



Consolidated Financial Statements

31 December 2016

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Endorsement and Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the year 2016 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and additional requirements in the Icelandic Financial Statement Act. The Consolidated Financial Statements comprise Kvika and its subsidiaries (together the "Group").

Kvika banki hf. is a specialised investment bank focusing on asset management and capital markets. Kvika provides businesses, investors and individuals with comprehensive investment banking and asset management services as well as selected banking services. Kvika's asset management has an established reputation and offers solutions covering all major asset classes, including fixed-income securities, equities, and alternative investments in both domestic and international markets. At the end of December 2016, the Group had ISK 121 billion of assets under management.

According to the Consolidated Income Statement, the Group's profit in 2016 amounted to ISK 1,955 million. According to the Consolidated Statement of Financial Position, the Group's equity at the end of the year 2016 amounted to ISK 7,397 million and total assets amounted to ISK 59,563 million.

The Board of Directors proposes that dividend on class B shares will be paid in the year 2017 on 2016 operations in accordance with the articles of association of the Bank. Further, the Board of Directors proposes that no dividend will be paid on class A share capital.

Share capital and shareholders

The Bank's issued share capital amounted to ISK 1,404 million as at 31 December 2016 (2015: ISK 1,605 million). At the end of the year the Bank held treasury shares with a nominal value of ISK 28 million (2015: ISK 14 million). The Bank's share capital was decreased by nominal value of ISK 253 million during the first half of the year and was increased by a nominal value of ISK 52 million during the second half of the year.

Kvika has issued bills and subordinated bonds that are listed on the NASDAQ Iceland stock exchange. Total nominal amount of outstanding bills and subordinated bonds at year end amounted to ISK 4 billion and ISK 550 million, respectively.

The Bank had 54 shareholders at year-end (2015: 72), none of which held more than 10% of shares in the Bank (2015: 0). The ownership of the Bank is transparent and it is the only bank that is fully owned by private entities, such as pension funds, companies and individuals. The ten largest shareholders are as follows:

Shareholder	31.12.2016	31.12.2015
Lífeyrissjóður verzlunarmanna	9.53%	9.90%
Brimgarðar ehf	8.31%	1.95%
K2B fjárfestingar ehf.	8.00%	-
Varða Capital ehf.	7.69%	7.99%
Sigla ehf.	7.27%	7.55%
Títan B ehf.	7.27%	7.23%
Grandier ehf.	7.00%	-
Ingimundur hf.	6.61%	6.86%
Mízar ehf.	6.60%	6.86%
Fagfjárfestastjóðurinn Norðurljós	5.77%	5.99%
	74.06%	54.32%

Further information about the shareholders of the Bank is provided in note 69.

Robust results in Kvika's first full year of operations

Revenue generation during 2016 was significantly above budget. All business segment showed good results during the year. Net interest income amounted to ISK 1,060 million, net fee income amounted to ISK 2,840 million and net trading income amounted to ISK 1,283. Total operating revenues amounted to ISK 5,318 million.

Administrative expenses were ISK 3,246 million and were in line with budget for the year. Profit attributable to the Bank's shareholders amounted to ISK 1,928 million corresponding to an annualised 34.7% return on equity based on the equity position at the beginning of the year adjusted for changes in share capital and transactions with treasury shares during the year.

The Bank paid out capital to its shareholders during 1H 2016 in the amount of ISK 1 billion or 15.2% of total equity. The Group's total capital ratio at the end of 2016 is 20.6%. The Bank's minimum regulatory capital requirement is 11.8%. Therefore, the Bank is well placed to fulfil the additional capital requirements that will be imposed following the implementation of CRD IV during the next few years.

The Bank maintains a strong liquidity position. The Bank's assets are liquid and its access to funding is constantly improving, reflected by the Bank's funding cost decreasing significantly during the year. As at end of 2016, the Group's 30 day liquidity coverage ratio (LCR) was 152%, well above the minimum level of 100% which became effective on 1 January 2017. Accordingly the Group is very well placed to cope with the potential impact on liquidity associated with the lifting of the capital controls in Iceland that were imposed in late 2008.

As part of its strategy Kvika is allocating more of its credit exposure to acquisition financing, bridge financing and mezzanine financing and to our private banking business. Kvika continues to focus on securities funding in capital markets but has reduced significantly traditional retail banking lending. Furthermore, Kvika has sold part of its loan portfolio, particularly mortgages and corporate loans during 2016 and will continue to source and structure credit opportunities that are fully or partly sold to other investors.

Risk management

The Bank is exposed to various types of risk in its operations. The Bank enforces a risk management framework which is further structured and outlined in the Bank's risk policy guide and rules on risk management. We refer to notes 42-57 on analysis of exposure to various types of risk.

Endorsement and Statement by the Board of Directors and the CEO

Corporate Governance

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

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

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

Non-financial information

In June 2016 the Icelandic Parliament passed a legal reform of the Icelandic Financial Statements Act no. 3/2006. These amendments became effective on January 1, 2016. The legal reform establishes several changes to the legislation including some additional requirements regarding entities that surpass the legal threshold of being considered as large companies. According to these amendments such companies are now required to provide a summary of certain information reflecting the environmental, social and employee aspects of the business. This is considered necessary to provide fundamental understanding of the company's development, performance and position on these non-financial matters. The summary shall also include a description of the company's policy regarding human rights matters, along with a description of the company's anti-bribery and anti-corruption policies. At last the summary shall include a brief description of the company's business model and non-financial key performance indicators. If the company has not adopted policies for one or more of the matters mentioned above, it shall disclose that fact and provide a detailed explanation in that regard. These requirements are entered into Icelandic law as part of the implementation of EU directive 2013/34/EU that will become effective for Member States in 2017. The EU has currently not published any further guidelines for implementation of the directive. The Bank is defined as a Public Interest Entity and is therefore subject to the aforementioned requirements. Due to the short timeframe from the passing of the legal reform and the end of the financial year, the Bank has currently not been able to implement the necessary changes required. It shall be noted that these requirements will, however, be fully implemented in the year 2017 and the required information published along with the next financial statements.

