2 in ISK	2015	2025	At maturity .	CPI-Indexed, fixed 5.50%	562,339	0
Total					562,339	0

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

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within Tier 2. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

In the calculation of the capital ratio, subordinated liabilities are included within Tier 2 and are included in the equity base as the amount eligible for Tier 2 capital treatment is amortized on a straight-line basis over the final 5 years to maturity or up to 20% a year.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

34. Short positions held for trading

Short positions held for trading are specified as follows:

	31.12.2015	31.12.2014
Listed government bonds and bonds with government guarantees	595,014	2,875,806
Listed bonds	0	64,152
Listed shares	188,648	48,290
Unlisted shares	0	7
Total	783,662	2,988,256

Short positions held for trading are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 59-61.

35. Short positions used for hedging

Short positions used for hedging are specified as follows:

	31.12.2015	31.12.2014
Listed government bonds and bonds with government guarantees	1,024,390	217,637
Listed shares	0	31,521
Total	1,024,390	249,158

Short positions used for hedging are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 59-61.

36. Other liabilities

Other liabilities are specified as follows:

	31.12.2015	31.12.2014
Unsettled securities transactions	150,310	0
Accounts payable and accrued expenses	175,632	127,537
Taxes	28,965	109
Withholding taxes	432,501	288,376
Salaries and salary related expenses	266,762	160,897
Other liabilities	256,562	431,077
Total	1,310,733	1,007,996

37. Equity

a. Share capital

The nominal value of shares issued by the Bank is ISK 1 per share or a multiple thereof. All currently issued shares have a nominal value of ISK 1 per share, and are fully paid. The holders of shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per nominal value of ISK 1 at shareholders' meetings.

	31.12.2015	31.12.2014
Share capital according to the Bank's Articles of Association	1,604,599	1,170,800
Nominal amount of treasury shares	13,956	800
Authorised but not issued shares	281,500	1,500,000

b. Share capital increase

The share capital of the Bank was increased by a nominal amount of 434 million shares in conjunction with the merger with Straumur fjárfestingabanki hf. during 2015.

c. Share capital increase authorizations

A shareholder meeting in June 2015 authorized the Board of Directors to increase the share capital by up to ISK 200,000,000 through a subscription for new shares. This authorization expires at the Bank's Annual General Meeting in 2016. The Board of Directors is moreover authorized during a five year period to increase the share capital of the Bank in stages by up to ISK 20,000,000 in nominal value, for the purposes of fulfilling share option agreements in accordance with the Bank's share incentive scheme. The Board of Directors is finally authorized to increase the share capital of the Bank by up to ISK 61,500,000 in nominal value, until 12 December 2016, for the purposes of fulfilling the Bank's obligations under issued subscription rights (warrants). A copy of the Bank's Articles of Association, including the temporary provisions, is available on the Bank's website, www.kvika.is.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

38. Warrants

In December 2014 the Bank sold warrants for ISK 61.5 million in new share capital, with an exercise price of ISK 2.60 per share. The warrants were outstanding as at 31 December 2015 and expire on 15 December 2016.

39. Capital adequacy ratio (CAD)

Equity at the end of the year was ISK 6,531 million (31.12.2014: 5,597 million), equivalent to 10.6% (31.12.2014: 11.3%) of total assets according to the statement of financial position. The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 23.5% (31.12.2014: 17.4%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Capital base	**31.12.2015**	**31.12.2014**
Total equity	6,531,154	5,596,506
Goodwill and intangibles	(45,924)	(248,766)
Deferred tax asset	(106,557)	(578,080)
Tier 1 capital	6,378,672	4,769,660
Subordinated liabilities	562,339	0
Accrued interests	(10,251)	0
Tier 2 capital	552,088	0
Shares in financial institutions	(121,806)	(3,709)
Subordinated fixed income securities	(120,415)	(97,907)
Total capital base	6,688,539	4,668,044

Capital requirements	**31.12.2015**	**31.12.2014**
Credit risk	1,290,773	1,431,518
Market risk	418,946	168,464
Operational risk	568,427	546,350
Total Capital requirements	2,278,146	2,146,333
Surplus capital	4,410,393	2,521,711
Capital adequacy ratio (CAD)	23.5%	17.4%

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

Minimum capital requirement is based on the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and is reviewed by the FME through the Supervisory Review and Evaluation Process (SREP). The Bank's minimum regulatory capital requirement based on SREP is 11.8%.

Notes to the Consolidated Financial Statements

Risk management

40. Risk management framework

a. Board of Directors

The Bank's Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite setting. Risk management policies are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

b. Board of Directors sub-committees

The Bank's Board of Directors has established two sub-committees, Remuneration Committee and Risk and Audit committee. The Risk and Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures. The Risk and Audit Committee is assisted in its oversight role by Internal Audit.

c. CEO

The CEO is responsible for the effective implementation through the corporate governance structure and committees. The CEO has established three committees, which are responsible for developing and monitoring risk management policies in their specified areas.

d. Committees

The Bank operates three committees that are involved in risk management: an Asset and Liability Committee (ALCO), a Credit Committee and a Quality and Security Committee.

The ALCO Committee meets regularly and each department reports on its operations and positions activity since the previous meeting. The committee addresses matters regarding the Bank's risk management, financing, capital management and proprietary trading.

The Credit Committee addresses matters regarding the Bank's loan activities. The committee is responsible for the approval of individual loans as well as deciding on credit limits for individual clients in derivative trades, and is the primary forum for the discussion of loan activity policy.

The Quality and Security Committee is responsible for supervision and implementation of the Bank‘s security and quality policies. The security policy mainly addresses data security and operational security in IT systems, physical security for the personnel and proper access controls and monitoring in the Bank‘s premises. The quality work is aimed at upholding proper quality in work processes, IT systems and services to support performance and profitability, lower operational risk and increase the customer experience.

e. Risk management

The purpose of the Bank's risk management unit is to identify, quantify, control and report on the risks that the Group is exposed to in its daily activities. The unit also participates in drafting the overall risk policy and has representatives on the ALCO committee, Credit committee and the Quality and Security committee. The unit’s main activities include monitoring and managing credit risk, market risk, liquidity risk and operational risk. The Board of Directors sets the rules and guidelines regarding the Group's risk policy and the obligations of risk management and credit control. The division reports regularly on the Group’s positions and exposure to risk to the Board of Directors, the CEO and to the ALCO committee.

f. Compliance Officer

The Compliance unit ensures that the Group adheres to its rules on securities trading and insider trading and operation comply with the Act on Securities Transactions, the Act on Actions to Combat Money Laundering and Terrorist Financing and other relevant legislation and regulations.

g. Internal audit

Internal audit has the role to give objective opinion on the Group's operations and advisory that aims to increase its value, and to strengthen risk management and internal control. The tasks of internal audit and main emphasis are to estimate whether processes and systems are in place, and whether they are relevant and efficient. Internal auditor is recruited by the board and is located accordingly in the hierarchy. It's operations cover all units of operations, including subsidiaries.

41. Hedging

A part of the Group’s portfolio consists of securities held as a hedge against derivatives positions of customers. The Group hedges currency exposure between the Group's loan portfolio and debts to the extent possible, but does not apply hedge accounting.

Notes to the Consolidated Financial Statements

42. Credit risk - overview

a. Definition

One of the Group’s primary sources of risk is counterparty credit risk. Credit risk is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

b. Management

The risk management unit is responsible for managing and reporting on credit risk. The Group uses a variety of tools and processes to manage credit risk, including collaterals, hedges and loan portfolio management.

c. Credit approval process

The originating department prepares a proposal for each loan or credit line which is presented to the credit committee for approval. The proposal consists of a basic description of the client, the purpose of the loan, a simple credit assessment and arguments for or against granting the loan. The committee decides whether there is need for further credit assessment and on what terms the loan may be granted.

A more thorough credit assessment may be conducted if considered appropriate and can include an assessment of a borrower’s fundamental credit strength as well as the value of any collateral. To assess the borrower’s capacity to meet his or her obligations the committee can request stress test analysis of the borrower’s cash flow or call for third party assessments.

d. Collateral

Securing loans with collateral is a traditional method to reduce credit risk. The Group uses different methods to reduce credit risk by obtaining collateral from customers where appropriate. Such collateral gives the Group right to the collateralised assets for current and future obligations incurred by the customer.

The Group places emphasis on ensuring that loans are secured with collateral that can be marked to market, and that asset coverage exceeds 100%. The Group applies appropriate haircuts on all collateral in order to ensure proper risk mitigation. For all collateral in listed securities, the Group maintains the right to liquidate collateral in case its market value falls below a predefined limit.

To a very large extent the Group’s loan portfolio consists of senior loans, most of which are highly collateralised.

e. Credit rating, control and provisioning

The risk management unit is responsible for credit rating and reviewing the loan portfolio. In case of any significant delay of payments or defaults the unit carefully analyses the underlying assets and loan documents and organizes the process of collection.

The Group monitors the value of collateral by listed securities on a real time basis, and takes prompt action when necessary.

