Íslandsbanki

Condensed Consolidated Interim Financial Statements

First quarter 2018

Unaudited

440 4000

@islandsbanki

islandsbanki.is

Contents

Highlights

Íslandsbanki

Our profile

- A leader in financial services in Iceland, Íslandsbanki is a universal bank with total assets of ISK 1,088bn and a 25% - 50% market share across all domestic business segments.
- Building on over 140 years of servicing key industries, Íslandsbanki has developed specific expertise in tourism, seafood and energy related industries.
- Driven by the vision to be #1 for service, Íslandsbanki's relationship banking business model is propelled by three business divisions that manage and build relationships with the Bank's customers.
- Íslandsbanki has developed a wide range of online services such as the Íslandsbanki, Kreditkort and Kass apps, enabling customers to do their banking whenever and wherever. At the same time, the Bank continues to operate the most efficient branch network in Iceland through its strategically located 14 branches.
- For the fifth consecutive year, Íslandsbanki led the Icelandic Customer Satisfactory Index for banks in 2017 and was also named Bank of the Year in Iceland by the Banker.
- Íslandsbanki has a BBB+/A-2 rating from S&P Global Ratings and BBB/F3 from Fitch.

Our Bank

14 branches

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

70.000 APP users

Market Share[1]

33% individuals

36% SMEs

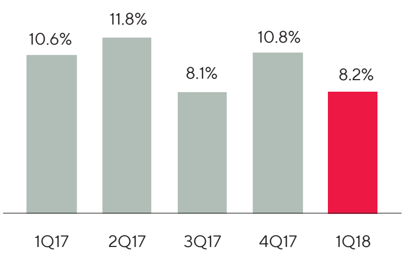
32% large companies

Credit Ratings

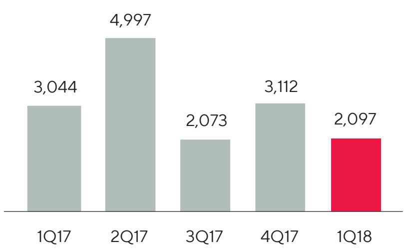
S&P Global Ratings **BBB+/A-2** Stable outlook

FitchRatings **BBB/F3** Stable outlook

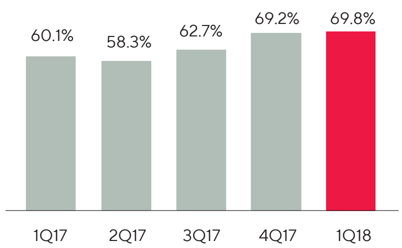
ROE reg. operations CET1 15%[2]



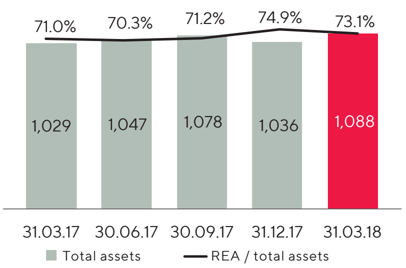
Profit after tax
(ISKm)



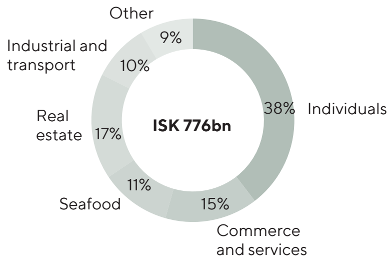
Cost / income ratio[3]



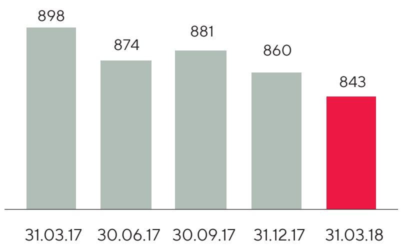
REA / total assets
(ISKbn)



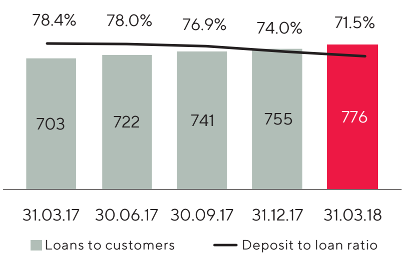
Loans to customers – sector split
As of 31.3.18



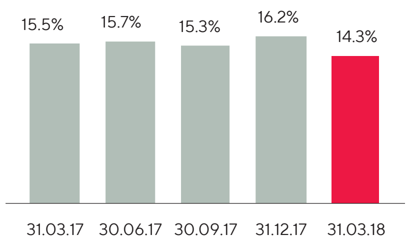
Number of FTE' s for Parent Company
Excluding seasonal employees



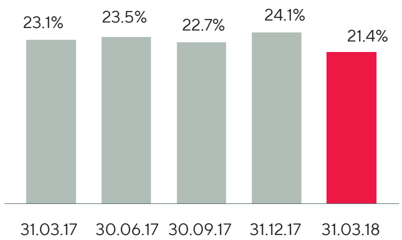
Loans to customers
(ISKbn)



Leverage ratio



Total capital ratio



[1] Based on Gallup survey regarding primary bank.
[2] Earnings on regular income now includes profit from discontinued operations.
[3] The cost / income ratio for the parent company is 64.4%

Directors' Report

These are the condensed consolidated interim financial statements for the period 1 January to 31 March 2018 (“the interim financial statements”) of Íslandsbanki hf. (“the Bank” or “Íslandsbanki”) and its subsidiaries (together referred to as "the Group").

Operations in the reporting period

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

The profit from the Group's operations for the reporting period amounted to ISK 2,097 million, which corresponds to 4.8% return on equity. At the end of the reporting period, the Group employed 1,027 full-time members of staff, including 843 within the Bank itself.

Net interest income increased by 5% between years, due to balance sheet growth. Net fee income was down by 15%, where strong growth in the Bank was offset by reduced activity in Borgun and Hringur, subsidiaries of the Bank. Net financial loss was by ISK 283 million, the loss derives largely from losses in mark-to-market of derivative hedges and losses on equity trading. Administrative expenses were up by 6.7% between years, partly as a result of reduced capitalisation of salaries in 2018 due to an investment in the Bank's core banking systems. Net impairments were positive by ISK 88 million as the loan book continued to perform well on the back of a strong economy. Profit from discontinued operations amounted to ISK 713 million, mainly resulting from the sale of listed equities from a subsidiary of the Bank.

The implementation of the new accounting rules for financial instruments (IFRS 9) resulted in an increase in the allowance account of ISK 3,358 million at 1 January 2018 as a result of the introduction of the new expected credit loss impairment model. The total effect of ISK 4,010 million, including the other changes due to the implementation of IFRS 9 (net of tax), has reduced shareholders' equity at 1 January 2018. The CET1 capital ratio reduced by 25 basis points. Note 3 provides more information. Figures for previous periods have not been restated.

The Group's balance sheet grew by 5.1% in the quarter on the back of a 2.8% growth in loans to customers and considerable growth in liquid assets. As a result of the IFRS 9 implementation, the Bank is re-assessing its measurements and targets for loan book quality. Customer deposits increased by 1.4% during the quarter and the customer deposit-to-loan ratio was 74.1% at the end of the period.

The Bank continues to have good access to capital markets. The Bank issued a €300m 6 year non-call 5 year bond in January priced at 75 basis points above 5-year mid swaps. The issuance was very well received by investors and was four times oversubscribed. In the domestic market, the Bank has issued ISK 3.3 billion of commercial papers and ISK 9.5 billion of covered bonds, thereby making good progress with the 2018 issuance plan of ISK 20-25 billion for covered bonds.

The Group's total equity amounted to ISK 166.3 billion and total assets were ISK 1,088.3 billion at the end of the reporting period and the Group's total capital ratio was 21.4%. The Bank's liquidity position remains strong and well above regulatory requirements.

On 22 March 2018, Íslandsbanki's Annual General Meeting approved the Board's proposal to pay ISK 13 billion dividend of the profit for 2017 to the Bank's shareholders. The dividend was paid to the shareholders on 28 March 2018. The Board was also authorised to call an extraordinary shareholders' meeting later in the year to propose payment of additional dividends if the Bank's accumulated capital reserves are considered to exceed its long-term capital requirements.

Outlook

Economic growth is slowing down in Iceland and falling in line with OECD peers. The growth rate peaked at 7.5% in 2016, slowed to 3.6% in 2017 and is expected to be at around 2.3% in 2018. The main sources of growth are shifting from the corporate sector to households, from exports and business investment to private consumption and residential investment. Private consumption growth is however moderating due to slower real wage growth and reduced population growth, but still expected to grow by a relatively healthy 4.7% in 2018, and by 3.0% in 2019.

Iceland's net external position was positive by ISK 190bn, or 7.5% of GDP, at the end of 2017, the best IIP (International investment position) in Iceland's modern economic history. Gross central government debt has at the same time decreased from 88% of GDP to 41% of GDP over the past 7 years.

As the Bank's earnings are closely related to the momentum of the economy, the growth in the balance sheet can be expected to moderate from the figures seen in 2017 and the first quarter of 2018. The Bank's challenge will be to reach target earnings in this period and manage the increased earnings volatility which is expected to come as a result of the IFRS 9 implementation.

Directors' Report

Statement by the Board of Directors and the CEO

The interim financial statements for the period 1 January to 31 March 2018 have been prepared on a going concern basis in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting as adopted by the European Union; the Act on Annual Accounts, no. 3/2006; the Act on Financial Undertakings, no. 161/2002; and rules on accounting for credit institutions, where applicable.