Statement by the Board of Directors and the CEO

To the best of our knowledge the Consolidated Financial Statements of Kvika banki hf. for the year 2016 comply with International Financial Reporting Standards as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and give a true and fair view of the Group's assets, liabilities and financial position as at 31 December 2016 and the financial performance of the Group and changes of cash flows for the year 2016.

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

The Board of Directors and the CEO of the Bank have today discussed the Consolidated Financial Statements for the year 2016, and confirm them by the means of their signatures.

Reykjavík, 16 February 2017.

Board of Directors

Ólafur Pálsson
 Friðrik Stefánsson
 Inga Björnsdóttir
 Anna Sliedörk
 Jóna Vigney

CEO



Independent Auditors' Report

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

Opinion

We have audited the consolidated financial statements of Kvika banki hf. for the year ended December 31, 2016 which comprise, the consolidated income statement and statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flows for the year then ended and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Kvika banki hf. as at December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the consolidated Financial Statements section of our report. We are independent of Kvika banki hf. in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) as well as the Icelandic Institute of State Authorized Public Accountants, Code of Ethics (FLE Code) and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How the matter was addressed in our audit
Loan valuation and Impairment loss allowance	
We refer to disclosure 18 and 81 related to accounting policies related to impairment loss allowance.	We have tested the relevant controls over the impairment process, including controls in place for capturing loans that needs to be reviewed for impairment.
Loans to customers are ISK 26,015 million and 44% of the balance sheet. As described in note 18 to the financial statement the group held impairment provisions of ISK 307 million against a gross loan book of ISK 26,322 million at 31 December 2016.	We selected a sample of loans from the full population, both performing and non-performing loans. For selected sample we have challenged the appropriateness of management’s key processes and assumptions used in the calculations of impairment for loans and advances and assessed whether the provisions are in accordance with IFRS. This included the impaired accounts and valuation of underlying collateral.
The assessment of the group’s calculation of impairment loss allowances for loans to customers requires management to make significant judgements including measurement of incurred but not specifically identified losses.	We assessed the technique management uses to estimate incurred but not reported losses, including benchmarking the assumptions against economic data and industry practices to validate assumptions made.
Based on the management judgment and the important of this assessment we have assessed this as a Key Audit matter.	We have reviewed the disclosures to the financial statements to confirm compliance with IFRS.
Valuation and classification of derivatives	
We refer to disclosure 19 and 94 related to accounting policies surrounding derivatives.	We have examined the valuation carried out by management and evaluated the methodology applied and the assumptions used.
At year end derivative assets amounted to ISK 552.5 million and derivative liabilities amounted to ISK 498.8 million.	During our audit we have tested relevant controls related to accounting for derivatives.
Derivatives are unlisted financial contracts and as such do not have a quoted market price. Valuation of derivatives are subject to management judgement in: <ul style="list-style-type: none">• Choosing the model to be used• Identifying the most relevant market data• Determining the adjustments to be made to the risk-free market value, including counterparty risk and expected funding cost. Changes in the model and adjustments may have a significant impact on the measurement of derivatives.	We have selected sample of open derivative contracts and challenged management’s valuation and recalculated the fair value of the derivative position. We have tested that the classification is in accordance with international accounting standard 39 (IAS).
The accounting polices surrounding derivatives are also complex and therefore we have assessed this as a key audit matter.	In addition, we have assessed the related P&L effect to determine whether undisclosed profits/ losses might have occurred.
	We have reviewed the disclosures to the financial statements to confirm compliance with IFRS.

Independent Auditors' Report

Revenue recognition	
Interest income and fee income are key elements to the core business of the bank. Those are the largest items of income within the consolidated statement of comprehensive income.	We reviewed the policies, processes and controls surrounding the revenue recognition. We have tested relevant controls related to accounting for interest income and fee income. We have tested the appropriateness of the interest calculation in accordance with IAS 39.
Therefore, we consider the interest income and fee income as key audit matter.	We tested interest income by select sample of loan and compare the underlying data to the loans system. We also tested the interest income and fee income using analytical procedures. Interest accrual was tested on sample of loans to ensure that interest is being accrued correctly.
The basis for revenue recognition and accounting policies are presented in note 82 and 83 to the consolidated financial statements.	We selected sample of fee income and agreed the fee to contracts and payments, to ensure revenue recognition in accordance with IAS 18. We also selected sample of contracts related to long-term project to ensure the revenue recognition were in accordance with IAS 18.

Other information

The Board of Directors and CEO are responsible for the other information. The other information comprises the report of the Board of Directors.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon, except from our confirmation related to the report of Board of Director as described below.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the financial statements.

Responsibilities of the Board of Directors and the CEO for the Consolidated Financial Statements

The Board of Directors and the CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and for such internal control as the Board of Directors and the CEO determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors and the CEO are responsible for assessing Kvika banki hf.'s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors and the CEO either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Kvika banki hf.'s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

Independent Auditors' Report

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Kvika banki hf. to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Kvika banki hf. to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors and the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors and the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors and the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Kópavogur, 16 February 2017.

Deloitte ehf.