Provisioning for loan impairments is estimated on the basis of models assessing a portfolio as a whole based on the seniority of the loans, the degree of collateralisation and the Group's history of defaulted loans. Risk management suggest a provisioning percentage for the portfolio, based on the loss assessment. Risk management reassess impairments in the event of collateral decay, delayed payments or other early warning signs. Provisions require approval by the CEO and the credit committee.

f. Loan portfolio management

To ensure an effective diversification of the loan portfolio the board has set a limit framework defining maximum exposure as a ratio of the Group’s equity and/or the total size of the loan portfolio. These limits include limitation on joint exposure to associated clients, exposure to individual and associated industries, single regions and countries etc. It is the responsibility of risk management to monitor that these limits are not being violated and to report discrepancies to the credit committee.

g. Impairment

The Group's impairment policy is discussed in notes 81-82.

h. Renegotiation of terms and forbearance

The Group's forbearance policy is discussed in note 82.

i. Derivatives

The Group offers derivative contracts in the form of swap contracts on listed, highly liquid securities. On the day when the contract is entered into, the Group purchases the underlying security and hedges its exposure to price changes. Collateral is in the form of cash or listed, highly liquid securities. The risk management sets rules about the level of collateralisation and monitors the compliance to these rules. Contracts are closed if required levels of collateralisation are not met.

j. Securities used for hedging

The Group hedges itself for market risk of derivative contracts by purchasing the underlying securities at the commencement of the contract. Since the contracts require delivery of the underlying securities to the customer on the settlement day, the credit risk towards the issuer is immaterial.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Risk management

43. Maximum exposure to credit risk

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

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2015
Cash and cash equivalents	16,440,893	3,476,080			19,916,973
Receivables from Central Bank					0
Fixed income securities	1,758,550	2,741,719	148,833		4,649,103
Securities used for hedging	1,612,202				1,612,202
Loans to customers	3,997	374,228	16,019,757	5,194,757	21,592,738
Derivatives		210,462	112,745	4,785	327,993
Other assets	41,995	54,173	343,842	185,180	625,190
	19,857,637	6,856,662	16,625,178	5,384,722	48,724,199
Loan commitments	100	155,949	2,377,348	581,524	3,114,921
Financial guarantee contracts			537,941	2,380	540,321
Total	19,857,737	7,012,611	19,540,467	5,968,626	52,379,441

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2014
Cash and cash equivalents	9,292,160	3,678,258			12,970,418
Receivables from Central Bank	98,832				98,832
Fixed income securities	2,806,395	1,207,858	182,077		4,196,330
Securities used for hedging	3,675,958	53,418			3,729,376
Loans to customers	3,835	497,665	15,899,159	5,886,479	22,287,138
Derivatives		108,151	116,114	9,420	233,685
Other assets	3,764	48,355	563,914	77,831	693,863
	15,880,943	5,593,706	16,761,263	5,973,730	44,209,642
Loan commitments	234	83,641	1,991,361	794,775	2,870,010
Financial guarantee contracts			334,054	10,568	344,622
Total	15,881,177	5,677,346	19,086,678	6,779,072	47,424,274

44. Credit quality of financial assets

a. Breakdown

Credit quality of financial assets is specified as follows:

31.12.2015	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Less specific impairment allowance	Less collective impairment allowance	Carrying amount
Cash and cash equivalents	19,916,973			19,916,973			19,916,973
Receivables from Central Bank				0			0
Fixed income securities	4,649,103			4,649,103			4,649,103
Securities used for hedging	1,612,202			1,612,202			1,612,202
Loans to customers	20,364,740	983,153	659,594	22,007,487	(208,880)	(205,869)	21,592,738
Derivatives	327,993			327,993			327,993
Other assets	625,190		15,132	640,322	(10,132)	(5,000)	625,190
Total	47,496,201	983,153	674,726	49,154,080	(219,012)	(210,869)	48,724,199

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

44. Credit quality of financial assets (cont.)

31.12.2014	**Neither past due nor individually impaired**	**Past due but not individually impaired**	**Individually impaired**	**Total**	**Less specific impairment allowance**	**Less collective impairment allowance**	**Carrying amount**
Cash and cash equivalents	12,970,418			12,970,418			12,970,418
Receivables from Central Bank	98,832			98,832			98,832
Fixed income securities	4,196,330			4,196,330			4,196,330
Securities used for hedging	3,729,376			3,729,376			3,729,376
Loans to customers	21,471,192	954,285	152,077	22,577,554	(108,761)	(181,654)	22,287,138
Derivatives	233,685			233,685			233,685
Other assets	687,063		9,853	696,916		(3,053)	693,863
Total	43,386,896	954,285	161,930	44,503,111	(108,761)	(184,707)	44,209,642

b. Past due but not individually impaired

Past due but not individually impaired financial assets are those assets where contractual payments are 1 or more days past due but the Group believes that impairment is not appropriate on the basis of the level of security or future cash flows of the borrower. Past due loans are reported as the total claim value and not only those payments that are past due.

	31.12.2015	**31.12.2014**
Past due 1-30 days	742,618	629,911
Past due 31-60 days	25,053	159,759
Past due 61-90 days	120,224	5,561
Past due 91-180 days	21,544	44,831
Past due 180-360 days	62,660	94,757
Past due more than 360 days	11,054	19,466
Total	983,153	954,285

c. Individually impaired

Individually impaired financial assets are those assets where there is objective evidence of impairment, the asset has been individually assessed and comparison of the carrying amount and the present value of the expected cash flow from the asset reveals a need for impairment. All individually impaired assets are considered non-performing.

31.12.2015	**Impaired but not Past due**	**Past due 1-30 days**	**Past due 31-60 days**	**Past due 60-90 days**	**Past due over 90 days**	**Claim value**
Corporate						
Services	132,295				65,431	197,726
Holding companies	206,643	414	253		45,467	252,777
Retail	200,297					200,297
Real estate, construction and industry		5,059				5,059
Individuals					18,866	18,866
Total	539,235	5,473	253	0	129,765	674,726

31.12.2014	**Impaired but not Past due**	**Past due 1-30 days**	**Past due 31-60 days**	**Past due 60-90 days**	**Past due over 90 days**	**Claim value**
Corporate						
Services					4,653	4,653
Holding companies					19,843	19,843
Retail					9,662	9,662
Real estate, construction and industry					57,139	57,139
Individuals	12,951	449	821		56,411	70,633
Total	12,951	449	821	0	147,708	161,930

Kvika Amounts are in ISK thousands

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45. Breakdown of loans to customers

a. By industry

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

31.12.2015	Claim value	Impairment allowance	Carrying amount	%
Public entities	4,035	(39)	3,997	0.0%
Financial institutions	377,857	(3,630)	374,228	1.7%
Corporate				
Services	7,679,186	(159,265)	7,519,922	34.8%
Holding companies	5,098,667	(108,051)	4,990,616	23.1%
Retail	2,032,564	(22,005)	2,010,559	9.3%
Real estate, construction and industry	1,096,061	(14,228)	1,081,834	5.0%
Other	420,869	(4,043)	416,827	1.9%
Individual	5,298,245	(103,488)	5,194,757	24.1%
Total	22,007,487	(414,748)	21,592,738	100.0%

31.12.2014	Claim value	Impairment allowance	Carrying amount	%
Public entities	3,866	(31)	3,835	0.0%
Financial institutions	501,723	(4,058)	497,665	2.2%
Corporate				
Services	8,722,923	(73,166)	8,649,758	38.8%
Holding companies	3,436,347	(33,810)	3,402,537	15.3%
Retail	2,350,508	(28,436)	2,322,072	10.4%
Real estate, construction and industry	1,189,373	(42,360)	1,147,013	5.1%
Other	380,860	(3,080)	377,780	1.7%
Individual	5,991,953	(105,474)	5,886,479	26.4%
Total	22,577,554	(290,415)	22,287,138	97.7%

b. By seniority

The following definitions are used when ranking its loan portfolio by seniority:

- Senior I
  Loans in this category have first priority claims on the borrower's assets, are secured with collateral which can be marked to market and have asset coverage exceeding 100%.
- Senior II
  Loans in this category have sufficient coverage and liquid collateral, but the collateral can in some cases not be marked to market, e.g. unlisted shares.
- Junior
  Junior loans have second lien claims on the borrower's assets or lower levels of collateral coverage.
- Mezzanine
  Mezzanine loans are loans which are unsecured and subordinated to all of the borrower's other liabilities.