To the best of our knowledge, these interim financial statements provide a true and fair view of the Group's operating profits and cash flows in the reporting period and its financial position as of 31 March 2018.

The Board of Directors and the CEO have today discussed and approved the Condensed Consolidated Interim Financial Statements for the period 1 January to 31 March 2018.

Kópavogur, 9 May 2018

Board of Directors:

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

Chief Executive Officer:

Birna Einarsdóttir

Consolidated Interim Income Statement

	Notes	2018 1.1-31.3	2017 1.1-31.3
Interest income		14,995	13,852
Interest expense		(7,255)	(6,455)
Net interest income	10	7,740	7,397
Fee and commission income		4,273	5,129
Fee and commission expense		(1,495)	(1,859)
Net fee and commission income	11	2,778	3,270
Net financial (expense) income	12	(283)	12
Net foreign exchange (loss) gain	13	(10)	201
Other operating income	14	13	160
Other net operating income		(280)	373
Total operating income		10,238	11,040
Salaries and related expenses	15	(3,926)	(3,659)
Other operating expenses	16	(2,924)	(2,759)
Contribution to the Depositors' and Investors' Guarantee Fund		(292)	(253)
Bank tax		(785)	(720)
Total operating expenses		(7,927)	(7,391)
Profit before net impairment on financial assets		2,311	3,649
Net impairment on financial assets	17	88	240
Profit before tax		2,399	3,889
Income tax expense	18	(1,015)	(1,130)
Profit for the period from continuing operations		1,384	2,759
Profit from discontinued operations, net of income tax	19	713	285
Profit for the period		2,097	3,044
Profit attributable to:			
Shareholders of Íslandsbanki hf.		2,186	2,955
Non-controlling interests		(89)	89
Profit for the period		2,097	3,044
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to the shareholders of Íslandsbanki hf.	20	0.15	0.27

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

Amounts are in ISK million

Consolidated Interim Statement of Comprehensive Income

	2018 1.1-31.3	2017 1.1-31.3
Profit for the period	2,097	3,044
Items that are or will be reclassified to profit or loss:		
Foreign currency translation differences for foreign operations	-	5
Net change in fair value of financial assets and financial liabilities, net of tax	302	196
Other comprehensive income for the period, net of tax	302	201
Total comprehensive income for the period	2,399	3,245

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

Amounts are in ISK million

Consolidated Interim Statement of Financial Position

	Notes	31.3.2018	31.12.2017
Assets			
Cash and balances with Central Bank	21	177,029	189,045
Bonds and debt instruments	5	49,140	27,090
Shares and equity instruments	5	10,208	10,177
Derivatives	22	4,673	2,896
Loans to credit institutions	23	47,220	26,617
Loans to customers	24	776,149	755,175
Investments in associates	26	672	704
Property and equipment		7,025	7,128
Intangible assets		4,412	4,231
Other assets	28	10,732	9,993
Non-current assets and disposal groups held for sale	29	1,048	2,766
Total Assets		1,088,308	1,035,822
Liabilities			
Deposits from Central Bank and credit institutions	30	13,563	11,189
Deposits from customers	31	575,196	567,029
Derivative instruments and short positions	22	8,104	5,492
Debt issued and other borrowed funds	33	269,255	217,748
Subordinated loans	34	8,838	9,505
Tax liabilities		7,908	7,787
Other liabilities	36	39,028	35,947
Non-current liabilities and disposal groups held for sale	29	79	80
Total Liabilities		921,971	854,777
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		4,991	6,179
Retained earnings		93,930	107,387
Total equity attributable to the equity holders of Íslandsbanki hf.		163,921	178,566
Non-controlling interests		2,416	2,479
Total Equity		166,337	181,045
Total Liabilities and Equity		1,088,308	1,035,822

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

Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity

	Share capital	Share premium	Restricted reserves	Fair value reserve	Liability credit reserve	Other reserves	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1.1.2017	10,000	55,000	1,673	(25)	-	2,491	105,563	174,702	4,223	178,925
Profit for the period							2,955	2,955	89	3,044
Dividends paid							(10,000)	(10,000)	(1,405)	(11,405)
Net change in fair value of AFS financial assets				125				125	71	196
Translation differences for foreign operations						5		5		5
Restricted due to capitalised development cost			382				(382)	-		-
Restricted due to fair value changes			8				(8)	-		-
Restricted due to subsidiaries and associates			269				(269)	-		-
Equity as at 31.3.2017	10,000	55,000	2,332	100	-	2,496	97,859	167,787	2,978	170,765
Equity as at 31.12.2017	10,000	55,000	3,440	239	-	2,500	107,387	178,566	2,479	181,045
Impact of adopting IFRS 9, see Note 3					(1,486)		(2,530)	(4,016)	6	(4,010)
Impact of adopting IFRS 15, see Note 3							(97)	(97)		(97)
Equity as at 1.1.2018	10,000	55,000	3,440	239	(1,486)	2,500	104,760	174,453	2,485	176,938
Profit for the period							2,186	2,186	(89)	2,097
Dividends paid							(13,000)	(13,000)		(13,000)
Net change in fair value of financial assets through OCI				33				33	20	53
Net change in fair value of financial liabilities					249			249		249
Restricted due to capitalised development cost			164				(164)	-		-
Restricted due to fair value changes			(107)				107	-		-
Restricted due to subsidiaries and associates			(41)				41	-		-
Equity as at 31.3.2018	10,000	55,000	3,456	272	(1,237)	2,500	93,930	163,921	2,416	166,337

Dividends:

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

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

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

	Notes	2018 1.1-31.3	2017 1.1-31.3
Cash flows from operating activities:			
Profit for the period		2,097	3,044
Non-cash items included in profit for the period		4,084	2,599
Changes in operating assets and liabilities		(49,483)	(49,907)
Dividends received		11	29
Income tax and bank tax paid		(883)	(292)
Net cash (used in) operating activities		(44,174)	(44,527)
Net investments in associated companies		-	(12)
Proceeds from sale of property and equipment		4	4
Purchase of property and equipment		(64)	(343)
Purchase of intangible assets		(232)	(397)
Net cash (used in) investing activities		(292)	(748)
Proceeds from borrowings		55,299	11,741
Repayment of borrowings		(3,428)	(3,936)
Dividends paid		(10,140)	(449)
Dividends paid non-controlling interests		-	(1,405)
Net cash provided by financing activities		41,731	5,951
Net (decrease) in cash and cash equivalents		(2,735)	(39,324)
Effects of foreign exchange rate changes		(60)	(16)
Cash and cash equivalents at the beginning of the period		187,438	240,263
Cash and cash equivalents at the end of the period		184,643	200,923

Reconciliation of cash and cash equivalents:			
Cash on hand	21	2,025	3,503
Cash balances with Central Bank	21	175,004	206,934
Bank accounts	23	22,702	13,335
Mandatory reserve and special restricted balances with Central Bank	21	(15,088)	(22,849)
Cash and cash equivalents at the end of the period		184,643	200,923

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

Interest received from 1 January to 31 March 2018 was ISK 14,170 million (2017: ISK 15,569 million) and interest paid in the same period 2018 was ISK 4,224 million (2017: ISK 5,408 million). Interest paid is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

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

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

Non-cash items included in profit for the period:	2018 1.1-31.3	2017 1.1-31.3
Depreciation and impairment	164	176
Amortisation of intangible assets	51	45
Share of loss (gain) of associates	32	(263)
Accrued interest and fair value changes on debt issued	2,500	1,341
Impairment on loans	-	(397)
Net impairment on financial assets	(88)	157
Foreign exchange loss (gain)	10	(201)
Net (gain) on sale of property and equipment	(1)	(2)
Unrealised fair value losses recognised in profit and loss	329	178
Net profit on non-current assets classified as held for sale	(713)	(285)
Bank tax	1,015	1,130
Income tax	785	720
Non-cash items included in profit for the period	4,084	2,599
Changes in operating assets and liabilities:		
Mandatory reserve and special restricted balances with Central Bank	2,478	24,344
Loans and receivables to credit institutions	(16,038)	(15,597)
Loans and receivables to customers	(28,784)	(13,803)
Trading assets	(23,848)	(12,934)
Other operating assets	(432)	(7,121)
Non-current assets and liabilities held for sale	2,440	1,392
Deposits with credit institutions and Central Bank	2,500	6,339
Deposits from customers	11,127	(27,420)
Trading financial liabilities	(270)	14
Derivatives	1,105	(140)
Other operating liabilities	239	(4,981)
Changes in operating assets and liabilities	(49,483)	(49,907)

Non-cash transactions 2018

The Bank paid dividends amounting to ISK 13,000 million. Thereof are non-cash transactions amounting to ISK 2,860 million which is capital income tax due in May 2018.

Non-cash transactions 2017

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

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

Financial Statements first quarter 2018 10 Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Condensed Consolidated Interim Financial Statements

1. Corporate information

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

The interim financial statements were authorised for issue by the Board of Directors of Íslandsbanki hf. on 9 May 2018.