Pálína Árnadóttir
State Authorized Public Accountant



Þorsteinn Pétur Guðjónsson
State Authorized Public Accountant

Consolidated Income Statement

For the year 2016

	Notes	2016	2015
Interest income		4,189,589	3,494,870
Interest expense		(3,125,309)	(2,370,785)
Net interest income	3	1,064,281	1,124,085
Fee and commission income	4	2,880,710	2,635,153
Fee and commission expense		(40,521)	(26,840)
Net fee and commission income		2,840,188	2,608,313
Net financial income	5, 6	1,282,690	350,383
Share in loss of discontinued operations		(13,488)	0
Share in profit (loss) of associates, net of income tax	21	148,985	(1,998)
Negative goodwill		0	297,560
Other operating (expense) income		(4,420)	53,769
Other operating income		1,413,767	699,714
Net operating income		5,318,236	4,432,112
Administrative expenses	7-10	(3,219,406)	(3,945,176)
Impairment of loans and receivables	18	(226,349)	(215,797)
(Loss) profit from assets held for sale	28, 100	(3,395)	3
Profit before taxes		1,869,086	271,142
Income tax	11	94,612	(730,616)
Special tax on financial institutions	13	(9,036)	(23,409)
Profit (loss) for the year		1,954,662	(482,882)

	Notes	2016	2015
Attributable to the shareholders of Kvika banki hf.		1,927,945	(510,844)
Attributable to non-controlling interest	20	26,717	27,962
Profit (loss) for the year		1,954,662	(482,882)

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Comprehensive Income

For the year 2016

	Notes	2016	2015
Profit (loss) for the year		1,954,662	(482,882)
Translation of foreign operations			
Exchange difference on translation of foreign operations		(3,367)	(3,028)
Other comprehensive income that are or may be reclassified to profit and loss, net of tax		(3,367)	(3,028)
Total comprehensive income (loss) for the year		1,951,295	(485,911)

	Notes	2016	2015
Attributable to the shareholders of Kvika banki hf.		1,924,578	(513,872)
Attributable to non-controlling interest		26,717	27,962
Total comprehensive income (loss) for the year		1,951,295	(485,911)

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position

As at 31 December 2016

Assets	Notes	31.12.2016	31.12.2015
Cash and cash equivalents	13	12,032,879	19,916,973
Fixed income securities	14	3,945,778	4,649,103
Shares and other variable income securities	15	3,154,466	3,006,042
Securities used for hedging	16	12,389,392	11,057,833
Loans to customers	17, 18	26,015,321	21,592,738
Derivatives	19	552,493	327,993
Investment in associates	21	127,262	0
Intangible assets	24	41,530	45,924
Property and equipment	25	59,135	76,749
Deferred tax assets	26	189,429	106,557
Other assets	18, 27	967,954	748,032
Assets classified as held for sale	28	87,720	85,813
Total assets		59,563,359	61,613,757
Liabilities			
Deposits from customers	29	32,478,933	30,544,407
Deposits from credit institutions		0	714,134
Borrowings	30	13,498,785	15,220,126
Issued bills	31	3,922,918	3,908,480
Subordinated liabilities	32	572,385	562,339
Short positions held for trading	33	80,186	783,662
Short positions used for hedging	34	0	1,024,390
Derivatives	19	498,769	987,486
Current tax liabilities	26	11,039	22,864
Deferred tax liabilities	26	1,789	3,982
Other liabilities	35	1,101,679	1,310,733
Total liabilities		52,166,483	55,082,604
Equity			
Share capital	36	1,375,819	1,590,644
Share premium		912,768	850,445
Option reserve		4,771	3,228
Warrants reserve	37	40,300	11,070
Deficit reduction reserve		3,103,697	3,850,917
Other reserves		(17,054)	(13,687)
Restricted retained earnings		403,553	0
Retained earnings		1,524,391	0
Total equity attributable to the shareholders of Kvika banki hf.		7,348,246	6,292,617
Non-controlling interest		48,630	238,537
Total equity		7,396,876	6,531,154
Total liabilities and equity		59,563,359	61,613,757

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Equity

For the year 2016

	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
1 January 2016 to 31 December 2016												
Equity as at 1 January 2016		1,590,644	850,445	3,228	11,070	3,850,917	(13,687)	0	0	6,292,617	238,537	6,531,154
Profit for the year									1,927,945	1,927,945	26,717	1,954,662
Restricted retained earnings								403,553	(403,553)	0		0
Translation of foreign operations												
Exchange difference on translation of foreign operations							(3,367)			(3,367)		(3,367)
Total comprehensive income for the year		0	0	0	0	0	(3,367)	403,553	1,524,391	1,924,578	26,717	1,951,295
Transactions with owners of the Bank												
Capital decrease		(252,779)				(747,221)				(1,000,000)		(1,000,000)
Impact of capital decrease on treasury shares		2,205	6,519							8,724		8,724
Impact of capital decrease on treasury shares due to purchased treasury shares			31,195							31,195		31,195
Treasury shares transactions		(42,172)	(142,828)							(185,000)		(185,000)
Transactions with own shares		26,110	105,746							131,857		131,857
Stock options				1,543						1,543		1,543
Warrants sold	37				40,300					40,300		40,300
Warrants exercised		51,812	61,690		(11,070)					102,432		102,432
Other transactions												
Acquisition of non-controlling interest via purchase											(28,581)	(28,581)
Decrease due to liquidation of subsidiaries											(211,641)	(211,641)
Sale of shares in subsidiaries											23,598	23,598
Equity as at 31 December 2016		1,375,819	912,768	4,771	40,300	3,103,697	(17,054)	403,553	1,524,391	7,348,246	48,630	7,396,876