The breakdown of loans by categories is as follows:

	Senior I	Senior II	Junior	Mezzanine	31.12.2015
Neither past due nor individually impaired	9,181,543	7,177,080	1,907,624	1,901,908	20,168,155
Past due but not individually impaired	401,693	392,989	93,784	85,403	973,869
Individually impaired	158,171	31,929	178,149	82,464	450,714
Total	9,741,407	7,601,998	2,179,557	2,069,775	21,592,738

	Senior I	Senior II	Junior	Mezzanine	31.12.2014
Neither past due nor individually impaired	7,158,273	9,499,752	2,944,486	1,628,183	21,230,694
Past due but not individually impaired	506,982	316,168	110,868	79,111	1,013,129
Individually impaired	1,634	6,950	27,131	7,601	43,315
Total	7,666,889	9,822,870	3,082,485	1,714,895	22,287,138

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

46. Collateral and other credit enhancements

a. Valuation

The Group applies the same valuation methods to collateral held as other comparable assets held by the Group. The methods used for financial assets are outlined in note 60. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2015
Financial institutions	76	80	377,702				377,857
Corporate customers	754,400	71,504	5,371,576	6,725,838	143,907	1,507,355	14,574,579
Individuals	32,031	21,408	32,759	4,353,646		82,687	4,522,529
Total	786,507	92,991	5,782,037	11,079,483	143,907	1,590,041	19,474,966

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2014
Financial institutions	1	309,110					309,111
Corporate customers	720,827	52,435	2,801,236	9,191,701	327,599	2,299,054	15,392,852
Individuals	23,197	8,219	3,016	4,635,572	47,900	90,461	4,808,366
Other	509	54,187	2,004				56,700
Total	744,533	423,952	2,806,256	13,827,274	375,499	2,389,515	20,567,029

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

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2015
Financial institutions	677,331	309,716	531,764				1,518,811
Corporate customers	462,125	62,294	278,487				802,905
Individuals	18,136	27,391	18,533				64,060
Total	1,157,592	399,401	828,784	0	0	0	2,385,776

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2014
Financial institutions	349,070	13,484	1,260,637				1,623,190
Corporate customers	307,432	39,852	58,395				405,679
Individuals	1,281	3,478	87,779				92,539
Total	657,783	56,814	1,406,811	0	0	0	2,121,409

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

47. Foreclosed assets

Should a borrower default on their obligations the Group may initiate foreclosure of pledged assets. In certain circumstances the Group may bid for the foreclosed assets to protect its interests. Should the Group be the highest bidder it is Group policy to classify such assets as held for sale and dispose of them as soon as possible. The value of foreclosed assets is specified as follows:

	2015	2014
Buildings and land	0	38,630
Total	0	38,630

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

48. Loan-to-value

a. General

The loan-to-value ratio (LTV) is the ratio of the gross amount of the loan to the value of the collateral, if any. The general creditworthiness of a customer is viewed as the most reliable indicator of credit quality of a loan. Valuation of collateral held against loans is therefore not updated unless the creditworthiness of a borrower deteriorates.

b. Breakdown

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

	31.12.2015	%	31.12.2014	%
Less than 50%	5,631,820	26.1%	5,101,171	22.9%
51-70%	8,478,930	39.3%	8,837,367	39.7%
71-90%	3,189,633	14.8%	4,109,840	18.4%
91-100%	613,606	2.8%	1,548,464	6.9%
More than 100%	2,404,247	11.1%	1,122,592	5.0%
No collateral	1,274,503	5.9%	1,567,704	7.0%
Total	21,592,738	100.0%	22,287,138	100.0%

49. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 625/2013 on financial institutions' large exposures, total exposure towards a customer is classified as a large exposure if it exceeds 10% of the Bank's capital base (see note 39).

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

		31.12.2015		31.12.2014
Large exposures before risk adjusted mitigation	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	7	6,476,091	12	7,985,737
20-25% of capital base	0	0	0	0
Exceeding 25% of capital base	1	1,680,741	0	0
Total	8	8,156,833	12	7,985,737
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	3	1,777,595	3	1,987,230
Large exposures net of risk adjusted mitigation	2	1,774,606	11	4,948,076

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

50. Liquidity risk

a. Definition

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

b. Management

Liquidity is managed by treasury and monitored by risk management. Liquidity position is reported to the ALCO committee. The Central Bank of Iceland sets minimum requirements for the coverage ratio between cash flows of assets and liabilities (LCR) and stable funding in foreign currencies (NSFR). The minimum 30 day LCR was 80% in 2015 (100% for non-ISK assets) and will increase to 90% in 2016 and 100% in 2017. The minimum NSFR in foreign currencies was 80% in 2015 and will increase to 90% in 2016 and 100% in 2017.

The Group was in compliance with internal and external liquidity requirements throughout the years 2015 and 2014. At year-end 2015 the liquidity coverage ratio (LCR) was 199%.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

50. Liquidity risk (cont.)

c. Maturity analysis of financial assets and financial liabilities

31.12.2015 **Financial assets by type**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative assets							
Cash and cash equivalents	19,929,033					19,929,033	19,916,973
Fixed income securities	4,456,504	192,598				4,649,103	4,649,103
Shares and other variable income securities	2,369,818	102,144	534,080			3,006,042	3,006,042
Securities used for hedging	11,057,833					11,057,833	11,057,833
Loans to customers	3,131,621	1,912,750	7,082,554	8,683,177	7,093,109	27,903,210	21,592,738
Other assets	53,638	187,331	384,221			625,190	625,190
	40,998,447	2,394,823	8,000,856	8,683,177	7,093,109	67,170,411	60,847,879
Derivative assets							
Inflow	6,790,416	1,464,205		51,312		8,305,932	
Outflow	(6,594,796)	(1,377,726)		(5,418)		(7,977,940)	
	195,620	86,479	0	45,894	0	327,993	327,993

Financial liabilities by type	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative liabilities							
Deposits from customers	(23,441,881)	(3,687,399)	(2,450,025)	(1,031,159)	(99,059)	(30,709,523)	30,544,407
Deposits from credit institutions	(714,134)					(714,134)	714,134
Borrowings	(3,037,419)	(9,237,150)	(3,116,222)			(15,390,791)	15,220,126
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,908,480
Subordinated liabilities			(30,008)		(701,495)	(731,504)	562,339
Short positions held for trading	(783,662)					(783,662)	783,662
Short positions used for hedging	(1,024,390)					(1,024,390)	1,024,390
Other liabilities		(1,310,733)				(1,310,733)	1,310,733
	(29,001,486)	(16,235,282)	(7,596,255)	(1,031,159)	(800,555)	(54,664,736)	54,068,271
Derivative liabilities							
Inflow	9,036,198	541,918				9,578,116	
Outflow	(9,829,366)	(736,236)				(10,565,602)	
	(793,168)	(194,319)	0	0	0	(987,486)	987,486
Unrecognized financial items							
Loan commitments							
Inflow	296,910	1,120,322	1,788,736	2,099		3,208,067	
Outflow	(3,114,921)					(3,114,921)	
Financial guarantee contracts							
Inflow	540,321					540,321	
Outflow	(540,321)					(540,321)	
	(2,818,011)	1,120,322	1,788,736	2,099	0	93,147	
Summary							
Non-derivative assets	40,998,447	2,394,823	8,000,856	8,683,177	7,093,109	67,170,411	
Derivative assets	195,620	86,479		45,894		327,993	
Non-derivative liabilities	(29,001,486)	(16,235,282)	(7,596,255)	(1,031,159)	(800,555)	(54,664,736)	
Derivative liabilities	(793,168)	(194,319)				(987,486)	
Net assets (liabilities) excluding unrecognized items	11,399,413	(13,948,299)	404,601	7,697,912	6,292,555	11,846,182	
Net unrecognized items	(2,818,011)	1,120,322	1,788,736	2,099		93,147	
Net assets (liabilities)	8,581,403	(12,827,977)	2,193,338	7,700,011	6,292,555	11,939,328	

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

50. Liquidity risk (cont.)

31.12.2014 **Financial assets by type**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative assets							
Cash and cash equivalents	12,976,773					12,976,773	12,970,418
Receivables from Central Bank		98,832				98,832	98,832
Fixed income securities	3,923,384	272,946				4,196,330	4,196,330
Shares and other variable income securities	438,671	288,967	63,086			790,723	790,723
Securities used for hedging	6,856,641					6,856,641	6,856,641
Loans to customers	2,949,155	3,238,920	5,097,777	9,435,183	8,013,669	28,734,704	22,287,138
Other assets	51,561	511,527	130,774			693,863	693,863
	27,196,185	4,411,192	5,291,637	9,435,183	8,013,669	54,347,865	47,893,946
Derivative assets							
Inflow	5,584,453	8,883		39,441		5,632,776	
Outflow	(5,394,177)			(4,914)		(5,399,091)	
	190,275	8,883	0	34,527	0	233,685	233,685

Financial liabilities by type	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative liabilities							
Deposits from customers	(21,094,424)	(1,626,087)	(1,145,948)	(3,246,384)	(97,113)	(27,209,956)	26,764,581
Deposits from credit institutions	(2,711,342)					(2,711,342)	2,711,342
Borrowings	(4,327,318)	(4,714,988)	(883,210)			(9,925,516)	9,854,731
Short positions held for trading	(2,988,252)					(2,988,252)	2,988,256
Short positions used for hedging	(249,158)					(249,158)	249,158
Other liabilities	(299,259)	(479,618)	(175,394)	(53,725)		(1,007,996)	1,007,996
	(31,669,753)	(6,820,693)	(2,204,552)	(3,300,109)	(97,113)	(44,092,220)	43,576,063
Derivative liabilities							
Inflow	4,333,842	273,363				4,607,204	
Outflow	(4,468,024)	(293,376)				(4,761,400)	
	(134,182)	(20,013)	0	0	0	(154,196)	154,196
Unrecognized financial items by type							
Loan commitments							
Inflow	538,284	1,124,132	1,034,879	201,033	30,167	2,928,496	
Outflow	(2,870,010)					(2,870,010)	
Financial guarantee contracts							
Inflow	344,622					344,622	
Outflow	(344,622)					(344,622)	
	(2,331,726)	1,124,132	1,034,879	201,033	30,167	58,486	
Summary							
Non-derivative assets	27,196,185	4,411,192	5,291,637	9,435,183	8,013,669	54,347,865	
Derivative assets	190,275	8,883		34,527		233,685	
Non-derivative liabilities	(31,669,753)	(6,820,693)	(2,204,552)	(3,300,109)	(97,113)	(44,092,220)	
Derivative liabilities	(134,182)	(20,013)				(154,196)	
Net assets (liabilities) excluding unrecognized items	(4,417,475)	(2,420,632)	3,087,084	6,169,600	7,916,556	10,335,134	
Net unrecognized items	(2,331,726)	1,124,132	1,034,879	201,033	30,167	58,486	
Net assets (liabilities)	(6,749,200)	(1,296,499)	4,121,964	6,370,634	7,946,723	10,393,621	