2. Basis of preparation

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

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

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

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

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

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

Important accounting estimates and judgements

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

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

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

3. Changes to accounting policies

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

IFRS 9 – Financial Instruments

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

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

Classification and measurement

Financial assets

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

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

The business models

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

Solely payments of principal and interest (“SPPI”)

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

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

Financial assets at amortised cost

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

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

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

3. Cont'd

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

Equity instruments at FVOCI

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

Debt instruments at FVOCI

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

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

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

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

Financial liabilities

Financial liabilities designated as at fair value through profit or loss

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

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

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

Hedge accounting

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

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

Impairment

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

Stage assignment

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

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

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

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

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

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

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

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

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

3. Cont'd

Expected credit loss (ECL)

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

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

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

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

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

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

Write-off policy

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

The impairment process

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

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

Impact of adoption of IFRS 9

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

3. Cont'd

Transition of financial assets and financial liabilities

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

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

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

3. Cont'd

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

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

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

Allowance for credit losses

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

	Collectively assessed	Individually assessed	Total	Transition adjustments	Stage 1	Stage 2	Stage 3	Total
Loans at amortised cost*	1,729	8,662	10,391	2,745	2,741	1,244	9,151	13,136
Other assets at amortised cost	-	5	5	3	6	2	-	8
Off-balance sheet loan commitments and financial guarantees	-	64	64	610	467	101	106	674
Total allowance for credit losses	1,729	8,731	10,460	3,358	3,214	1,347	9,257	13,818

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

Amounts are in ISK million

3. Cont'd

IFRS 15 – Revenue from Contracts with Customers

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

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

4. Operating segments

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

Comparative amounts have not been adjusted.

The Group is currently organised into four main operating segments:

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

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

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

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

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

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

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

4. Cont'd

1 January to 31 March 2018 Operations	Retail Banking	Corporate & Investment Banking	Treasury	Proprietary Trading & Subsidiaries	Cost centres & Eliminations	Total
Net interest income	4,995	1,465	1,034	305	(59)	7,740
Net fee and commission income	1,423	737	(63)	679	2	2,778
Other operating income	6	94	(150)	(226)	(4)	(280)
Total operating income	6,424	2,296	821	758	(61)	10,238
Salaries and related expenses	(1,201)	(394)	(40)	(699)	(1,592)	(3,926)
Other operating expenses	(883)	(146)	(103)	(611)	(1,181)	(2,924)
Deposit Guarantee Fund and bank tax .	(285)	(4)	(788)	-	-	(1,077)
Net impairment on financial assets	354	(245)	(29)	8	-	88
Profit (loss) before cost allocation & tax	4,409	1,507	(139)	(544)	(2,834)	2,399
Net segment revenue from external customers	6,690	4,342	(1,644)	851	(1)	10,238
Of which fee and commission income ..	1,818	796	(48)	2,478	(771)	4,273
Net segment revenue from other segments	(266)	(2,046)	2,465	(93)	(60)	-
At 31 March 2018						
Loans to customers	485,916	283,750	146	6,307	30	776,149
Other assets	3,869	1,220	258,013	57,029	(7,972)	312,159
Total segment assets	489,785	284,970	258,159	63,336	(7,942)	1,088,308
Deposits from customers	495,072	17,345	66,824	396	(4,441)	575,196
Other liabilities	4,375	4,093	309,860	26,830	1,617	346,775
Total segment liabilities	499,447	21,438	376,684	27,226	(2,824)	921,971
Allocated equity	57,639	46,699	48,898	22,880	(9,779)	166,337
Risk exposure amount	409,401	316,520	29,781	42,478	(2,257)	795,923

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

1 January to 31 March 2017 Operations	Retail Banking	Corporate Banking	Markets	Wealth Manage-ment	Treasury	Subsidiaries & Equity Investments	Cost Centres & Eliminations	Total
Net interest income	4,337	1,830	403	137	507	248	(65)	7,397
Net fee and commission income	1,143	129	309	524	(31)	1,202	(6)	3,270
Other operating income	3	-	(7)	39	301	2,511	(2,474)	373
Total operating income	5,483	1,959	705	700	777	3,961	(2,545)	11,040
Salaries and related expenses	(965)	(257)	(256)	(243)	(37)	(535)	(1,366)	(3,659)
Other operating expenses	(910)	(67)	(50)	(58)	(37)	(569)	(1,068)	(2,759)
Deposit Guarantee Fund and bank tax .	(235)	(1)	-	(15)	(722)	-	-	(973)
Net loan impairment	178	52	-	-	-	31	(21)	240
Profit (loss) before cost allocation & tax	3,551	1,686	399	384	(19)	2,888	(5,000)	3,889
Net segment revenue from external customers	4,489	4,126	863	284	(343)	4,100	(2,479)	11,040
Net segment revenue from other segments	994	(2,167)	(158)	416	1,120	(139)	(66)	-
At 31 March 2017								
Loans to customers	402,228	295,876	319	-	-	5,965	(941)	703,447
Other assets	5,072	139	18,688	3,518	253,497	60,669	(16,222)	325,361
Total segment assets	407,300	296,015	19,007	3,518	253,497	66,634	(17,163)	1,028,808
Desposits from customers	434,030	2,627	11	31,863	103,464	6	(4,515)	567,486
Other liabilities	8,960	1,680	2,754	2,480	245,754	40,772	(11,843)	290,557
Total segment liabilities	442,990	4,307	2,765	34,343	349,218	40,778	(16,358)	858,043
Allocated equity	46,667	46,506	2,076	2,968	63,378	14,487	(5,317)	170,765
Risk exposure amount	329,220	326,324	13,793	5,397	28,714	21,654	5,018	730,120

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

5. Classification of financial assets and financial liabilities

At 31 March 2018	Notes	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Fair value through OCI	Amortised cost	Total carrying amount
Cash and balances with Central Bank	21	-	-	-	-	177,029	177,029
Listed bonds and debt instruments		47,289	-	-	-	-	47,289
Unlisted bonds and debt instruments		1,851	-	-	-	-	1,851
Listed shares and equity instruments		6,793	-	-	-	-	6,793
Unlisted shares and equity instruments		2,127	-	-	1,288	-	3,415
Derivatives	22	4,588	85	-	-	-	4,673
Loans to credit institutions	23	-	-	-	-	47,220	47,220
Loans to customers	24	-	-	-	-	776,149	776,149
Other financial assets		-	-	-	-	10,158	10,158
Total financial assets		62,648	85	-	1,288	1,010,556	1,074,577
Deposits from CB and credit institutions	30	-	-	-	-	13,563	13,563
Deposits from customers	31	-	-	-	-	575,196	575,196
Derivative instruments and short positions	22	8,104	-	-	-	-	8,104
Debt issued and other borrowed funds	33	-	36,459	82,265	-	150,531	269,255
Subordinated loans	34	-	-	-	-	8,838	8,838
Other financial liabilities		-	-	-	-	34,797	34,797
Total financial liabilities		8,104	36,459	82,265	-	782,925	909,753

At 31 December 2017	Held for trading	Held for hedging	Designated as at FVTPL	Loans & receivables	Available for sale	Liabilities at amortised cost	Total carrying amount
Cash and balances with Central Bank	-	-	-	189,045	-	-	189,045
Listed bonds and debt instruments	24,716	-	373	-	-	-	25,089
Unlisted bonds and debt instruments	-	-	2,001	-	-	-	2,001
Listed shares and equity instruments	5,108	-	1,645	-	-	-	6,753
Unlisted shares and equity instruments	-	-	2,188	-	1,236	-	3,424
Derivatives	2,891	5	-	-	-	-	2,896
Loans to credit institutions	-	-	-	26,617	-	-	26,617
Loans to customers	-	-	-	755,175	-	-	755,175
Other financial assets	-	-	-	9,847	-	-	9,847
Total financial assets	32,715	5	6,207	980,684	1,236	-	1,020,847
Deposits from CB and credit institutions	-	-	-	-	-	11,189	11,189
Deposits from customers	-	-	-	-	-	567,029	567,029
Derivative instruments and short positions	5,071	421	-	-	-	-	5,492
Debt issued and other borrowed funds	-	-	-	-	-	217,748	217,748
Subordinated loans	-	-	-	-	-	9,505	9,505
Other financial liabilities	-	-	-	-	-	10,467	10,467
Total financial liabilities	5,071	421	-	-	-	815,938	821,430

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

6. Fair value information for financial instruments

Financial instruments carried at fair value

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

The table below shows financial instruments carried at fair value at 31 March 2018 categorised into three levels of fair value hierarchy that reflect the type of inputs used in making the fair value measurements. The different levels have been defined as follows:

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

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

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

At 31 March 2018

	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	47,332	132	1,676	49,140
Shares and equity instruments	6,747	96	3,365	10,208
Derivative instruments	-	4,673	-	4,673
Total financial assets	54,079	4,901	5,041	64,021
Derivative instruments	-	8,104	-	8,104
Debt issued and other borrowed funds designated as at FVTPL	82,265	-	-	82,265
Total financial liabilities	82,265	8,104	-	90,369

At 31 December 2017

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

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

6. Cont'd

Reconciliation of financial instruments categorised into Level 3:

	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2018	1,828	3,373
Purchases	-	133
Net (loss) on financial instruments recognised in profit or loss	(64)	(194)
Net gain on financial instruments recognised in other comprehensive income	-	53
Other	(88)	-
Fair value at 31 March 2018	1,676	3,365
Fair value at 1 January 2017	1,872	2,072
Purchases	13	578
Sales	(10)	(2)
Net (loss) gain on financial instruments recognised in profit or loss	(48)	126
Net gain on financial instruments recognised in other comprehensive income	-	417
Transfers from Level 1 or 2	-	206
Other	1	(24)
Fair value at 31 December 2017	1,828	3,373

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

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

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

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

Level 3 assets contain primarily unlisted and illiquid equities and bonds. Unlisted equities and bonds are initially recorded at their transaction price but are revalued each quarter based on the models as described above. At end of the first quarter of 2018, the Group's Level 3 equities amounted to ISK 3,365 million. These include shares in four professional investment funds and investment companies investing in unlisted equities and specialised investments in Iceland totalling ISK 1,460 million. In 2016 the Group obtained Series C preferred shares in Visa Inc. in relation to the sale of its shares in Visa Europe. The shares are subject to selling restrictions for a period of up to 12 years and under certain conditions may have to be recalled. The shares are classified as Level 3 for the valuation of the fair value, amounted to ISK 1,288 million at 31 March 2018.