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Equity

For the year 2015

	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
1 January 2015 to 31 December 2015												
Equity as at 1 January 2015		1,170,000	9,069	4,541	11,070	3,850,917	(10,659)	0	288,853	5,323,792	272,714	5,596,506
Loss for the year									(510,844)	(510,844)	27,962	(482,882)
Translation of foreign operations												
Exchange difference on translation of foreign operations							(3,028)			(3,028)		(3,028)
Total comprehensive loss for the year		0	0	0	0	0	(3,028)	0	(510,844)	(513,872)	27,962	(485,911)
Accumulated deficit set off against the share premium account			(221,991)						221,991			
Transactions with owners of the Bank												
Capital increase		433,799	1,083,468							1,517,268		1,517,268
Acquisition of non-controlling interest via merger									0		290,844	290,844
Treasury shares acquired via merger		(228,724)	(568,067)							(796,791)		(796,791)
Treasury shares held by the Bank before the merger and delivered to shareholders via merger	68	800	3,200							4,000		4,000
Treasury shares delivered to shareholders via merger		228,724	568,067							796,791		796,791
Purchased treasury shares		(13,956)	(23,301)							(37,257)		(37,257)
Share-based payment transactions				(1,314)						(1,314)		(1,314)
Other transactions												
Acquisition of non-controlling interest via purchase											(67,462)	(67,462)
Dividend paid by subsidiaries to non-controlling interest											(6,600)	(6,600)
Sale of non-controlling interest											(278,921)	(278,921)
Equity as at 31 December 2015		1,590,644	850,445	3,228	11,070	3,850,917	(13,687)	0	0	6,292,617	238,537	6,531,154

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Cash Flows

For the year 2016

Cash flows from operating activities	Notes	2016	2015
Profit (loss) for the year		1,954,662	(482,882)
Adjustments for:			
Indexation and exchange rate difference		(790,119)	(240,183)
Share in loss (profit) of associates, net of income tax	21	(148,985)	1,998
Depreciation and amortisation	24, 25	31,142	260,876
Net interest income	3	(1,064,281)	(1,124,085)
Impairment of loans and receivables	18	226,349	215,797
Income tax	11	(94,612)	730,616
Negative goodwill		0	(297,560)
Other adjustments		29,325	(1,638)
		143,482	(937,062)
Changes in:			
Receivables from Central Bank		0	98,832
Fixed income securities		646,816	(405,167)
Shares and other variable income securities		(366,135)	(2,215,319)
Securities used for hedging		(1,331,559)	1,883,065
Loans to customers		(4,556,609)	1,774,974
Derivatives - assets		(224,500)	171,311
Deferred tax assets		15,022	(26,999)
Other assets		(219,922)	1,911,222
Deposits from customers		3,102,155	(6,012,708)
Deposits from credit institutions		(714,134)	(1,997,208)
Short positions		(1,727,866)	(2,318,185)
Derivatives - liabilities		(488,717)	478,953
Other liabilities		(220,879)	(553,723)
		(5,942,846)	(8,148,015)
Interest received		4,070,511	3,307,367
Interest paid		(2,641,197)	(2,152,462)
Income tax paid		(5,475)	0
Net cash to operating activities		(4,519,006)	(6,993,110)
Cash flows from investing activities			
Cash and cash equivalent acquired in business combination		0	4,324,080
Acquisition of intangible assets	24	(6,519)	(7,688)
Acquisition of property and equipment	25	(10,367)	(46,934)
Acquisition of non-controlling interest		0	(62,139)
Proceeds from the sale of property and equipment		10,752	4,334
Proceeds from the sale of a non-controlling interest		49,868	0
Acquisition of a non-controlling interest		(28,581)	0
Proceeds from the sale of assets classified as held for sale	28, 100	29,000	204,838
Acquisition of assets classified as held for sale		(37,656)	0
Net cash from investing activities		6,498	4,416,492
Cash flows from financing activities			
Proceeds from borrowings		232,382,450	119,250,102
Repayment of borrowings		(234,103,791)	(113,996,895)
Issued bills		(252,184)	3,835,772
Subordinated liabilities		(31,857)	556,622
Treasury share transactions		91,890	(37,257)
Reduction of share capital		(244,391)	0
Reduction of deficit reduction reserve		(747,221)	0
Net cash (to) from financing activities		(2,905,105)	9,608,344
Net (decrease) increase in cash and cash equivalents		(7,417,613)	7,031,726
Cash and cash equivalents at the beginning of the year	13	19,916,973	12,970,418
Effects of exchange rate fluctuations on cash and cash equivalents held		(466,480)	(85,171)
Cash and cash equivalents at the end of the year	13	12,032,879	19,916,973
Investing and financing activities not affecting cash flows			
Assets and liabilities acquired from Straumur fjárfestingabanki hf.		0	(2,321,259)
Capital increase		0	1,517,268
Treasury shares delivered to shareholders		0	803,991

The notes on pages 13 to 58 are an integral part of these Consolidated Financial Statements.

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Notes to the Consolidated Financial Statements

General information

1. Reporting entity

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

The Consolidated Financial Statements for the year ended 31 December 2016 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). The Group is primarily involved in investment and corporate banking, capital markets, asset management and fund management.