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

51. Market risk

a. Definition

Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk. Notes 52-57 relate to market risk exposure.

b. Management

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

52. Interest rate risk

a. Definition

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

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

b. Management

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

53. Interest rate risk associated with trading portfolios

a. Breakdown

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

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2015
Fixed income securities			426,664	2,897,702	1,324,736	4,649,103
Short positions - fixed income securities					(783,662)	(783,662)
Net imbalance	0	0	426,664	2,897,702	541,074	3,865,441

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2014
Fixed income securities		118,896	435,123	977,050	2,665,261	4,196,330
Short positions - fixed income securities			(1,046,034)	(927,852)	(966,072)	(2,939,958)
Net imbalance	0	118,896	(610,911)	49,198	1,699,188	1,256,371

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

53. Interest rate risk associated with trading portfolios (cont.)

b. Sensitivity analysis

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

	Shift in basis points	31.12.2015 Downward	31.12.2015 Upward	31.12.2014 Downward	31.12.2014 Upward
Indexed	50	(7,915)	7,915	38,541	(38,541)
Non-indexed	100	121,360	(121,360)	(22,830)	22,830
Total		113,445	(113,445)	15,710	(15,710)

54. Interest rate risk associated with non-trading portfolios

a. Breakdown

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

31.12.2015

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	19,233,507	683,466				19,916,973
Receivables from Central Bank						0
Loans to customers	16,574,015	3,066,303	1,269,637	555,007	127,777	21,592,738
Financial assets excluding derivatives	35,807,522	3,749,769	1,269,637	555,007	127,777	41,509,711
Effect of derivatives	11,906,641	1,302,604		1,020,000		14,229,245
Total	47,714,163	5,052,373	1,269,637	1,575,007	127,777	55,738,956

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	30,428,269	522	97,118		18,498	30,544,407
Deposits from credit institutions	714,134					714,134
Borrowings	3,037,948	9,154,793	3,027,386			15,220,126
Issued bills		1,971,358	1,937,122			3,908,480
Subordinated liabilities					562,339	562,339
Financial liabilities excluding derivatives	34,180,351	11,126,672	5,061,626	0	580,837	50,949,486
Effect of derivatives	3,583,064	1,144,293				4,727,357
Total	37,763,414	12,270,965	5,061,626	0	580,837	55,676,843
Total interest repricing gap	9,950,748	(7,218,592)	(3,791,988)	1,575,007	(453,061)	62,113

31.12.2014

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	10,733,984	2,236,434				12,970,418
Receivables from Central Bank	98,832					98,832
Loans to customers	11,813,845	8,133,183	1,317,469	791,214	231,427	22,287,138
Financial assets excluding derivatives	22,646,661	10,369,617	1,317,469	791,214	231,427	35,356,388
Effect of derivatives	9,904,103	273,363		539,441		10,716,906
Total	32,550,764	10,642,979	1,317,469	1,330,655	231,427	46,073,295

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	26,640,567	2,545	5,875		115,594	26,764,581
Deposits from credit institutions	2,711,342					2,711,342
Borrowings	4,289,789	4,701,770	863,173			9,854,731
Issued bills						0
Subordinated liabilities						0
Financial liabilities excluding derivatives	33,641,697	4,704,315	869,048	0	115,594	39,330,653
Effect of derivatives	9,855,079	280,578		504,914		10,640,571
Total	43,496,776	4,984,893	869,048	504,914	115,594	49,971,224
Total interest repricing gap	(10,946,012)	5,658,086	448,421	825,741	115,833	(3,897,930)

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

54. Interest rate risk associated with non-trading portfolios (cont.)

b. Sensitivity analysis

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

	Shift in		31.12.2015		31.12.2014
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	(194)	194	23,332	(23,332)
ISK, non-indexed	100	(11,541)	11,541	12,559	(12,559)
Other currencies	20	159	(159)	178	(178)
Total		(11,575)	11,575	36,069	(36,069)

55. Exposure towards changes in the CPI

a. Definition

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

The Group is exposed to Icelandic inflation since CPI indexed assets exceed CPI indexed liabilities. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in CPI are recognised in the income statement as interest.

b. Management

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

c. Balance of CPI linked assets and liabilities

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

	31.12.2015	**31.12.2014**
Assets	6,991,287	9,025,399
Liabilities	(5,497,903)	(6,216,950)
Total	1,493,384	2,808,449

d. Sensitivity to changes in CPI

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

		31.12.2015		**31.12.2014**
	-1%	1%	-1%	1%
Government bonds	(658)	658	(22,040)	22,040
Other fixed income securities	(8,173)	8,173	(13,550)	13,550
Loans to customers	(50,883)	50,883	(49,269)	49,269
Derivatives	(10,200)	10,200	(5,394)	5,394
Short positions	7,295	(7,295)	6,719	(6,719)
Deposits	42,184	(42,184)	55,450	(55,450)
Subordinated debt	5,500	(5,500)	0	0
	(14,934)	14,934	(28,084)	28,084

The effect on equity would be the same.

56. Currency risk

a. Definition

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

b. Management

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

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2015 and 31 December 2014 the Group's position in foreign currencies was within those limits.

c. Exchange rates

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

	Closing 31.12.2015	**Average 2015**	**Closing 31.12.2014**	**Average 2014**
EUR/ISK	141.3	146.3	154.3	155.2
USD/ISK	129.6	131.9	126.9	116.8
ISK trade index	180.6	189.5	194.8	195.8

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

56. Currency risk (cont.)

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

31.12.2015

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	2,114,311	1,807,189	432,716	34,624	331,630	4,720,470
Fixed income securities				73,865		73,865
Shares and other variable income securities		6,464	24		35,271	41,759
Securities used for hedging						0
Loans to customers	926,020	202,315			20,125	1,148,460
Other assets		26,048				26,048
Financial assets excluding derivatives	3,040,331	2,042,016	432,740	108,489	387,027	6,010,603
Derivatives	4,939					4,939
Total	3,045,271	2,042,016	432,740	108,489	387,027	6,015,543

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	2,460,166	2,008,660	494,917	98,399	171,802	5,233,944
Borrowings	41,980					41,980
Short positions held for trading						0
Short positions used for hedging						0
Other liabilities						0
Financial liabilities excluding derivatives	2,502,146	2,008,660	494,917	98,399	171,802	5,275,924
Derivatives	706,600					706,600
Total	3,208,746	2,008,660	494,917	98,399	171,802	5,982,524

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	3,045,271	2,042,016	432,740	108,489	387,027	6,015,543
Financial liabilities	(3,208,746)	(2,008,660)	(494,917)	(98,399)	(171,802)	(5,982,524)
Financial guarantee contracts	115,882	12,476				128,359
Total	(47,593)	45,833	(62,178)	10,091	215,224	161,377

31.12.2014

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	1,614,337	1,286,923	330,286	226,143	334,126	3,791,814
Fixed income securities				84,637		84,637
Shares and other variable income securities	220	62,583		0	28,909	91,712
Securities used for hedging		391		0		391
Loans to customers	665,865	150,887			21,383	838,135
Other assets		1		1	59,964	59,965
Financial assets excluding derivatives	2,280,422	1,500,784	330,286	310,781	444,383	4,866,656
Derivatives		2,967				2,967
Total	2,280,422	1,503,751	330,286	310,781	444,383	4,869,622

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	2,327,604	1,096,531	341,028	246,917	139,397	4,151,477
Borrowings						0
Short positions held for trading		126				126
Short positions used for hedging		391				391
Other liabilities					17,649	17,649
Financial liabilities excluding derivatives	2,327,604	1,097,048	341,028	246,917	157,046	4,169,643
Derivatives						0
Total	2,327,604	1,097,048	341,028	246,917	157,046	4,169,643

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	2,280,422	1,503,751	330,286	310,781	444,383	4,869,622
Financial liabilities	(2,327,604)	(1,097,048)	(341,028)	(246,917)	(157,046)	(4,169,643)
Financial guarantee contracts	(206,105)	(83,949)			(10,568)	(300,622)
Total	(253,287)	322,754	(10,742)	63,864	276,769	399,358

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

56. Currency risk (cont.)

e. Sensitivity to currency risk

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

		31.12.2015		31.12.2014
Assets and liabilities denominated in foreign currencies	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(4,759)	4,759	(25,329)	25,329
USD	4,583	(4,583)	32,275	(32,275)
GBP	(6,218)	6,218	(1,074)	1,074
NOK	1,009	(1,009)	6,386	(6,386)
Other currencies	21,522	(21,522)	27,677	(27,677)
Total	16,138	(16,138)	39,936	(39,936)

The effect on equity would be the same.