The Group's Level 3 bonds amounted to ISK 1,676 million. The majority of the amount in Level 3 bonds is estimated by discounting cash flow where the yield is the contractual currency's base rate with a premium that is decided by expert judgement on projected risk and financing cost.

Amounts are in ISK million

7. Financial instruments not carried at fair value

Assets

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

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

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

Liabilities

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

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

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

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

At 31 March 2018	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	177,029	-	177,029	177,029
Loans to credit institutions	-	47,220	-	47,220	47,220
Loans to customers	-	-	778,576	778,576	776,149
Other financial assets	-	10,158	-	10,158	10,158
Total financial assets	-	234,407	778,576	1,012,983	1,010,556
Deposits from Central Bank and credit institutions	-	13,570	-	13,570	13,562
Deposits from customers	-	575,387	-	575,387	575,196
Debt issued and other borrowed funds	132,949	58,012	-	190,961	186,990
Subordinated loans	8,793	-	-	8,793	8,838
Other financial liabilities	-	34,797	-	34,797	34,797
Total financial liabilities	141,742	681,766	-	823,508	819,383

Financial Statements first quarter 2018 24 Amounts are in ISK million

7. Cont'd

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

8. Offsetting financial assets and financial liabilities

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

Financial assets	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 March 2018	Financial assets before netting	Netting with financial liabilities	Net financial assets	Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Reverse repurchase agreements	101	-	101	-	-	-	101	-	101
Derivatives	4,673	-	4,673	(877)	(2,981)	(29)	786	-	4,673
Total assets	4,774	-	4,774	(877)	(2,981)	(29)	887	-	4,774
At 31 December 2017									
Reverse repurchase agreements	618	-	618	(270)	-	-	348	-	618
Derivatives	2,896	-	2,896	(733)	(1,482)	(9)	672	-	2,896
Total assets	3,514	-	3,514	(1,003)	(1,482)	(9)	1,020	-	3,514

Financial liabilities	Financial liabilities subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 March 2018	Financial liabilities before netting	Netting with financial assets	Net financial liabilities	Financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total financial liabilities recognised in the balance sheet
Derivative instruments and short positions	8,104	-	8,104	(877)	(240)	-	6,987	-	8,104
At 31 December 2017									
Derivative instruments and short positions	5,492	-	5,492	(733)	(492)	-	4,267	-	5,492

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

9. Quarterly statements

	2018 Q1	2017 Q4	2017 Q3	2017 Q2	2017 Q1
Net interest income	7,740	7,338	7,450	7,814	7,397
Net fee and commission income	2,778	3,632	3,305	3,543	3,270
Net financial (expense) income	(283)	260	(1,084)	97	12
Net foreign exchange (loss) gain	(10)	81	76	169	201
Other operating income	13	122	291	55	160
Salaries and related expenses	(3,926)	(4,297)	(3,168)	(4,109)	(3,659)
Other operating expenses	(2,924)	(3,358)	(2,879)	(2,739)	(2,759)
Contribution to the Depositors' and Investors' Guarantee Fund	(292)	(288)	(280)	(262)	(253)
Bank tax	(785)	(614)	(806)	(752)	(720)
Net impairment on financial assets	88	969	147	200	240
Profit before tax	2,399	3,845	3,052	4,016	3,889
Income tax expense	(1,015)	(816)	(1,072)	(1,133)	(1,130)
Profit for the period from continuing operations	1,384	3,029	1,980	2,883	2,759
Profit from discontinued operations, net of income tax	713	83	93	2,114	285
Profit for the period	2,097	3,112	2,073	4,997	3,044

10. Net interest income

	2018 1.1-31.3	2017 1.1-31.3
Cash and balances with Central Bank*	2,161	2,989
Loans at amortised cost*	12,353	10,814
Financial assets mandatorily at fair value through profit or loss	431	-
Financial assets designated as at fair value through profit or loss	-	20
Other assets	50	29
Total interest income	14,995	13,852
Deposits from credit institutions and Central Bank*	(97)	(17)
Deposits from customers*	(4,095)	(4,708)
Debt issued and other borrowed funds at fair value through profit or loss	(288)	-
Debt issued and other borrowed funds at amortised cost*	(2,050)	(1,725)
Subordinated loans*	(34)	-
Other financial liabilities	(687)	-
Other interest expense	(4)	(5)
Total interest expense	(7,255)	(6,455)
Net interest income	7,740	7,397

*Interest calculated using the effective interest rate method.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

11. Net fee and commission income

	2018 1.1-31.3	2017 1.1-31.3
Asset management	475	473
Investment banking and brokerage	496	431
Payment processing	2,554	3,416
Loans and guarantees	340	352
Other fee and commission income	408	457
Total fee and commission income	4,273	5,129
Brokerage	(68)	(33)
Clearing and settlement	(1,424)	(1,824)
Other commission expenses	(3)	(2)
Total commission expenses	(1,495)	(1,859)
Net fee and commission income	2,778	3,270

12. Net financial (expense) income

	2018 1.1-31.3	2017 1.1-31.3
Net gain on financial assets and financial liabilities held for trading	-	28
Net (loss) on financial assets designated as at fair value through profit or loss	-	(79)
Net gain on financial assets mandatorily at fair value through profit or loss	112	63
Net (loss) on financial liabilities designated as at fair value through profit or loss	(364)	-
Net (loss) on fair value hedges	(31)	-
Net financial (expense) income	(283)	12

13. Net foreign exchange (loss) gain

	2018 1.1-31.3	2017 1.1-31.3
Cash and balances with Central Bank	(60)	(21)
Financial assets held for trading	-	532
Financial assets designated as at fair value through profit or loss	-	10
Financial assets mandatorily at fair value through profit or loss	(1,542)	-
Loans at amortised cost	(6,720)	2,133
Other assets	(78)	103
Net foreign exchange (loss) gain for assets	(8,400)	2,757
Deposits	3,086	(710)
Debt issued and other borrowed funds designated as at fair value through profit or loss	2,404	-
Debt issued and other borrowed funds at amortised cost	2,117	(1,713)
Subordinated loans	669	-
Other liabilities	114	(133)
Net foreign exchange gain (loss) for liabilities	8,390	(2,556)
Net foreign exchange (loss) gain	(10)	201

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

14. Other operating income

	2018 1.1-31.3	2017 1.1-31.3
Share of (loss) profit of associates, net of income tax	(32)	102
Service level agreement fees	1	10
Legal cost and fees	19	29
Rental income	9	10
Other net operating income	16	9
Other operating income	13	160

15. Salaries and related expenses

	2018 1.1-31.3	2017 1.1-31.3
Salaries	3,020	2,980
Contributions to pension funds	440	405
Social security charges and financial activities tax*	433	455
Other	33	28
Capitalisation of internal staff costs in software development	-	(209)
Salaries and related expenses	3,926	3,659

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

16. Other operating expenses

	2018 1.1-31.3	2017 1.1-31.3
Professional services	1,324	1,154
Real estate and fixtures	872	724
Depreciation and amortisation	214	221
Other administrative expenses	514	660
Other operating expenses	2,924	2,759

17. Net impairment on financial assets

	2018 1.1-31.3	2017 1.1-31.3
Allowance for expected credit losses, on-balance sheet	53	-
Allowance for expected credit losses, off-balance sheet	35	-
Specific impairment	-	321
Collective impairment	-	76
Impairment changes due to court rulings	-	(218)
Impairment reversal due to revised estimated future cash flows	-	61
Net impairment on financial assets	88	240

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

18. Income tax expense

Income tax is recognised based on applicable tax rates and tax laws. The income tax rate for legal entities in 2018 is 20% (2017: 20%). Special financial activities tax is calculated as 6% of taxable profits exceeding ISK 1 billion in accordance with the Act on Financial Activities Tax no. 165/2011. The effective income tax rate in the Group's income statement for the first quarter 2018 is 42.2% (2017: 29.1%).

Income tax recognised in the income statement is specified as follows:	2018 1.1-31.3	2017 1.1-31.3
Current tax expense excluding discontinued operations	1,195	849
Special financial activities tax	297	177
Difference in prior year's imposed and calculated income tax	1	-
Changes in temporary differences due to deferred tax assets/liabilities	(478)	104
Total	1,015	1,130

The effective income tax rate is specified as follows:	2018 1.1-31.3		2017 1.1-31.3	
Profit before tax	2,399		3,889	
20% income tax calculated on the profit for the period	480	20.0%	778	20.0%
Special financial activities tax	297	12.4%	177	4.6%
Expenses (income) not subject to tax	25	1.0%	(21)	(0.5%)
Non-deductible expenses	157	6.5%	149	3.8%
Other differences	56	2.3%	47	1.2%
Income tax expense	1,015	42.2%	1,130	29.1%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf.