2. Basis of preparation

a. Statement of compliance

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

b. Basis of measurement

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

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

A breakdown of the accounting classification of financial assets and financial liabilities is provided in note 58.

c. Functional and presentation currency

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

The Group's assets and liabilities which are denominated in other currency than ISK are translated to ISK using the exchange rate as at the end of day 31 December 2016.

d. Going concern

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

e. Estimates and judgements

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

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

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

Information about areas of estimation uncertainty and critical judgements made by management in applying accounting policies that can have a significant effect on the amounts recognised in the Consolidated Financial Statements is provided in note 111.

f. Relevance and importance of notes to the reader

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

Notes to the Consolidated Financial Statements

Income statement

3. Net interest income

Interest income is specified as follows:

	2016	2015
Cash and cash equivalents	1,357,964	883,356
Derivatives	877,645	785,990
Loans to customers	1,924,136	1,812,841
Other interest income	29,845	12,682
Total	4,189,589	3,494,870

Interest expense is specified as follows:

	2016	2015
Deposits from customers	1,369,387	1,053,606
Deposits from credit institutions	53,364	109,789
Borrowings	1,183,623	1,000,411
Issued bills	266,623	0
Subordinated liabilities	41,902	0
Derivatives	151,516	139,506
Other interest expense	58,894	67,472
Total	3,125,309	2,370,785

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 3,312 million (2015: ISK 2,709 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 2,974 million (2015: ISK 2,231 million).

4. Fee and commission income

Fee and commission income is specified as follows:

	2016	2015
Banking	511,111	301,415
Capital Markets	856,194	763,971
Asset Management	1,138,437	1,043,161
Other	374,967	526,605
Total	2,880,710	2,635,153

5. Net financial income

Net financial income is specified as follows:

	2016	2015
Financial assets held for trading		
Fixed income securities	583,054	151,081
Shares and other variable income securities	268,231	410,862
Derivatives	150,839	(77,857)
Financial assets designated at fair value through profit or loss		
Fixed income securities	0	8,358
Shares and other variable income securities	166,767	(151,485)
Foreign currency exchange difference	113,798	9,425
Total	1,282,690	350,383

6. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	2016	2015
Gain on financial instruments at fair value through profit and loss	35,637	4,340
Gain on other financial instruments	78,162	5,086
Total	113,798	9,425
Change in the ISK trade index during the year	+18.5%	+7.9%

Note 55 provides information about the development of foreign exchange rates against the Icelandic krona.

Notes to the Consolidated Financial Statements

7. Administrative expenses

Administrative expenses are specified as follows:

	2016	2015
Salaries and related expenses	2,073,879	2,192,807
Other operating expenses	1,047,275	1,431,503
Depositors' and Investors' Guarantee Fund contributions	67,111	59,990
Depreciation and amortisation	31,142	260,876
Total	3,219,406	3,945,176

ISK 280 million of one off merger costs related to termination of employment contracts are included in salaries and related expenses for the 2015 figures in the table above. Additionally, ISK 93 million in other one off merger costs are included in other operating expenses for the 2015 figures in the table.

8. Salaries and related expenses

Salaries and related expenses are specified as follows:

	2016	2015
Salaries	1,626,341	1,664,407
Performance based payments excluding share-based payments	(10,846)	12,069
Share-based payment expenses	1,543	(1,314)
Pension fund contributions	218,612	259,019
Tax on financial activity	100,833	107,021
Other salary related expenses	137,395	151,605
Total	2,073,879	2,192,807
Average number of full time employees during the year	84	81
Total number of full time employees at year-end	86	86

The figures for 2015 do not include employees of Straumur fjárfestingabanki hf. ("Straumur"). At the beginning of 2015, Straumur had 34 full time employees and Kvika and its subsidiaries had 75, or 109 in total.

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2015: 5.50%).

9. Employment terms of the Board of Directors and management

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

	31.12.2016			31.12.2015		
	Salaries and benefits	Number of shares	Warrants and options	Salaries and benefits	Number of shares	Warrants and options
Sigurður Atli Jónsson, CEO	48,212	8,425	24,566	49,094	10,000	17,300
Þorsteinn Pálsson, Chairman of the Board	9,174	0	0	11,387	0	0
Finnur Reyur Stefánsson, Deputy Chairman of the Board	4,587	51,033	0	2,145	90,576	0
Inga Björg Hjaltadóttir, Board member	4,741	0	0	6,049	0	0
Jónas Hagan Guðmundsson, Board member	6,850	26,993	0	2,106	32,040	0
Anna Skúladóttir, Board member	3,515	8,425	0	0	0	0
Ármann Fr. Ármannsson, alternate Board member	1,639	93	0	0	110	0
Kristín Guðmundsdóttir, alternate Board member	4,331	621	0	2,586	737	0
Skúli Mogensen, former Board member	1,053	101,989	0	5,593	116,060	0
Þórunn Pálsdóttir, former Board member	1,073	0	0	2,145	0	0
Magnús Bjarnason, former Board member *	0	0	0	1,930	0	0
Hanna K. Friðriksson, former alternate Board member	0	0	0	4,470	0	0
Vilmundur Jósefsson, former alternate Board member	0	3,370	0	3,680	4,000	0
Ástríður Þórðardóttir, former alternate Board member	0	0	0	3,032	0	0
Managing Directors (2016: 5, 2015: 5)	184,375	1,264	100,050	183,596	8,650	30,000
Total	269,550	202,212	124,616	277,813	262,172	47,300

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

Notes to the Consolidated Financial Statements

9. Employment terms of the Board of Directors and management (cont.)

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

Figures for shares, share options and warrants are in thousands and include shares held by companies owned by or under the control of the respective parties as at 31 December 2016 and 31 December 2015. If the holdings are held indirectly through companies, then only the pro rata ownership of the aforementioned persons has been included.

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

The Bank has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. Further information about the remuneration policy is provided in notes 66-68.