57. Other price risk

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

			31.12.2015			31.12.2014
	Average	**Max**	**Exposure**	**Average**	**Max**	**Exposure**
Listed shares	550,031	1,373,262	725,822	259,833	500,651	296,055
Listed unit shares			0	222	237	220
Unlisted shares	417,564	692,292	527,601	304,154	365,127	291,500
Unlisted unit shares	751,839	1,206,151	1,102,037	195,926	374,099	160,292
Total			2,355,461			748,067

58. Operational risk

a. Definition

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

b. Management

Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management unit monitors operational risk by tracking loss events, quality deficiencies, potential risk indicators and other early-warning signals. The unit takes an active role in internal control and quality management.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Financial assets and liabilities

59. Accounting classification of financial assets and liabilities

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

31.12.2015 **Financial assets**	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents			19,916,973		19,916,973
Receivables from Central Bank					0
Fixed income securities	4,625,217	23,886			4,649,103
Shares and other variable income securities	2,490,530	515,513			3,006,042
Securities used for hedging	11,057,833				11,057,833
Loans to customers			21,592,738		21,592,738
Derivatives	327,993				327,993
Other assets			625,190		625,190
Total	18,501,572	539,399	42,134,901	0	61,175,872

Financial liabilities	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits from customers				30,544,407	30,544,407
Deposits from credit institutions				714,134	714,134
Borrowings				15,220,126	15,220,126
Issued bills				3,908,480	3,908,480
Subordinated liabilities				562,339	562,339
Short positions held for trading	783,662				783,662
Short positions used for hedging	1,024,390				1,024,390
Derivatives	987,486				987,486
Other liabilities				1,310,733	1,310,733
Total	2,795,538	0	0	52,260,219	55,055,757

31.12.2014 **Financial assets**	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents			12,970,418		12,970,418
Receivables from Central Bank			98,832		98,832
Fixed income securities	3,923,384	272,946			4,196,330
Shares and other variable income securities	440,816	349,907			790,723
Securities used for hedging	6,856,641				6,856,641
Loans to customers			22,287,138		22,287,138
Derivatives	233,685				233,685
Other assets			693,863		693,863
Total	11,454,526	622,853	36,050,251	0	48,127,631

Financial liabilities	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits from customers				26,764,581	26,764,581
Deposits from credit institutions				2,711,342	2,711,342
Borrowings				9,854,731	9,854,731
Short positions held for trading	2,988,256				2,988,256
Short positions used for hedging	249,158				249,158
Derivatives	154,196				154,196
Other liabilities				1,007,996	1,007,996
Total	3,391,609	0	0	40,338,650	43,730,259

Notes to the Consolidated Financial Statements

60. Financial assets and liabilities measured at fair value

a. Fair value hierarchy

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

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

b. Valuation process

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

c. Valuation techniques

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

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

d. Fair value hierarchy classification

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

31.12.2015

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	4,625,217			4,625,217
Shares and other variable income securities	2,369,818	102,144	18,568	2,490,530
Securities used for hedging	11,057,833			11,057,833
Derivatives		327,993		327,993
Designated at fair value				
Fixed income securities		23,886		23,886
Shares and other variable income securities		243	515,270	515,513
Total	18,052,867	454,265	533,838	19,040,970

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions held for trading	783,662			783,662
Short positions used for hedging	1,024,390			1,024,390
Derivatives		987,486		987,486
Total	1,808,052	987,486	0	2,795,538

There were no transfers between levels during the year.

31.12.2014

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	3,923,384			3,923,384
Shares and other variable income securities	440,816			440,816
Securities used for hedging	6,856,641			6,856,641
Derivatives		233,685		233,685
Designated at fair value				
Fixed income securities	3,981	29,655	239,310	272,946
Shares and other variable income securities	102,858	19,697	227,352	349,907
Total	11,327,680	283,037	466,662	12,077,379

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions held for trading	2,988,249	7		2,988,256
Short positions used for hedging	249,158			249,158
Derivatives		154,196		154,196
Total	3,237,406	154,203	0	3,391,609

There were no transfers between levels during the year.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

31.12.2015	Fixed income securities	Shares and other var. income securities	Total
Balance as at 1 January 2015	239,310	227,352	466,662
Total gains and losses in profit or loss	28,417	(61,372)	(32,956)
Additions through a merger		59,693	59,693
Purchases		308,165	308,165
Settlements	(2,470)		(2,470)
Sales	(265,257)		(265,257)
Balance as at 31 December 2015	0	533,838	533,838

31.12.2014	Fixed income securities	Shares and other var. income securities	Total
Balance as at 1 January 2014	197,537	257,594	455,131
Total gains and losses in profit or loss	52,597	(9,718)	42,878
Purchases		1,521	1,521
Settlements	(10,823)	(22,045)	(32,868)
Balance as at 31 December 2014	239,310	227,352	466,662

f. Change in unrealised gains or losses related to Level 3 financial assets held at year-end

Net financial income - 2015	Fixed income securities	Shares and other var. income securities	Total
Financial assets designated at fair value through profit or loss	28,417	(61,372)	(32,956)
Total	28,417	(61,372)	(32,956)

Net financial income - 2014	Fixed income securities	Shares and other var. income securities	Total
Financial assets designated at fair value through profit or loss	52,647	(9,718)	42,928
Total	52,647	(9,718)	42,928

g. Fair value measurements for Level 3 financial assets

Level 3 assets consist primarily of highly illiquid, unlisted bonds, shares and share certificates. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2015:

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2015
Unlisted shares	P/B multiplier	Equity	1.0-1.5	527,358
Unlisted unit shares	Investment multiplier	Original investment	0,05	6,480
Total				533,838

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2014
Unlisted bonds (performing)	Expected recovery	Value of assets	83-100%	239,310
Unlisted shares	P/B multiplier	Equity	1.07-1.17	164,769
Unlisted unit shares	Investment multiplier	Original investment	0.51	62,583
Total				466,662

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

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

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

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

	+10%	-10%
Shares and other variable income securities	53,384	(53,384)
Total	53,384	(53,384)

61. Financial assets and liabilities not measured at fair value

The Group holds financial instruments which are not measured at fair value. Except for loans to customers, the Group believes that the best estimate of the fair value of these financial instruments is equal to the carrying amount at the reporting date and does therefore not report a fair value for these financial instruments. Loans to customers are classified as level 3, in the fair value hierarchy, and have a book value of ISK 21,593 thousand at year end 2015. The estimated fair value of loans to customers at year end 2015 is ISK 21,430 thousand.

Cash and cash equivalents includes several components as detailed in note 14. Cash equivalent assets are either balances available on-demand or on very short notice, or other assets easily converted to cash. Other financial assets consist primarily of short-term receivables. The carrying amount of these assets is therefore a reasonable approximation of their fair value.

Deposits, deposits from credit institutions and other borrowings are typically either short-term or have variable interest rates. Other liabilities consist primarily of accounts payables, withholding taxes and other short-term payables. The carrying amount of these liabilities is therefore considered a reasonable approximation of their fair value.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Segment information

62. Geographical information

Net operating income is based on the customer's country of domicile and assets are based on the geographical location of the assets.

Net operating income	**2015**	**2014**
Iceland	4,654,901	3,398,901
Other regions	(28,219)	48,680
Eliminations	(194,570)	(119,323)
Total	4,432,112	3,328,258

Total assets	**31.12.2015**	**31.12.2014**
Iceland	65,153,797	50,099,773
Other regions	26,328	108,206
Eliminations	(3,566,369)	(863,653)
Total	61,613,757	49,344,327

63. Business segments

Following the merger with Straumur fjárfestingabanki hf. the Bank's organizational chart and operating segments were changed. Work associated with this took place during the second half of 2015 and as a result management reporting has not been based on the performance of individual segments or units. The Group does therefore present segment reporting for the year 2015. Segment reporting for the year 2014 is however presented, based on the operating segments that were reported on during that year.

a. Business segment balance sheet

31.12.2014	**Asset Management**	**Markets**	**Banking**	**Other Operations**	**Elimination entries**	**Total**
Segment assets 31.12.2014	150,625	76,965,970	15,131,712	1,743,965	(44,647,946)	49,344,327
Segment liabilities 31.12.2014	150,625	71,369,464	15,131,712	1,743,965	(44,647,946)	43,747,821
Segment equity 31.12.2014	0	5,596,506	0	0	0	5,596,506

Elimination entries arise primarily from internal funding, as all funding flows through Treasury which is a part of the Banking segment.

b. Business segments results

2014	**Asset Management**	**Markets**	**Banking**	**Other Operations**	**Elimination entries**	**Total**
Interest income	0	326,504	2,381,302	230,312	(39,227)	2,898,891
Interest expense	(21)	(29)	(1,607,993)	(28,053)	39,227	(1,596,870)
Net interest income	(21)	326,476	773,308	202,259	0	1,302,021
Net fee and commission income	296,753	816,760	285,396	357,479	(26,663)	1,729,725
Net financial income	(170)	(53,437)	44,235	189,684	0	180,312
Share in profit of associates, net of income tax	47,153	0	0	67,934	(92,660)	22,427
Other operating income	0	2,588	2,268	88,918	(0)	93,773
Net operating income from external customers	343,715	1,092,386	1,105,207	906,274	(119,323)	3,328,258
Net operating income from internal customers	3,986	(197,509)	405,616	(212,093)		0
Net operating income	347,700	894,877	1,510,823	694,181		3,328,258
Administrative expenses	(428,345)	(885,597)	(1,199,256)	(584,261)	26,663	(3,070,796)
Impairment of loans and receivables	0	0	(28,542)	39,233	0	10,692
Profit from assets held for sale	0	0	0	14,531	0	14,531
Profit before taxes	(80,644)	9,279	283,026	163,684	(92,660)	282,685

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Other information

64. Operating lease commitments

The Group leases under operating leases office premises for its operations in Reykjavik. In some leases the rent is based on the Icelandic Consumer Price Index and changes accordingly. Future non-cancellable minimum operating lease payments are specified as follows:

	31.12.2015	31.12.2014
Up to 1 year	83,525	81,422
1-5 years	229,199	144,361
Later than 5 years	289,525	0
Total	602,248	225,783

65. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland to the amount of ISK 3.0 billion as at 31 December 2015 (2014: 3.0 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 1.7 billion as at 31 December 2015 (2014: 4.0 billion).