19. Profit from discontinued operations

	2018 1.1-31.3	2017 1.1-31.3
Net profit from sale of foreclosed mortgages	40	124
Net share of profit (loss) from disposal groups held for sale	673	(1)
Net profit from sale of subsidiaries and associates	-	162
Profit from discontinued operations, net of income tax	713	285

20. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2018 1.1-31.3	2017 1.1-31.3	2018 1.1-31.3	2017 1.1-31.3
Profit attributable to equity holders of the Bank	1,473	2,670	2,186	2,955
Weighted average number of outstanding shares for the period, million	10,000	10,000	10,000	10,000
Basic earnings per share	0.15	0.27	0.22	0.30

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

Amounts are in ISK million

21. Cash and balances with Central Bank

	31.3.2018	31.12.2017
Cash on hand	2,025	1,976
Balances with Central Bank	159,916	169,503
Balances with Central Bank assets subject to special restrictions*	2,686	4,593
Included in cash and cash equivalents	164,627	176,072
Mandatory reserve deposits with Central Bank	12,402	12,973
Cash and balances with Central Bank	177,029	189,045

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

22. Derivative instruments and short positions

At 31 March 2018	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,204	112,935	2,900	128,913
Cross-currency interest rate swaps	418	16,561	4,262	52,144
Equity forwards	245	1,981	178	1,937
Equity options	18	-	-	-
Foreign exchange forwards	298	8,386	506	11,423
Foreign exchange swaps	2,459	31,012	212	8,717
Bond forwards	31	4,205	46	5,739
Derivatives	4,673	175,080	8,104	208,873
Short positions in listed bonds	-	-	-	-
Total	4,673	175,080	8,104	208,873

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

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

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

Amounts are in ISK million

22. Cont'd

The Group applies hedge accounting only with respect to certain euro denominated interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR denominated bonds (see Note 33) arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. The total fair value of the interest rate swaps at the end of March 2018 was positive and amounted to ISK 84.8 million. Their total notional values at the end of March 2018 amounted to ISK 36,459 million. At the beginning of 2018 Íslandsbanki derecognised certain EUR denominated interest rate swaps as hedging instruments and classified them as mandatorily at fair value through profit and loss due to changes in classification of certain EUR denominated bonds. The notional of those interest rate swaps was ISK 62,525 million at the end of 2017.

23. Loans to credit institutions

	31.3.2018	31.12.2017
Money market loans	24,518	10,658
Bank accounts	22,702	15,959
Loans to credit institutions	47,220	26,617

24. Loans to customers

At 31 March 2018	Gross carrying amount	ECL Stage 1	ECL Stage 2	ECL Stage 3	Net carrying amount
Individuals	302,992	(1,019)	(173)	(2,599)	299,201
Commerce and services	122,177	(563)	(89)	(3,147)	118,378
Construction	27,750	(165)	(18)	(711)	26,856
Energy	7,032	(14)	(12)	-	7,006
Financial services	176	-	-	(1)	175
Industrial and transportation	75,679	(236)	(524)	(547)	74,372
Investment companies	21,402	(156)	(131)	(488)	20,627
Public sector and non-profit organisations	14,750	(16)	(2)	(1)	14,731
Real estate	131,851	(399)	(54)	(405)	130,993
Seafood	84,611	(87)	(27)	(687)	83,810
Loans to customers	788,420	(2,655)	(1,030)	(8,586)	776,149

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

Amounts are in ISK million

25. Expected credit loss

Loans to customers

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	2,701	1,244	9,151	13,096
Transfer to Stage 1	534	(466)	(68)	-
Transfer to Stage 2	(161)	293	(132)	-
Transfer to Stage 3	(15)	(845)	860	-
Net remeasurement of loss allowance	(589)	745	(262)	(106)
New financial assets originated or purchased	233	155	24	412
Derecognitions and maturities	(48)	(96)	(242)	(386)
Write-offs	-	-	(947)	(947)
Recoveries of amounts previously written off	-	-	69	69
Changes in models/risk parameters	-	-	-	-
Foreign exchange	-	-	(39)	(39)
Unwinding of interests	-	-	172	172
At 31 March 2018	2,655	1,030	8,586	12,271

At the end of the first quarter 2018 the Group's 12-month ECL (Stage 1) for Loans to credit institutions amounted to ISK 70 million and for Other financial assets amounted to ISK 5 million. Lifetime ECL not credit-impaired (Stage 2) for other financial assets amounted to ISK 3 million.

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

26. Investments in associates

	2018 1.1-31.3	2017 1.1-31.12
Investments in associates at the beginning of the year	704	450
Additions during the period	-	36
Share of results	(32)	142
Dividends paid	-	(25)
Impairment	-	(60)
Other	-	161
Investments in associates	672	704

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

27. Investments in subsidiaries

Significant subsidiaries:

		31.3.2018	31.12.2017
Borgun hf., a payment acquirer and issuing processor, Ármúli 30, 108 Reykjavík	Iceland	63.5%	63.5%
Íslandssjóðir hf., an investment fund management company, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
IS Þróunarsjóðurinn Langbrók, a professional investment fund, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
Hringur-eignarhaldsfélag ehf., a holding company, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%
Allianz Ísland hf., an insurance agent, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%

Other non-significant subsidiaries:
In addition Íslandsbanki has control over 18 other subsidiaries.

28. Other assets

	31.3.2018	31.12.2017
Receivables	6,990	6,736
Unsettled securities transactions	2,540	2,620
Accruals	188	205
Prepaid expenses	347	215
Deferred tax assets	454	4
Other assets	213	213
Other assets	10,732	9,993

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

	31.3.2018	31.12.2017
Repossessed collateral	858	1,224
Assets of disposal groups classified as held for sale	190	1,542
Total	1,048	2,766

Land and property	832	1,194
Industrial equipment and vehicles	26	30
Repossessed collateral	858	1,224

30. Deposits from Central Bank and credit institutions

	31.3.2018	31.12.2017
Repurchase agreements with Central Bank	30	92
Deposits from credit institutions	13,533	11,097
Deposits from Central Bank and credit institutions	13,563	11,189

Amounts are in ISK million

31. Deposits from customers

	31.3.2018	31.12.2017
Demand deposits*	510,813	479,590
Time deposits	64,383	87,439
Deposits from customers	575,196	567,029

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

Deposits from customers specified by owners:

	31.3.2018		31.12.2017	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	5,028	1%	6,071	1%
Municipalities	4,444	1%	7,054	1%
Companies	297,793	51%	290,405	51%
Individuals	267,931	47%	263,499	47%
Deposits from customers	575,196	100%	567,029	100%

32. Pledged assets

	31.3.2018	31.12.2017
Financial assets pledged as collateral against liabilities	166,059	149,663
Financial assets pledged as collateral in foreign banks	1,130	908
Financial assets pledged as collateral in repurchase agreements	101	618
Pledged assets against liabilities	167,290	151,189

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

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

The comparative number in the line item "Financial assets pledged as collateral against liabilities" at 31.12.2017 has been increased by ISK 4,800 million for comparison with 31.03.2018 to take into consideration assets pledged as collateral to the Central Bank of Iceland to secure settlement in the Icelandic cash clearing systems.

Amounts are in ISK million

33. Debt issued and other borrowed funds

	Issued	Maturity	Maturity type	Terms of interest	31.3.2018	31.12.2017
Covered bond in ISK	2014-2017	2019	At maturity	Fixed, 6.93%	10,275	10,120
Covered bond in ISK	2015-2016	2023	At maturity	Fixed, 6.40%	7,588	7,469
Covered bond in ISK - CPI-linked	2012-2014	2019	At maturity	Fixed, 2.84%	8,670	8,666
Covered bond in ISK - CPI-linked	2014-2015	2020	At maturity	Fixed, 3.47%	4,184	4,117
Covered bond in ISK - CPI-linked	2015-2017	2022	At maturity	Fixed, 2.98%	17,479	17,467
Covered bond in ISK - CPI-linked	2012-2018	2024	At maturity	Fixed, 3.45%	27,379	21,963
Covered bond in ISK - CPI-linked	2015-2017	2026	At maturity	Fixed, 3.37%	24,430	24,049
Covered bond in ISK - CPI-linked	2017-2018	2030	At maturity	Fixed, 3.00%	20,695	15,089
Covered bonds					120,700	108,940
Senior unsecured bond in EUR*	2015-2016	2018	At maturity	Fixed, 2.88%	18,757	19,004
Senior unsecured bond in NOK	2015	2018	At maturity	Floating, NIBOR + 2.60%	6,333	6,391
Senior unsecured bond in SEK	2015	2019	At maturity	Floating, STIBOR + 3.10%	7,119	7,660
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.38%	364	375
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.40%	2,430	2,500
Senior unsecured bond in EUR	2017	2019	At maturity	Floating, EURIBOR + 0.50%	1,217	1,253
Senior unsecured bond in EUR*	2016	2020	At maturity	Fixed, 1.75%	63,508	63,651
Senior unsecured bond in SEK	2018	2019	At maturity	Floating, STIBOR + 0.34%	1,182	-
Senior unsecured bond in SEK	2018	2021	At maturity	Floating, STIBOR + 0.60%	1,182	-
Senior unsecured bond in SEK	2018	2021	At maturity	Floating, STIBOR + 0.74%	1,183	-
Senior unsecured bond in EUR**	2018	2024	At maturity	Fixed, 1.13%	36,459	-
Bonds issued					139,734	100,834
Bills issued					8,448	7,538
Other debt securities					373	436
Other borrowed funds					8,821	7,974
Debt issued and other borrowed funds					269,255	217,748

*At the date of initial application of IFRS 9 the Group changed the classification of certain debt securities to being designated as at fair value through profit or loss. The impact of this change on 1.1.2018 amounted to ISK 1,908 million. The total carrying amount of the bond issuance amounted to ISK 82,265 million and included in the amount are fair value changes amounting to ISK 1,726 million. The carrying amount of the debt securities designated as at fair value through profit or loss at 31 March 2018 was ISK 1,702 million higher then the contractual amount due at maturity.