10. Auditor's fees

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

	2016	2015
Audit of annual accounts	33,635	27,507
Review of interim accounts	6,768	10,287
Other audit related services	4,705	5,131
Total	45,107	42,925
Thereof to the auditors of the Bank	35,454	38,774

11. Income tax

The Group will not pay income tax on its profit for 2016 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2016, the tax loss carry forward of the Group amounted to ISK 160 billion. A substantial part of the deferred tax asset is utilisable until end of year 2018 and 2019. Management is of the opinion that the Group's operations in the years to come will result in taxable results which will be offset with the tax loss carry forward. The Group has therefore recognised a part of the tax loss carry forward as a deferred tax asset in the consolidated statement of financial position. The deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The deferred tax asset is reviewed at each reporting date.

Income tax is recognised based on the tax rates and tax laws enacted during the current year, according to which the domestic corporate income tax rate was 20.0% (2015: 20.0%)

Reconciliation of effective tax rate:

		2016		2015
Profit before income tax		1,869,086		271,142
Income tax using the domestic corporation tax rate	20.0%	(373,817)	20.0%	(54,228)
Non-deductible expenses	0.0%	(351)	0.5%	(1,375)
Non-taxable income	(8.1%)	151,748	(232.0%)	628,987
Recognition (derecognition) of tax losses	(16.1%)	301,472	324.4%	(879,479)
Other changes	(0.8%)	15,561	156.6%	(424,520)
Effective income tax	(5.1%)	94,612	269.5%	(730,616)

Profit before tax amounts to ISK 1,869 million. Income tax amounts to ISK 95 million, resulting in an effective tax rate of -5.1%. This is substantially different from the Icelandic corporate tax rate of 20%, mainly due to non-taxable income from shares and revaluation of the deferred tax asset.

12. Special tax on financial institutions

According to Act No. 155/2010 on Special Tax on Financial Institutions, certain types of financial institutions, including banks, must pay annually a tax based on the carrying amount of their liabilities as determined for tax purposes in excess of ISK 50 billion at year-end. The tax rate is set at 0.376% (2015: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

Notes to the Consolidated Financial Statements

Statement of Financial Position

13. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	31.12.2016	31.12.2015
Deposits with the Central Bank of Iceland	8,363,848	15,676,543
Cash on hand	15,375	80,881
Balances with banks	3,263,947	3,476,080
Treasury bills	389,709	683,469
Total	12,032,879	19,916,973

14. Fixed income securities

Fixed income securities are specified as follows:

	31.12.2016	31.12.2015
Held for trading		
Listed government bonds and bonds with government guarantees	1,521,804	1,684,684
Listed treasury bills	0	73,865
Listed bonds	2,268,305	2,717,833
Unlisted bonds	155,669	148,833
Designated at fair value through profit or loss		
Unlisted bonds	0	23,886
Total	3,945,778	4,649,103

15. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	31.12.2016	31.12.2015
Held for trading		
Listed shares	1,144,496	1,376,404
Unlisted shares	136,997	18,568
Unlisted unit shares	1,437,759	1,095,558
Designated at fair value through profit or loss		
Unlisted shares	430,779	509,033
Unlisted unit shares	4,434	6,480
Total	3,154,466	3,006,042

Further discussion about the accounting classification of financial assets is provided in notes 58-60.

16. Securities used for hedging

Securities used for hedging are specified as follows:

	31.12.2016	31.12.2015
Listed government bonds and bonds with government guarantees	5,298,637	1,325,364
Listed bonds	21,243	286,838
Listed shares	6,990,913	8,582,712
Unlisted unit shares	78,599	862,919
Total	12,389,392	11,057,833

Securities used for hedging are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 58-60.

17. Loans to customers

Loans to customers are specified as follows:

	31.12.2016	31.12.2015
Loans to customers, gross amount	26,321,932	22,007,487
Specific allowance for impairment losses	(44,404)	(208,880)
Collective allowance for impairment losses	(262,208)	(205,869)
Total	26,015,321	21,592,738

Notes to the Consolidated Financial Statements

18. Allowance for impairment losses

Change in allowance for impairment losses is specified as follows:

a. Loans to customers

31.12.2016	Specific	Collective	Total
Balance as at 1 January 2016	208,880	205,869	414,748
Charge to the income statement for the year	207,497	56,339	263,836
Recoveries	(35,829)	0	(35,829)
Write-offs	(336,144)	0	(336,144)
Balance as at 31 December 2016	44,404	262,208	306,611

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

b. Other assets - accounts receivable

31.12.2016	Specific	Collective	Total
Balance as at 1 January 2016	10,132	5,000	15,132
Charge to the income statement for the year	(1,658)	0	(1,658)
Write-offs	(8,401)	0	(8,401)
Balance as at 31 December 2016	73	5,000	5,073

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

19. Derivatives

Derivatives are specified as follows:

	Notional		Carrying value	
	Assets	Liabilities	Assets	Liabilities
31.12.2016				
Interest rate derivatives	1,020,000	1,020,000	71,224	
Currency forwards	2,997,361	2,863,685	146,318	12,641
Bond and equity total return swaps	1,075,779	13,709,091	249,496	478,462
Equity options	2,867		75,294	
Bond options	600,000	600,000	10,161	7,665
	5,696,008	18,192,775	552,493	498,769

	Notional		Carrying value	
	Assets	Liabilities	Assets	Liabilities
31.12.2015				
Interest rate derivatives	1,020,000	1,020,000	45,894	
Currency forwards	725,839	711,559	14,287	
Bond and equity total return swaps	7,378,992	9,537,610	267,811	884,545
Equity options	(400,590)			102,941
Bond options				
	8,724,241	11,269,169	327,993	987,486