66. Related parties

a. Definition of related parties

The Group has a related party relationship with the board members of the Bank, the CEO of the Bank and key employees (together referred to as management), associates as disclosed in note 22, shareholders with significant influence over the Bank (defined as holding 10% or greater of the shares in the Bank as disclosed in note 70), close family members of individuals identified as related parties and entities under the control or joint control of related parties.

b. Arm's length

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

c. Effects on statement of financial position

31.12.2015	Loans & receivables	Deposits & payables
Shareholders	1,291	61,950
Management	7,136	727,446
Total	8,426	789,397

31.12.2014	Loans & receivables	Deposits & payables
Shareholders	3,455	120,800
Management	5,366	2,620
Total	8,821	123,420

d. Off-balance sheet obligations

There were no off-balance sheet obligations with related parties during year.

e. Effects on income statement

2015	Interest income	Interest expense	Fees received	Fees paid
Shareholders	4	3,305	7,559	14,280
Management	134	22,448	2,569	12,183
Total	138	25,753	10,128	26,463

2014	Interest income	Interest expense	Fees received	Fees paid
Shareholders	0	6,438	27	30,972
Management	54	54	0	695
Total	54	54	0	695

Further information about salaries and benefits paid to the Board of Directors, the CEO and Managing Directors is provided in note 10.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

67. Remuneration policy

The Board of Directors has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy was approved by the Bank's Annual General Meeting in March 2015.

The remuneration policy conforms to Article 57 of Act No. 161/2002 on Financial Undertakings, Act No. 2/1995 on Public Limited Companies and the Icelandic FSA's directive No. 700/2011 on Incentive Schemes. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. A more detailed description of the policy can be found on the Bank's website, www.kvika.is.

68. Incentive scheme

The Board of Directors has approved a performance based incentive scheme at the proposal of the Remuneration Committee. The scheme forms a part of the remuneration policy adopted by the Bank.

a. Description
The incentive scheme conforms to the Icelandic FSA's directive No. 700/2011 on Incentive Schemes. Payments according to the scheme are based on key performance indicators (KPIs) that reflect the goals of the Bank, the division and the employee. The basis for performance based pay reflects sound risk management and does not induce excessive risk taking. Performance based pay to individual employees does not exceed 25% of their annual base salary, and payment of 40-60% of the performance based pay is deferred for three years. Performance based pay can be in the form of cash payments or share options. Share based payments are discussed in note 69.

b. Performance based payments

		2015		2014
	Cash	**Options**	**Cash**	**Options**
Non-deferred	9,669	0	0	0
Deferred	2,400	0	0	2,126
Total	12,069	0	0	2,126

c. On-balance sheet deferred performance based payments

	31.12.2015	**31.12.2014**
Deferred cash payments	38,957	40,585
Deferred cash payments, acquired via merger	31,570	0
Total	70,527	40,585

69. Share-based payments

The remuneration policy approved by the Board of Directors of the Bank includes a share-based incentive scheme. The Board of Directors is authorised to increase the share capital of the Bank by up to ISK 20 million to fulfil any obligations arising from the scheme.

In 2012 the Bank established a share based incentive scheme that grants key personnel options to purchase shares in the Bank at a fixed price. The options are equity-settled, have a term of five years and will vest in three tranches with vesting dates 36, 48 and 60 months from the grant date. The grant is subject to the participant's continued employment by the company, and various other conditions satisfying the requirements of the Icelandic FSA.

As at 31 December 2015, the Bank had enrolled 4 employees in the share-based incentive scheme, with a total number of options granted equalling 14 million shares in the bank. Options vested as at 31 December 2015 amounted to 4.9 million shares, no options were exercised in 2015.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

70. Shareholders of the Bank

Ownership in the Bank is specified as follows:

Shareholder	Country	31.12.2015 %	31.12.2014 %	Beneficial owners
Lífeyrissjóður verslunarmanna	Iceland	9.90%	9.74%	
Varða Capital ehf.	Iceland	7.99%	-	Grímur Alfreð Garðasson (50%), Edward Schmidt (25%), Jónas Hagan Guðmundsson (25%)
Sigla ehf.	Iceland	7.55%	-	Tómas Kristjánsson (50%), Finnur Reyr Stefánsson (25%), Steinunn Jónsdóttir (25%)
Títan B ehf.	Iceland	7.23%	9.91%	Skúli Mogensen (100%)
Ingimundur hf.	Iceland	6.86%	-	Ármann Ármannsson (99,71%)
Mízar ehf.	Iceland	6.86%	9.40%	Guðmundur Steinar Jónsson (100%)
Eignarhaldsfélagið Mata hf.	Iceland	6.69%	-	Eggert Árni Gíslason (25%), Halldór Páll Gíslason (25%), Guðný Edda Gísladóttir (25%), Gunnar Þór Gíslason (25%)
Fagfjárfestasjóðurinn Norðurljós	Iceland	5.99%	8.20%	Investment fund managed by Júpiter rekstrarfélag hf.
Tryggingamiðstöðin hf.	Iceland	3.74%	5.12%	
Eignasafn Seðlabanka Íslands ehf.	Iceland	3.18%	4.36%	Seðlabanki Íslands
Klakki ehf.	Iceland	3.12%	4.27%	Each of Burlington Loan Management Ltd., BLM fjárfestingar ehf., Kaupthing ehf. and Glitnir HoldCo ehf. own more than 10%
MP Canada Iceland Ventures Inc.	Iceland	2.49%	3.42%	Robert Reich (100%)
Alkor ehf.	Canada	2.01%	2.76%	Berglind Björk Jónsdóttir (100%)
Brimgarðar ehf.	Iceland	1.95%	-	Eggert Árni Gíslason (10%), Halldór Páll Gíslason (10%), Guðný Edda Gísladóttir (10%), Gunnar Þór Gíslason (10%), Cold Rock Investments ltd. (60%)
H3 ehf.	Iceland	1.88%	-	Haraldur Ingólfur Þórðarson (100%)
ET sjón ehf.	Iceland	1.87%	2.56%	Eiríkur Ingvar Þorgeirsson (100%)
Snæból ehf.	Iceland	1.87%	2.56%	Finnur Reyr Stefánsson (50%), Steinunn Jónsdóttir (50%)
Salvus ehf.	Iceland	1.61%	-	Sigþór Jónsson (100%)
P 126 ehf.	Iceland	1.25%	1.71%	Einar Sveinsson (100%)
Stekkur fjárfestingarfélag ehf	Iceland	1.25%	1.71%	Kristinn Aðalsteinsson (100%)
Others, each less than 1%		13.87%	34.22%	2015: 52, 2014: 36
		99.13%	99.93%	
Treasury shares		0.87%	0.07%	
Issued share capital		100.00%	100.00%	

Beneficial owners are defined as owners holding a share of 10% or greater, directly or indirectly. The information presented is, among other things, based on publicly available information.

71. Other matters

Following the approval of the merger at the shareholders' meetings of the merged entities, four shareholders of Straumur fjárfestingabanki hf. requested redemption of their shares based on Article 131 of Act. no. 2/1995 on Public Limited Companies. In aggregate these parties hold 3.12% of the issued share capital of Kvika banki hf. There is an ongoing dispute between the parties concerned relating to the redemption price. According to the Bank's legal advisers, the redemption price should be based on the value of Straumur fjárfestingabanki hf. stand-alone in June 2015. The Bank has sought an independent assessment of the redemption price and offered to settle the redemption request based on that redemption price.

72. Events after the reporting date

There are no material events after the reporting date.

Notes to the Consolidated Financial Statements

Significant accounting policies

73. Basis of consolidation

The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements, and have been applied consistently by Group entities.

a. Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses its relationship with an entity when there is a change in one or more of the elements of control.

The Group uses the acquisition method to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in the income statement.

b. Non-controlling interest

Non-controlling interest represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank. Non-controlling interest is presented separately in the income statement and is included in equity in the statement of financial position, separately from equity attributable to owners of the Bank.

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

c. Fiduciary services

The Group provides custody services, fund management and discretionary and advisory investment management services which require the Group to make decisions on the handling, acquisition or disposal of financial instruments on behalf of its clients.