**The Group applies hedge accounting to this bond issuance and uses certain EUR denominated interest rate swaps as hedging instruments (see Note 22). The interest rate swaps are hedging the exposure of the Group's changes in the fair value of this fixed-rate EUR denominated bond arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. The total carrying amount of the bond issuance amounted to ISK 36,459 million and included in the amount are fair value changes amounting to ISK 71 million.

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

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

34. Subordinated loans

	Issued	Maturity	Maturity type	Terms of interest	31.3.2018	31.12.2017
Loans which qualify as Tier 2 capital:						
Subordinated loans in SEK	2017	2027	At maturity	Floating, STIBOR + 2.0%	8,838	9,505
Subordinated loans					8,838	9,505

Amounts are in ISK million

35. Changes in liabilities arising from financing activities

	31.12.2017	Reclassi-fication IFRS 9	1.1.2018	Cash flows	Non-cash changes: Accrued interest	Foreign exchange movement	Fair value changes	31.3.2018
Coverd bonds NIL	17,589	-	17,589	-	274	-	-	17,863
Coverd bonds CPI	91,351	-	91,351	10,022	1,464	-	-	102,837
Senior unsecured bonds FX	37,182	(19,003)	18,179	3,690	123	(982)	-	21,010
Senior unsecured bonds FX at fair value	-	82,655	82,655	-	288	(2,404)	1,726	82,265
Assets held to hedge long-term borrow.	63,652	(63,652)	-	37,436	87	(1,135)	71	36,459
Short-term borrowings	7,974	-	7,974	755	92	-	-	8,821
Subordinated loans	9,505	-	9,505	(32)	34	(669)	-	8,838
Total	227,253	-	227,253	51,871	2,362	(5,190)	1,797	278,093

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

36. Other liabilities

	31.3.2018	31.12.2017
Accruals	4,120	4,049
Liabilities to retailers for credit cards	22,201	23,878
Provision for effects of court rulings	1,810	1,811
Off-balance sheet loan commitments and financial guarantees	639	64
Withholding tax	3,538	1,596
Unsettled securities transactions	2,832	1,384
Deferred income	197	199
Sundry liabilities	3,691	2,966
Other liabilities	39,028	35,947

Amounts are in ISK million

36. Cont'd

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

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2018	467	101	106	674
Transfer to Stage 1	22	(19)	(3)	-
Transfer to Stage 2	(10)	11	(1)	-
Transfer to Stage 3	(1)	(65)	66	-
Net remeasurement of loss allowance	(113)	21	1	(91)
New financial assets originated or purchased	158	17	22	197
Derecognitions and maturities	(104)	(16)	(21)	(141)
At 31 March 2018	419	50	170	639

37. Related party

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

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

The Group's associates, and their key management personnel and legal entities controlled by them, are also defined as related parties.

The Group's products and services are offered to the Icelandic Government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from government-related entities under generally accepted commercial terms.

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

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

At 31 March 2018	Assets	Liabilities	Net balance	Commitments and overdraft
Shareholders with control over the Group	-	(104)	(104)	1
Board of Directors and key management personnel	215	(418)	(203)	57
Associated companies and other related parties	300	(407)	(107)	240
Balances with related parties	515	(929)	(414)	298

	Interest income	Interest expense	Other income
Shareholders with control over the Group	-	(1)	-
Board of Directors and key management personnel	4	(4)	-
Associated companies and other related parties	4	(4)	-
Transactions with related parties	8	(9)	-

Financial Statements first quarter 2018 37 Amounts are in ISK million

37. Cont'd

At 31 December 2017

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

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

No impairment allowances were recognised in the period against balances outstanding with related parties (2017: none). No share option programmes were operated during the reporting period 1 January - 31 March 2018.

38. Custody assets

	31.3.2018	31.12.2017
Custody assets - not managed by the Group	2,134,921	2,101,434

39. Contingencies

Provisions

Foreign currency-linked loan contracts

Due to the statute of limitations, all remaining disputes relating to foreign currency-linked loan contracts must be filed in court before 16 June 2018. The Group believes that the effect of the two remaining open cases (both filed by individuals) will be insignificant. Likewise, in light of numerous precedents, it is considered highly unlikely that any new cases filed before the previously mentioned date will lead to further costs. A total provision of ISK 1,010 million (see Note 36) has been recognised in the interim financial statements due to the previously mentioned loan contracts.

Variable rate loan contracts

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

The Group referred the matter to the courts and the Supreme Court found in favour of the Consumer Agency in October 2017. The Group has recognised a provision of ISK 800 million (see Note 36) against the loss due to this ruling. The latest estimate is that close to 1,600 customers out of possible 5,800 were affected. Repayments to affected customers have commenced.

Amounts are in ISK million

39. Cont'd

Contingent liabilities

Borgun hf.

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

Landsbankinn hf. (the plaintiff) is asking the court to affirm the joint liability of Borgun hf., BPS ehf., Eignarhaldsfélagið Borgun slf. and the former CEO of Borgun to pay damages for the plaintiff's alleged loss resulting from the defendants' negligence to inform the plaintiff of the value of Borgun's share in Visa Europe Ltd. The defendants have denied liability. The plaintiff does not quantify the claim, however, his estimate of the loss of profit is approximately ISK 1,930 million (by selling the shares in Borgun). Seeing that the conclusion of the case is uncertain and the financial effect cannot be estimated, the Group has not recognised a provision in relation to this matter.

Kortaþjónustan hf.

Kortaþjónustan hf., a payment acquirer, filed a suit against Íslandsbanki hf., Arion banki hf., Landsbankinn hf., Borgun hf. and Valitor hf. in June 2013. The plaintiff asked for damages in the amount of ISK 1,191 million, plus interest, mainly due to alleged infringements of competition law. The Group entered a motion for dismissal. The Supreme Court found in favour of the Group. The plaintiff refiled the case in October 2017, asking for ISK 923 million in damages, collectively. The disstrict court dismissed the case again in March. Kortaþjónustan has appealed. The Group has not recognised a provision in relation to this matter.

Contingent assets

Settlement of the 2011 Byr acquisition

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

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

40. Events after the reporting period

In April the Group finalised the sale of properties, the estimated profit amounts to ISK 1.5 billion. The profit from the sale will be recognised in the consolidated interim income statement in the second quarter of 2018.

41. Risk management

Risk governance

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

42. Credit risk

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

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

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

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

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

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

43. Maximum credit exposure

The Group's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position, see Note 24. The maximum exposure for off-balance sheet items is the amount that the Group might have to pay out against financial guarantees and loan commitments, less provisions that have been made because of these items. The maximum credit exposure for a derivative contract is calculated by adding potential future credit exposure to the positive market value of the contract.

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

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

Credit risk exposure

43. Cont'd

Maximum credit exposure at 31 March 2018

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	177,029	-	-	-	-	-	-	-	-	-	177,029
Bonds and debt instruments	-	36,312	-	-	102	10,626	1,483	59	558	-	-	49,140
Derivatives	3	-	138	-	1,463	3,217	188	3,177	1	238	171	8,596
Loans to credit institutions	-	-	-	-	-	47,071	149	-	-	-	-	47,220
Loans to customers:	299,201	-	118,378	26,856	7,006	175	74,372	20,627	14,731	130,993	83,810	776,149
Overdrafts	11,111	-	12,467	4,107	31	4	5,565	2,867	3,145	4,379	9,755	53,431
Credit cards	14,159	-	1,428	201	6	26	402	31	114	65	35	16,467
Mortgages	229,985	-	-	-	-	-	-	-	-	-	-	229,985
Capital leases	7,215	-	23,685	2,234	7	-	7,197	197	63	1,091	200	41,889
Other loans	36,731	-	80,798	20,314	6,962	145	61,208	17,532	11,409	125,458	73,820	434,377
Other financial assets	908	11	184	9	1	8,754	36	87	7	152	9	10,158
Off-balance sheet items:	43,607	-	29,047	13,057	9,470	5,257	12,787	3,114	3,754	16,599	7,954	144,646
Financial guarantees	1,492	-	5,692	4,008	12	1,164	2,309	36	5	981	526	16,225
Undrawn loan commitments	-	-	9,501	6,361	9,188	-	6,336	2,692	-	12,524	2,497	49,099
Undrawn overdrafts	9,961	-	8,975	1,905	235	3,947	2,873	239	3,032	2,857	4,754	38,778
Credit card commitments	32,154	-	4,879	783	35	146	1,269	147	717	237	177	40,544
Total maximum credit exposure	343,719	213,352	147,747	39,922	18,042	75,100	89,015	27,064	19,051	147,982	91,944	1,212,938

Amounts are in ISK million

43. Cont'd

Maximum credit exposure at 31 December 2017

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

Amounts are in ISK million

44. Credit exposure covered by collateral

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

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

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

For capital leases the Group remains the owner of the leased object. In the table below ISK 35,632 million of the collateral are leased objects.

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

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

At 31 March 2018

Collateral held against non credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral
Derivatives	8,596	-	-	4,279	-	-	4,279
Loans and commitments to customers:	898,064	490,992	72,981	4,330	47,782	60,185	676,270
Individuals	333,294	246,147	5	508	13,008	155	259,823
Commerce and services	145,070	51,667	716	225	26,447	22,360	101,415
Construction	37,596	23,392	-	380	1,806	1,758	27,336
Energy	16,476	3,633	-	370	-	88	4,091
Financial services	5,428	-	-	168	-	-	168
Industrial and transportation	83,711	22,215	2	96	5,956	16,259	44,528
Investment companies	23,408	6,938	-	2,297	100	9,163	18,498
Public sector and non-profit organisations	18,461	927	-	10	49	2	988
Real estate	143,560	129,525	-	238	225	915	130,903
Seafood	91,060	6,548	72,258	38	191	9,485	88,520
Total	906,660	490,992	72,981	8,609	47,782	60,185	680,549

Collateral held against credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral
Derivatives	-	-	-	-	-	-	-
Loans and commitments to customers:	22,731	15,067	317	234	586	4,258	20,462
Individuals	9,514	8,622	16	20	192	8	8,858
Commerce and services	2,355	1,589	191	9	220	35	2,044
Construction	2,317	306	-	-	11	2,366	2,683
Energy	-	-	-	-	-	-	-
Financial services	4	-	-	-	-	-	-
Industrial and transportation	3,448	380	46	7	113	1,849	2,395
Investment companies	333	298	-	52	3	-	353
Public sector and non-profit organisations	24	11	-	-	-	-	11
Real estate	4,032	3,102	-	146	3	-	3,251
Seafood	704	759	64	-	44	-	867
Total	22,731	15,067	317	234	586	4,258	20,462

Amounts are in ISK million

44. Cont'd

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

45. Credit quality of financial assets

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

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

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

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

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

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

The Bank is in the process of implementing a new harmonised definition of default that encompasses four similar definitions previously in use, i.e. default according to article 178 of the CRR (Capital Requirements Regulation), credit-impaired according to IFRS 9 (Stage 3), non-performing according to FINREP and Risk Class 10 according to the Bank's internal classification. The new definition is broader than each individual definition, in particular the previous definition of Risk Class 10. Currently, ISK 8.915m of the exposure in Stage 3 is attributable to the new definition and would otherwise not have been classified as risk class 10.

At 31 March 2018

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	203,374	102	-	203,476
Risk class 5-6	308,195	7,151	-	315,346
Risk class 7-8	164,250	23,505	-	187,755
Risk class 9	37,414	8,154	-	45,568
Risk class 10	-	-	30,165	30,165
Unrated	5,212	866	32	6,110
	718,445	39,778	30,197	788,420
ECL	(2,655)	(1,030)	(8,586)	(12,271)
Net carrying amount	715,790	38,748	21,611	776,149

Financial Statements first quarter 2018 44 Amounts are in ISK million

45. Cont'd

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	69,096	23	-	69,119
Risk class 5-6	49,428	578	-	50,006
Risk class 7-8	21,003	493	-	21,496
Risk class 9	2,017	229	-	2,246
Risk class 10	-	-	1,290	1,290
Unrated	258	870	-	1,128
	141,802	2,193	1,290	145,285
ECL	(419)	(50)	(170)	(639)
Net carrying amount	141,383	2,143	1,120	144,646

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

46. Forbearance and write-offs

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

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

Once an asset has been classified as forborne, it will remain forborne for a minimum 24 month probation period. In order for a loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of the customers facilities have to be considered performing
- The probation period of two years has passed from the date the forborne contract was considered performing
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period
- The customer does not have any contract that is more than 30 days past due

Gross carrying amount of forbearance measures granted during the reporting period amounted to ISK 7,894 million.

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

Amounts are in ISK million

46. Cont'd

At 31 March 2018	Gross carrying amount of forborne assets			
	Stage 1	Stage 2	Stage 3	Total
Individuals	2,857	1,525	1,884	6,266
Companies	2,940	11,743	10,022	24,705
Total	5,797	13,268	11,906	30,971

	ECLs of forborne assets			
	Stage 1	Stage 2	Stage 3	Total
Individuals	(18)	(58)	(344)	(420)
Companies	(62)	(225)	(2,081)	(2,368)
Total	(80)	(283)	(2,425)	(2,788)

Gross carrying amount written off during the reporting period and still subject to enforcement activity is shown below.

	Gross carrying amount
Individuals	248
Companies	123
Total	371

47. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by regulation no. 233/2017. The Bank has internal criteria that define connections between clients. These criteria reflect the Bank's interpretation of Article (1)(a) of the Act on Financial Undertakings no. 161/2002, where groups of connected clients are defined. Since the interim financial statements for the first quarter of the year are not audited, the official capital is based on reviewed own fund items at 31 December 2017.

The exposure is evaluated both before and after credit risk mitigating effects eligible according to the Financial Supervisory Authority rules. After mitigating effects, the Group has currently two large exposures which are both 12% of its capital base. No large exposure is above the maximum 25% single large exposure limit set by the law.

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

	31.3.2018	
Client groups	Before	After
Group 1	106%	0%
Group 2	12%	12%
Group 3	12%	12%

	31.12.2017	
Client groups	Before	After
Group 1	102%	0%
Group 2	11%	11%
Group 3	10%	10%

Financial Statements first quarter 2018 46 Amounts are in ISK million

48. Liquidity risk

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

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

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

The Group complies with the liquidity coverage ratio rules no. 266/2017 implemented in March 2017 replacing the older rules no. 1031/2014 and rules no. 1032/2014, covering the funding ratio in foreign currencies.

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

Net Stable Funding Ratio	31.3.2018	31.12.2017
For all currencies	116%	117%
Foreign currencies	140%	122%

Liquidity Coverage Ratio	31.3.2018	31.12.2017
For all currencies	158%	142%
Foreign currencies	359%	155%

	For all currencies		Foreign currencies	
At 31 March 2018	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1	196,207	196,207	33,718	33,718
Liquid assets level 2	2,108	641	2,043	641
Total liquid assets	198,315	196,848	35,761	34,359
Deposits	451,662	149,047	70,432	33,794
Debt issued	474	474	54	54
Other outflows	99,088	30,960	22,214	4,450
Total outflows	551,224	180,481	92,700	38,298
Short term deposits with other banks	46,469	43,374	45,573	43,373
Other inflows	29,046	12,705	4,539	4,006
Total inflows	75,515	56,079	50,112	47,379
Liquidity coverage ratio		158%		359%

Amounts are in ISK million

48. Cont'd

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

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

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

Maturity analysis 31 March 2018

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	13,563	3,204	5,652	-	5,213	-	-	14,069
Deposits from customers	575,196	399,665	113,475	26,735	25,628	30,049	-	595,552
Debt issued and other borrowed funds	269,255	416	6,359	51,046	116,886	129,080	-	303,787
Subordinated loans	8,838	-	35	120	1,188	11,358	-	12,701
Other financial liabilities	34,797	28,889	3,992	1,916	-	-	-	34,797
Total	901,649	432,174	129,513	79,817	148,915	170,487	-	960,906

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

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	16,225	-	-	-	-	-	16,225
Undrawn loan commitments	49,099	-	-	-	-	-	49,099
Undrawn overdrafts	38,778	-	-	-	-	-	38,778
Credit card commitments	40,544	-	-	-	-	-	40,544
Total	144,646	-	-	-	-	-	144,646
Total non-derivative financial liabilities and off-balance sheet liabilities	576,820	129,513	79,817	148,915	170,487	-	1,105,552

Amounts are in ISK million

48. Cont'd

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

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	15,977	39,095	42,713	796	-	98,581
Outflow	-	(15,908)	(40,978)	(47,438)	(927)	-	(105,251)
Total	-	69	(1,883)	(4,725)	(131)	-	(6,670)
Net settled derivatives	-	(170)	-	-	-	-	(170)
Total	-	(101)	(1,883)	(4,725)	(131)	-	(6,840)

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

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	177,029	23,706	150,637	-	-	2,686	-	177,029
Bonds and debt instruments	49,140	728	12,313	21,161	6,124	8,814	-	49,140
Shares and equity instruments	10,208	-	-	-	-	-	10,208	10,208
Loans to credit institutions	47,220	21,045	26,175	-	-	-	-	47,220
Loans to customers	776,149	4,553	97,270	74,521	228,305	371,500	-	776,149
Other financial assets	10,158	3,502	583	162	30	6	5,875	10,158
Total	1,069,904	53,534	286,978	95,844	234,459	383,006	16,083	1,069,904

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	34,698	61,779	12,065	1,140	-	109,682
Outflow	-	(33,046)	(56,601)	(11,734)	(1,198)	-	(102,579)
Total	-	1,652	5,178	331	(58)	-	7,103
Net settled derivatives	-	273	-	-	-	-	273
Total	-	1,925	5,178	331	(58)	-	7,376

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

Maturity analysis 31 December 2017

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

Amounts are in ISK million

48. Cont'd

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

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

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

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

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

Composition and amount of liquid assets	31.3.2018	31.12.2017
Cash and balances with Central Bank	167,243	183,834
Domestic bonds eligible as collateral against borrowing at Central Bank	4,298	3,654
Foreign government bonds	33,203	11,872
Loans to credit institutions	43,315	23,768
Total	248,059	223,128