The financial statements of managed funds and investment portfolios managed by the Group on behalf of customers are not included in the financial statements, as they do not constitute assets or liabilities of the Group.

d. Transactions eliminated on consolidation

Intra-bank balances, income and expenses, and unrealised gains and losses arising from intra-bank transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

e. Structured entities

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

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

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

The Group has set up a formal procedure to assess whether or not to consolidate investment funds managed and administered by the Group on behalf of its customers and other investors in the consolidated financial statements. As part of this assessment, the Group reviews all facts and circumstances including the purpose and design of the investment fund, to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal when the Group acts as fund manager and cannot be removed without cause, has variable returns through significant holdings and is able to influence the returns of the funds by exercising its power.

Notes to the Consolidated Financial Statements

74. Foreign currency

a. Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency of the respective Group's entity using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency using the exchange rate at the reporting date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the exchange rate at the date the fair value was determined.

Foreign currency differences are posted as a separate line item under net financial income as disclosed in notes 6 and 85.

b. Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into the functional currency at spot exchange rate current at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the spot exchange rates at the dates of the transactions.

Translation differences on foreign operations are presented as a separate category in the statement of changes in equity.

75. Recognition and derecognition of financial assets and liabilities

a. Recognition

Loans to customers and deposits are recognised on the date that they are originated. All other financial assets and liabilities are initially recognised on the trade date, which is the date when the Group becomes a party to the contractual provisions of the instrument.

b. Derecognition

A financial asset is derecognised when the contractual rights to the cash flows from the asset expire, or when the Group enters into a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

Financial liabilities are derecognised when the obligation of the Group is discharged, cancelled or expires.

76. Offsetting

Financial assets and liabilities are offset, and the net amount reported in the statement of financial position, when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis for gains and losses arising from a group of similar transactions, such as in the Group's trading activity, or other circumstances permitted by International Financial Reporting Standards.

77. Amortised cost measurement of financial assets and liabilities

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

78. Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment, when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

Notes to the Consolidated Financial Statements

79. Financial instruments - accounting classification

Upon initial recognition, financial assets and liabilities are classified into one of the categories below. This classification determines amongst other things initial measurement, subsequent accounting and handling of interest revenue and expenses. International Financial Reporting Standards restrict the reclassification of financial instruments after initial recognition.

a. Held for trading

A financial instrument is classified as held for trading if it is purchased or incurred with the intention to resell and repurchase within a short period of time, or if it is a part of a group of defined financial instruments managed on a portfolio basis and historical data shows recent pattern of short-term profit taking or it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

Financial assets held for trading include fixed income securities, shares and other variable income securities and derivatives and securities used for hedging. Financial liabilities held for trading include derivatives and short positions, i.e. commitments to deliver financial assets that the Bank has borrowed and sold to a third party.

Financial instruments held for trading are initially recognised at fair value, with transactions costs recognised in profit or loss. They are subsequently measured at fair value in the statement of financial position. Interest income and expense from derivatives is recognised in net interest income but all other interest income and expense, and all changes in fair value, are recognised as financial income.

b. Designated at fair value

A financial instrument is designated at fair value through profit and loss when it is a part of a portfolio of financial instruments that are managed on the basis of fair value and information provided to management is based on fair value.

Financial assets designated at fair value include fixed income securities and shares and other variable income securities

Financial instruments designated at fair value are initially recognised at fair value, with transactions costs recognised in profit or loss. They are subsequently measured at fair value in the statement of financial position. Interest income and expense, and all changes in fair value, are recognised as financial income.

c. Available for sale

Non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold indefinitely, but not necessarily to maturity, are classified as available for sale.

Financial assets classified as available for sale consist of fixed income securities.

Financial instruments classified as available for sale are initially recognised at fair value. They are subsequently measured at fair value in the statement of financial position, with interest income recognised in net interest income using the effective interest method. The difference between fair value and amortised cost is recognised in comprehensive income until the financial instrument is sold or reaches maturity, whereupon the cumulative gains or losses previously recognised in other comprehensive income are reclassified to financial income.

d. Loans and receivables

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables.

Financial assets classified as loans and receivables include cash and cash equivalents, loans to customers and receivables.

Financial assets classified as loans and receivables are initially recognised at fair value, which is typically equal to cost, i.e. cash advanced plus any transaction costs. They are subsequently measured at amortised cost using the effective interest method. Accrued interest, in the case of interest bearing assets, is included in the carrying amount. Interest income is recognised in net interest income.

e. Other at amortised cost

Non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market are classified as other at amortised cost.

Financial liabilities classified as other at amortised cost include deposits, borrowings and payables.

Financial liabilities classified as other at amortised cost are initially recognised at fair value, which is typically equal to cost, i.e. cash advanced less any transaction costs. They are subsequently measured at amortised cost using the effective interest method. Accrued interest, in the case of interest bearing liabilities is included in the carrying amount. Interest expense is recognised in net interest income.

Notes to the Consolidated Financial Statements

80. Determination of fair value

Fair value is the 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 in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk. When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. For further information on valuation techniques, refer to notes 60 - 61.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

81. Impairment

a. General principle
The carrying amount of the Group's non-financial assets and financial assets not at fair value through profit and loss is reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

b. Reversal of impairment
If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as reduction of cost in the income statement. An impairment loss recognised for goodwill is not reversed in a subsequent period.

c. Calculation of recoverable amount
The recoverable amount of the Group's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

82. Impairment of loans

a. Indications of impairment
Objective evidence of impairment includes information about one or more of the following:
- Indications of significant financial difficulties of the borrower, including financial restructuring and refinancing concessions that a lender would not otherwise consider
- A breach of contract, such as a default on instalments or on interest or principal payments
- An observable decrease in the estimated future cash flows from a group of loans due to adverse changes in the economic conditions of a sector or region in which the borrower operates, even if the decrease cannot yet be identified with the individual financial assets in the group
- The disappearance of an active market for an asset held as collateral

Impairment losses expected as a result of events taking place after the reporting date, no matter how likely, are not recognised.

b. Calculation of impairment losses
Impairment loss is calculated by comparing the carrying amount of individual loans with the present value of their expected future cash flows, discounted at their original effective interest rate. In the case of loans at variable interest rates, the discount rate used is their current effective interest rate.

c. Individually assessed loans
Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. This procedure is applied to all loans that are considered individually significant. In making the assessment, the following factors are considered:
- The Group's aggregate exposure towards the customer
- The amount and timing of expected receipts and recoveries
- The likely recovery upon liquidation or bankruptcy
- Complexity and uncertainty related to ranking of creditor claims and legal standing
- The realisable value of securities or other credit mitigants and the likelihood of successful repossession
- The likely deduction of any costs involved in recovery of amounts outstanding

Notes to the Consolidated Financial Statements

82. Impairment of loans (cont.)

d. Collectively assessed loans

Impairment losses on collectively assessed loans are determined by an evaluation of the exposures on a group of loans with similar risk characteristics. This procedure is applied to all loans that are not considered individually significant, or have been individually assessed but showed no indications of impairment. This loss covers loans that are impaired at the reporting date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account the following:
- Historical loss experience in portfolios of similar risk characteristics, for example, by industry sector, loan grade or product
- The estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan
- Management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

e. Loan write-offs

The carrying amount of impaired loans is reduced through the use of an allowance account. Loans are written off, partially or in full, when there is no realistic prospect of recovery.

f. Forbearance

The Group may modify the contractual terms of a loan for a variety of reasons. Changes in terms are subject to the same policies and limits as new loans and are evaluated on a case by case basis. If the change is triggered by the borrower's inability to meet the terms and conditions of the loan (a forbearance activity), the loan is first evaluated for indications of impairment. If there is evidence of impairment the loan is subject to specific impairment and classified as such. If there is no identified need for specific impairment the loan is considered performing.

83. Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash flows to the carrying amount of the financial asset or liability, over the expected life of the financial instrument. Estimated future cash flows take into account all contractual terms of the financial instruments but not future credit losses.

Interest income and expense presented in the income statement includes interest on:
- financial assets classified as loans and receivables
- financial assets classified as available for sale
- financial liabilities carried at amortised cost
- derivatives

Further information about the accounting classification of financial assets and liabilities is provided in notes 59 and 79.

84. Fee and commission income and expense

The Group earns income from providing various services to its customers. This includes fees for managing assets on behalf of customers, commissions received for equity and bond transactions and fees and commissions for various other financial services.

Fee and commission income and expense comprises the following:
- Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate
- Other fee and commission income is recognised in the income statement as the services are provided
- Fee and commission expense relates mainly to transaction fees, which are expensed as the services are received

85. Net financial income

Net financial income comprises the following:
- Realised and unrealised gains or losses from price changes of fixed income securities carried at fair value
- Realised and unrealised gains or losses from price changes of variable income securities
- Interest income from fixed income securities carried at fair value through profit or loss
- Dividends, excluding dividends from associates
- Fair value changes in derivatives
- Foreign exchange difference

86. Dividend income

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends, other than those from associates, are presented as a component of net financial income.

Notes to the Consolidated Financial Statements

87. Administrative expenses

Administrative expenses comprise expenses other than interest expenses, fee and commission expenses and expenses related to fair value changes. A breakdown of administrative expenses is provided in note 8.