Amounts are in ISK million

49. Deposits by LCR category

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

	Deposits maturing within 30 days					
At 31 March 2018	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	123,912	10%	60,851	5%	69,706	254,469
SMEs	58,230	10%	14,634	5%	6,448	79,312
Operational relationships	2,019	25%	-	5%	-	2,019
Corporations	57,770	40%	264	20%	23,806	81,840
Sovereigns, Central Bank and public sector entities	10,166	40%	232	20%	438	10,836
Financial institutions in composition	2,159	100%	-	-	-	2,159
Pension funds	48,974	100%	-	-	26,023	74,997
Domestic financial entities	36,086	100%	-	-	21,587	57,673
Foreign financial entities	1,026	100%	-	-	7,116	8,142
Other foreign entities	12,651	100%	1,703	25%	2,958	17,312
Total	352,993		77,684		158,082	588,759

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

50. Market risk

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

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

Financial Statements first quarter 2018 51 Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

51. Interest rate risk

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

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

52. Interest rate risk in the trading book

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

Trading bonds and debt instruments, long positions	31.3.2018			31.12.2017		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,541	7.77	(1.20)	1,750	7.17	(1.25)
Non-indexed	35,359	0.43	(1.51)	14,148	0.51	(0.73)
Total	36,900	0.74	(2.71)	15,898	1.24	(1.98)

Trading bonds and debt instruments, short positions	31.3.2018			31.12.2017		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	-	-	-	-	-	-
Non-indexed	-	-	-	-	-	-
Total	-	-	-	-	-	-

Net position of trading bonds and debt instruments	36,900	0.74	(2.71)	15,898	1.24	(1.98)

53. Interest rate risk in the banking book

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

The table below displays assets and liabilities in the banking book according to the next interest reset rate date as of 31 March 2018.

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	174,343	2,686	-	-	-	-	177,029
Bonds and debt instruments	1,653	132	60	172	107	92	2,216
Loans to credit institutions	47,220	-	-	-	-	-	47,220
Loans to customers	522,901	20,842	52,048	170,153	4,132	6,073	776,149
Total	746,117	23,660	52,108	170,325	4,239	6,165	1,002,614
Off-balance sheet items	83,485	59,699	5,797	67,485	-	-	216,466
Effect of derivatives held for hedging	-	-	-	36,471	-	-	36,471

Amounts are in ISK million

53. Cont'd

Liabilities	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Deposits from Central Bank and credit institutions	8,816	-	4,747	-	-	-	13,563
Deposits from customers	562,841	2,945	801	8,568	41	-	575,196
Debt issued and other borrowed funds	5,354	48,357	11,457	87,537	95,855	20,695	269,255
Subordinated loans	-	8,838	-	-	-	-	8,838
Total	577,011	60,140	17,005	96,105	95,896	20,695	866,852
Off-balance sheet items	130,585	7,170	46,066	34,875	768	-	219,464
Effect of derivatives held for hedging	36,473	-	-	-	-	-	36,473
Net interest gap on 31 March 2018	85,533	16,049	(5,166)	143,301	(92,425)	(14,530)	132,762

The Supreme Court ruling on 12 October 2017 regarding interest rate reset terms on consumer mortgage contracts will impact the Group's interest rate risk in the banking book since the Group will not be able to reset interest rates on those loan contracts containing the term clause in question. The Group has estimated that this applies to 4,100 loan contracts at most. A subset of borrowers have been asked to disclose their preference with respect to refinancing or updating of the loan terms. As loan terms are still under review and customers' intent regarding refinancing is still being assessed, the Group has not recognised any effect due to the ruling in regards to the Group's interest rate risk. A worst-case estimation is that ISK 50 billion of „Loans to customers“ will move from interest rate reset period 0-5 years to over 10 years. However, the effect is expected to be considerably lower according the Group's current assessment. For further information regarding the ruling see Note 39.

The following table displays assets and liabilities in the banking book according to the next interest rate reset date as of 31 December 2017.

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

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

Amounts are in ISK million

54. Currency risk

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

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

Currency analysis at 31 March 2018

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	197	81	64	18	5	29	28	47	48	517
Bonds and debt instruments	20,805	10,737	19	-	-	-	3,143	-	-	34,704
Shares and equity instruments	32	1,525	-	-	-	-	45	-	-	1,602
Loans to credit institutions	11,041	28,460	813	2,128	78	2,209	1,025	22	809	46,585
Loans to customers	93,129	22,615	2,227	1,124	3,151	3	4,728	616	3,758	131,351
Other assets	966	1,713	816	3	51	36	3	42	16	3,646
Total assets	126,170	65,131	3,939	3,273	3,285	2,277	8,972	727	4,631	218,405
Liabilities										
Deposits from credit institutions	4,996	356	-	4	163	-	-	-	-	5,519
Deposits from customers	20,182	33,658	4,344	192	434	617	2,473	1,897	365	64,162
Debt issued and other borrowed funds	123,103	-	-	-	-	10,667	6,333	-	-	140,103
Subordinated loans	-	-	-	-	-	8,838	-	-	-	8,838
Other liabilities	2,926	2,620	881	12	161	88	116	203	1,522	8,529
Total liabilities	151,207	36,634	5,225	208	758	20,210	8,922	2,100	1,887	227,151
Net on-balance sheet position	(25,037)	28,497	(1,286)	3,065	2,527	(17,933)	50	(1,373)	2,744	(8,746)
Net off-balance sheet position	24,657	(27,171)	1,531	(3,076)	(2,593)	18,068	(167)	1,323	(2,540)	10,032
Net position	(380)	1,326	245	(11)	(66)	135	(117)	(50)	204	1,286

Amounts are in ISK million

54. Cont'd

Currency analysis at 31 December 2017

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	238	124	78	19	5	39	30	60	65	658
Bonds and debt instruments	7,253	3,688	23	-	-	-	2,544	-	-	13,508
Shares and equity instruments	29	1,467	-	-	-	-	37	-	80	1,613
Loans to credit institutions	6,177	12,095	620	907	344	2,514	1,804	778	845	26,084
Loans to customers	92,179	19,693	2,287	1,220	3,198	3	4,791	673	4,213	128,257
Other assets	874	788	570	5	51	27	2	30	1,370	3,717
Total assets	106,750	37,855	3,578	2,151	3,598	2,583	9,208	1,541	6,573	173,837
Liabilities										
Deposits from credit institutions	2,366	378	-	4	4	-	-	-	-	2,752
Deposits from customers	25,396	24,405	4,468	190	336	703	2,683	2,452	380	61,013
Debt issued and other borrowed funds	87,166	-	-	-	-	7,660	6,391	-	-	101,217
Subordinated loans	-	-	-	-	-	9,505	-	-	-	9,505
Other liabilities	2,994	2,577	559	9	202	65	4	45	1,905	8,360
Total liabilities	117,922	27,360	5,027	203	542	17,933	9,078	2,497	2,285	182,847
Net on-balance sheet position	(11,172)	10,495	(1,449)	1,948	3,056	(15,350)	130	(956)	4,288	(9,010)
Net off-balance sheet position	11,492	(11,572)	1,466	(1,952)	(3,101)	15,390	(353)	1,022	(4,130)	8,262
Net position	320	(1,077)	17	(4)	(45)	40	(223)	66	158	(748)

Amounts are in ISK million

55. Derivatives

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

56. Inflation risk

The Group is exposed to inflation risk since the value of CPI-linked assets exceeds CPI-linked liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI affect profit and loss. A 1% increase in the index would lead to an ISK 100 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

Assets, CPI-linked	31.3.2018	31.12.2017
Bonds and debt instruments	2,228	2,442
Loans to customers	273,779	270,533
Off-balance sheet position	225	506
Total assets	276,232	273,481
Liabilities, CPI-linked		
Deposits from customers	94,320	92,077
Debt issued and other borrowed funds	102,837	91,351
Off-balance sheet position	69,101	62,569
Total liabilities	266,258	245,997
CPI imbalance	9,974	27,484

57. Capital management

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

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

The Bank aims at managing the Group's capital position and the corresponding capital ratios above the overall regulatory capital requirement.

At the end of the third quarter 2017 the Bank received the annual SREP report from the Financial Supervisory Authority where the overall capital requirement was 19.8%. The Group's capital target includes a 0.5-1.5% management buffer on top of the overall capital requirement.

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

Amounts are in ISK million

57. Cont'd

Risk exposure amount and capital base:

	31.3.2018	31.12.2017
CET1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	4,991	6,179
Retained earnings	93,930	107,387
Non-controlling interests	2,416	2,479
Fair value changes due to own credit standing	1,277	-
Tax assets	(454)	(4)
Intangible assets	(4,412)	(4,231)
Other regulatory adjustments	(1,338)	(1,285)
Total CET1 capital	161,410	175,525
Tier 2 capital		
Qualifying subordinated liabilities	8,838	9,505
General credit risk adjustments	-	1,729
Total capital base	170,248	186,759
Risk exposure amount		
- due to credit risk	701,035	682,525
- due to market risk:	9,887	8,102
Market risk, trading book	6,939	6,709
Currency risk	2,948	1,393
- due to credit valuation adjustment	1,670	1,534
- due to operational risk	83,331	83,331
Total risk exposure amount	795,923	775,492
Capital ratios		
CET1 ratio	20.3%	22.6%
Total capital ratio	21.4%	24.1%
Official CET 1 ratio	20.0%	22.6%
Official capital ratio	21.1%	24.1%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,077,431	1,026,879
Off-balance sheet exposures	46,443	51,328
Derivative exposures	8,613	6,334
Leverage ratio total exposure measure	1,132,487	1,084,541
Tier 1 capital	161,410	175,525
Leverage ratio	14.3%	16.2%

Amounts are in ISK million

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