88. Employee benefits

a. Short-term employee benefits

Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

b. Defined contribution plans

Obligations for contributions to defined contribution plans are expensed in profit or loss as the related service is provided. The Group has no further obligations once those contributions have been paid.

c. Shared-based payments

The grant date fair value of equity settled share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

89. Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognised there.

Current tax liabilities include the estimated tax payable next year on current year's profit according to the tax rates prevailing at reporting date, in addition to corrections on tax from previous years.

The deferred income tax asset and/or liability has been calculated and recognised in the statement of financial position. The calculation is based on the difference between assets and liabilities as presented in the tax return on the one hand, and in the consolidated financial statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the financial statements, mostly due to temporary differences arising from the recognition of revenue and expense in the tax returns and in the financial statements.

Deferred tax assets and tax liabilities are offset in the statement of financial position when there is a legal right to settle on a net basis and they are levied by the same taxing authority on the same entity or on different entities subject to joint taxation.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

90. Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, balances held with central banks and other financial institutions, and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to and insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

91. Receivables from Central Bank

Receivables from Central Bank of Iceland represent short-term claims on the Central Bank of Iceland resulting from reverse repurchase agreements.

92. Fixed income securities

Fixed income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 79.

93. Shares and other variable income securities

Shares and other variable income securities consist of equity investments and unit shares in mutual funds. Shares and other variable income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 79.

94. Securities used for hedging

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Group's risk exposure arising from derivative contracts with customers. Securities used for hedging are measured at fair value as discussed in note 79.

Notes to the Consolidated Financial Statements

95. Loans to customers

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include loans provided by the Group to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Group has no intention of selling immediately or in the near future.

Loans are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances. The carrying amount of impaired loans is reduced through the use of an allowance account.

When the Group purchases a financial asset and simultaneously enters into an agreement to resell the asset, or a substantially similar asset, at a fixed price at a future date (“reverse repo” or “stock borrowing”), the arrangement is accounted for as a loan and the underlying asset is not recognised in the Group’s statement of financial position.

96. Derivatives

A derivative is a financial instrument or another contract that falls under the scope of IAS 39 and has the following three characteristics:
- Its value changes due to changes in an underlying variable, such as bond price, share price, security or price index (including CPI), foreign currency exchange rate or interest rate
- The contract requires no initial investment or an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors
- Settlement takes place at a future date

The Group uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange risk and inflation and interest risk arising from operating, financing and investing activities. The Group does not apply hedge accounting.

Derivative assets and liabilities are initially recognised and subsequently measured at fair value in the statement of financial position. Derivatives with positive fair values are classified as financial assets and derivatives with negative fair values as financial liabilities. Revenue from derivatives is split into interest income and net income from financial instruments at fair value and presented in the corresponding line items in the income statement.

97. Intangible assets

a. Asset categories
The Group groups intangible assets into three categories:

- Software
  Software comprise acquired software licences and external costs associated with the development of bespoke applications.

- Goodwill
  Goodwill arises in business combinations. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration. Following initial recognition, goodwill is recognised at cost less any accumulated impairment losses.

- Other intangible assets
  Other intangible assets comprise licences and acquired trademarks used in the operation of the Group.

The Group has not defined any internally generated intangible assets.

b. Initial recognition
Intangible assets are initially recognised at cost.

c. Subsequent measurement
The Group uses the cost model for measurement after recognition and intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognised in accordance with the accounting policy for non-financial assets described in note 82.

d. Amortisation
Intangible assets with finite useful life are amortised using the straight-line method over their estimated useful economic life, with the amortisation recognised in the income statement. The estimated useful life of intangible assets is as follows:

Software	5-10 years
Other intangible assets with finite useful life	10 years

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 8. Further breakdown is provided in notes 25-26.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

98. Property and equipment

a. Asset categories
The Group groups tangible assets into two categories:

- Real estate, which includes office and residential buildings, land and building rights
- Other property and equipment, which includes automobiles, furniture and fixtures, computers and other office equipment

b. Initial recognition
Property and equipment is initially recognised at cost, which includes direct expenses related to the purchase.

c. Subsequent measurement
The Group uses the cost model for the measurement after recognition and property and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. Property and equipment is reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognized in accordance with the accounting policy for non-financial assets described in note 82.

d. Subsequent cost
The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The decision, if subsequent costs are added to the acquisition cost of property and equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are expensed in the income statement when incurred.

e. Depreciation
Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Real estate	15-50 years
Other property and equipment	3-5 years

Where parts of an item of property and equipment have different useful lives, those components are accounted for separately.

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 8. Further breakdown is provided in notes 25-26.

99. Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence generally exists when the Group holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

The Group's share of the total recognised gains and losses of associates is included in the financial statements of the Group on an equity accounted basis, from the date the significant influence commences until the date it ceases.

If the Group's share of loss exceeds its interest in an associate, the Group's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

100. Other assets

Other assets are measured at amortised cost.

101. Assets classified as held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Group's accounting policies. Thereafter the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

102. Deposits from customers

Deposits consist of time deposits and demand deposits. Money market deposits are included in borrowings. Deposits are recognised at amortised cost, including accrued interest.

Notes to the Consolidated Financial Statements

103. Borrowings

Borrowings are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset, or a substantially similar asset, at a fixed price at a future date ("repo" or "stock lending"), the arrangement is accounted for as a borrowing and the underlying asset continues to be recognised in the Group's statement of financial position.

104. Issued bills

Issued bills are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

105. Subordinated liabilities

Subordinated liabilities are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

106. Short positions held for trading

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. Short positions are carried at fair value with all fair value changes recognised in the income statement under net financial income.

107. Short positions used for hedging

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. Short positions used for hedging consist of non-derivative financial liabilities that are used to hedge the Group's risk exposure arising from derivative contracts with customers.

108. Other liabilities

Other liabilities are measured at amortised cost.

109. Share capital

a. Treasury shares
Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity. Incremental transaction costs of treasury share transactions are accounted for as a deduction from equity, net of any related income tax benefit.

b. Share premium
Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Group.

c. Dividends on share capital
Dividends on share capital are deducted from equity in the period in which they are approved by the Group's shareholders meetings.

110. Nature and purpose of equity reserves

a. Option reserve
The option reserve represents the cumulative charge to the income statement for options to purchase shares in the Bank granted under the Bank's Remuneration policy, which is discussed in notes 67-69.

b. Warrants reserve
The warrants reserve represents the consideration received for outstanding warrants, as disclosed in note 38.

c. Deficit reduction reserve
The deficit reduction reserve was created as a part of a share capital reduction approved by the Bank's Annual General Meeting in April 2014, as discussed in note 37. The reserve has no specified purpose and can only be used with the approval of a shareholders' meeting.

d. Equity instrument reserve
The equity instrument reserve represents the consideration received for financial instruments issued by the Bank, which meet the definition of an equity instrument.

e. Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations, until the operations are sold, dissolved or abandoned.

Notes to the Consolidated Financial Statements

110. Nature and purpose of equity reserves (cont.)

f. Fair value reserve
The fair value reserve comprises the cumulative net change in the fair value of available for sale financial assets, until the assets are derecognised or impaired.

g. Accumulated deficit - retained earnings
Accumulated deficit (Retained earnings if positive) consists of undistributed profits and losses accumulated, less transfers to other reserves.

111. New standards and interpretations

The Group has adopted amendments to existing standards which became effective for the first time in 2015. The amendments did not have a material effect on these financial statements.

A number of new standards, amendments to standards and interpretations were not yet effective for the year ended 31 December 2015 and have not been applied in the preparation of these financial statements. Early adoption of new standards and amendments is not planned.

IFRS 9 Financial Instruments, which will become effective for annual reporting periods beginning on or after 1 January 2018, includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets. Given the nature of the Group's operations, adoption of IFRS 9 is expected to have a considerable impact on the Group's financial statements. The Group is currently assessing the impact of the new standard on its financial statements.

IFRS 15 Revenue from Contracts with Customers, which will become effective for annual reporting periods beginning on or after 1 January 2018, establishes a comprehensive framework for those factors which need to be taken into consideration in determining how revenue is recognised. The new revenue standard will supersede all current revenue recognition requirements under IFRS.

112. Use of estimates and judgements

In the process of applying the Group's accounting policies, management makes use of judgements and estimates which are based on various assumptions. These judgements and estimates can affect the reported amounts of assets and liabilities, income and expense.

Assumptions and estimates are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances, and are reviewed on an on-going basis. The estimates form the basis for judgements about the carrying value of assets and liabilities that are not readily available from other sources and actual results may differ. Judgement may also be required in circumstances not involving estimates, e.g. when determining the substance of a particular transaction, contract or relationship.

The areas where the use of judgements and estimates has the most significant effect on the amounts recognised in the statement of financial position or the income statement are disclosed in this note.

a. Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets is determined using valuation techniques which are reviewed regularly as discussed in note 60.

b. Impairment of financial assets
As outlined in notes 81-82, the use of estimates and judgement is an important component of the calculation of impairment losses. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Unforeseen events could, however, result in further impairment losses which would have a material effect on the income statement and statement of financial position.

c. Deferred tax assets
Judgement is required to determine the extent to which deferred tax assets are recognised in the statement of financial position, based on the likely timing and level of future taxable profits.