Notes to the Consolidated Financial Statements

20. Group entities

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

Entity	Nature of operations	Domicile	Share	Share
			31.12.2016	31.12.2015
Ármúli fasteignir ehf.	Holding company	Iceland	100%	100%
Burðarás eignarhaldsfélag ehf.	Holding company	Iceland	100%	100%
Fasteignastýring ehf.	Dormant	Iceland	100%	100%
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	70%
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Nes Þróunarfélag GP ehf.	Dormant	Iceland	100%	100%
Pivot ehf.	Holding company	Iceland	100%	100%
Straumur eignarhaldsfélag ehf.	Dormant	Iceland	100%	100%
Straumur Equites ehf.	Dormant	Iceland	100%	100%
Straumur fjárfestingar hf.	Dormant	Iceland	100%	100%
Akta sjóðir hf.	Fund management	Iceland	51%	100%
Horn Florida Ltd.	Holding company	UK	100%	100%
Mánatún GP ehf.	Dormant	Iceland	-	100%
Foss eignarhaldsfélag ehf.	Dormant	Iceland	-	100%
Foss2 eignarhaldsfélag ehf.	Dormant	Iceland	-	100%
IB eignarhaldsfélag ehf.	Dormant	Iceland	-	100%
Íslensk eignastýring ehf.	Holding company	Iceland	-	79%
Teris	Holding company	Iceland	-	54%
Heildun UAB	Dormant	Lithuania	-	100%

Foss eignarhaldsfélag ehf. and Foss2 eignarhaldsfélag ehf., were disposed of in 2016. These were dormant Group entities and the disposals had an immaterial effect on the statement of financial position and the income statement.

During the year, the Group increased its shareholding in Íslensk eignastýring ehf., and subsequently merged it with Pivot ehf. Íslensk eignastýring ehf., had been used as a holding company for the Group's investment in Íslensk verðbréf hf., and had served its purpose following the Group's sale of its stake in that company.

The Bank sold a 49% stake in Akta sjóðir hf., previously Straumur sjóðir hf., during 2016 and holds a 51% stake at year end.

IB eignarhaldsfélag ehf. and Mánatún GP ehf. were liquidated at year end. These companies were dormant and no longer served any purpose for the Group.

Teris' liquidation was finalized close to year end. The Group received cash and a small shareholding in Auðkenni ehf., as distributed assets from the liquidation.

Nes Þróunarfélag slhf., previously Burðarás PE slhf., was a subsidiary at the beginning of 2016 but is an associate company at year as the Group sold ca. 67% of its shareholding during the year.

21. Investment in associates

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

Entity	Nature of operations	Domicile	Share	Share
			31.12.2016	31.12.2015
Londonderry Associates LLC	Holding company	USA	38%	38%
Nes Þróunarfélag slhf.	Holding company	Iceland	33%	100%

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

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

	31.12.2016	31.12.2015
Balance at the beginning of the year	(0)	0
Additions through a merger	0	29,052
Disposal of shares in associates	(23,152)	(27,054)
Reclassification	1,429	0
Share in profit (loss) of associates, net of income tax	148,985	(1,998)
Total	127,262	(0)

22. Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 72 Financial investments under control are presented in fixed income securities (2016: ISK 0 thousand, 2015: ISK 19,878) in the consolidated statement of financial position.

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

Notes to the Consolidated Financial Statements

23. Unconsolidated structured entities

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

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

	31.12.2016	31.12.2015
Investments funds	49,837,884	41,917,800

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

	Carrying amount	
	31.12.2016	31.12.2015
Investments funds	987,600	1,691,393
The Group received management fees during the period:		
Investments funds	481,664	489,538

24. Intangible assets

Intangible assets are specified as follows:

31.12.2016	Software	Goodwill	Other	Total
Balance as at 1 January 2016	20,304	0	25,620	45,924
Acquisitions	6,519	0	0	6,519
Amortisation	(6,033)	0	(4,880)	(10,913)
Balance as at 31 December 2016	20,790	0	20,740	41,530
Gross carrying amount	45,442	0	48,800	94,242
Accumulated amortization and impairment losses	(24,652)	0	(28,060)	(52,712)
Balance as at 31 December 2016	20,790	0	20,740	41,530
31.12.2015	Software	Goodwill	Other	Total
Balance as at 1 January 2015	133,673	0	115,094	248,766
Acquisitions	7,688	57,425	0	65,113
Additions through a merger	4,328	544,925	0	549,253
Discontinued	(80,790)	0	(71,059)	(151,849)
Disposals	(4,328)	(602,350)	0	(606,678)
Amortisation	(40,267)	0	(18,415)	(58,682)
Balance as at 31 December 2015	20,304	0	25,620	45,924
Gross carrying amount	264,508	0	184,150	448,658
Accumulated amortization and impairment losses	(130,835)	0	(69,056)	(199,892)
Balance as at 1 January 2015	133,673	0	115,094	248,766
Gross carrying amount	38,924	0	48,800	87,724
Accumulated amortization and impairment losses	(18,620)	0	(23,180)	(41,800)
Balance as at 31 December 2015	20,304	0	25,620	45,924

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

Notes to the Consolidated Financial Statements

25. Property and equipment

Property and equipment is specified as follows:

	Real estate	Other	Total
31.12.2016			
Balance as at 1 January 2016	0	76,749	76,749
Acquisitions	0	10,367	10,367
Disposals	0	(7,752)	(7,752)
Depreciation	0	(20,229)	(20,229)
Balance as at 31 December 2016	0	59,135	59,135
Gross carrying amount	0	197,507	197,507
Accumulated depreciation	0	(138,372)	(138,372)
Balance as at 31 December 2016	0	59,135	59,135
31.12.2015			
Balance as at 1 January 2015	0	74,873	74,873
Acquisitions	0	46,934	46,934
Additions through a merger	98,407	11,543	109,950
Discontinued	0	(17,122)	(17,122)
Disposals	(97,659)	(7,161)	(104,820)
Depreciation	(748)	(32,318)	(33,066)
Balance as at 31 December 2015	0	76,749	76,749
Gross carrying amount	0	194,207	194,207
Accumulated depreciation	0	(119,334)	(119,334)
Balance as at 1 January 2015	0	74,873	74,873
Gross carrying amount	0	197,507	197,507
Accumulated depreciation	0	(120,757)	(120,757)
Balance as at 31 December 2015	0	76,749	76,749

26. Deferred tax assets and liabilities

Change in deferred tax is specified as follows:

	31.12.2016	31.12.2015
Balance at the beginning of the year	102,575	574,107
Income tax for the year	94,612	(730,616)
Additions through a merger	0	236,466
Current income tax payable	11,039	22,864
Other changes	(20,587)	(247)
Net	187,640	102,575
Deferred tax assets	189,429	106,557
Deferred tax liabilities	(1,789)	(3,982)
Net	187,640	102,575

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

	31.12.2016	31.12.2015
Property and equipment	1,903	6,693
Intangible assets	(3,860)	6,853
Assets and liabilities denominated in foreign currencies	(5,380)	(5,380)
Other items	(73,218)	(796)
Tax losses carried forward	268,195	95,204
Total	187,640	102,575

At year end 2016, tax losses carried forward amount to ISK 160.3 billion, and are set to expire as follows:

	Losses
Tax losses 2008, expiring in 2018	56,576,184
Tax losses 2009, expiring in 2019	96,929,489
Tax losses 2010, expiring in 2020	66,358
Tax losses 2011, expiring in 2021	764,208
Tax losses 2012, expiring in 2022	640,623
Tax losses 2013, expiring in 2023	1,511,014
Tax losses 2014, expiring in 2024	781,928
Tax losses 2015, expiring in 2025	3,041,144
Total	160,310,949

Notes to the Consolidated Financial Statements

27. Other assets

Other assets are specified as follows:

	31.12.2016	31.12.2015
Unsettled transactions	108,739	0
Accounts receivable	716,360	625,190
Sundry assets	142,855	122,842
Total	967,954	748,032

28. Assets classified as held for sale

The Group has classified certain assets as held for sale. They are not part of the the Group's core operations. The Group intends to dispose of the majority of these assets in 2017 by offering them for sale either to select investors or an open sales process.

Assets classified as held for sale are specified as follows:

	31.12.2016	31.12.2015
Buildings and land	60,220	58,313
Unlisted shares	27,500	27,500
Total	87,720	85,813

29. Deposits from customers

Deposits from customers are specified as follows:

	31.12.2016	31.12.2015
Demand deposits	23,311,754	22,697,505
Time deposits	9,167,179	7,846,902
Total	32,478,933	30,544,407

30. Borrowings

Borrowings are specified as follows:

	31.12.2016	31.12.2015
Loans from credit institutions	0	2,053
Money market deposits	13,498,785	15,218,074
Total	13,498,785	15,220,126

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

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

31. Issued bills

Issued bills are specified as follows:

	31.12.2016	31.12.2015
Issued bills	3,922,918	3,908,480
Total	3,922,918	3,908,480

32. Subordinated liabilities

Subordinated liabilities are specified as follows:

	Issued	Maturity	Maturity	Terms of interest	31.12.2016	31.12.2015
	2015	2025	type			
Tier 2 in ISK			At maturity	CPI-Indexed, fixed 5.50%	572,385	562,339
Total					572,385	562,339

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

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

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

Notes to the Consolidated Financial Statements

33. Short positions held for trading

Short positions held for trading are specified as follows:

	31.12.2016	31.12.2015
Listed government bonds and bonds with government guarantees	0	595,014
Listed bonds	80,186	0
Listed shares	0	188,648
Total	80,186	783,662

34. Short positions used for hedging

Short positions used for hedging are specified as follows:

	31.12.2016	31.12.2015
Listed government bonds and bonds with government guarantees	0	1,024,390
Total	0	1,024,390

35. Other liabilities

Other liabilities are specified as follows:

	31.12.2016	31.12.2015
Unsettled securities transactions	204,520	150,310
Accounts payable and accrued expenses	98,330	175,632
Taxes payables	0	5,556
Special tax on financial institutions	8,948	23,409
Withholding taxes	380,040	432,501
Salaries and salary related expenses	188,588	266,762
Other liabilities	221,253	256,562
Total	1,101,679	1,310,733

36. Equity

a. Share capital

The share capital issued by the Bank is divided into two classes; class A and class B. The total share capital of the Bank is ISK 1,403,631,700; more specifically the share capital in class A amounts to ISK 1,393,631,700 and in class B it amounts to 10,000,000. The nominal value of shares issued by the Bank is ISK 1 per share in both share capital classes. Class A shares carry voting rights of one vote per nominal value of ISK 1 at shareholders' meetings, class B shares do not carry voting rights. Reference is made to the Bank's Articles of Association for more information about rights and restrictions associated with both classes of share capital.

	31.12.2016	31.12.2015
Share capital according to the Bank's Articles of Association	1,403,632	1,604,599
Nominal amount of treasury shares	27,812	13,956
Authorised but not issued shares	190,000	281,500

b. Changes made to the nominal amount of share capital

During the first half of 2016, the share capital of the Bank was decreased by a nominal amount of 253 million shares in accordance with the decisions made at the 2016 annual general meeting and the continued annual general meeting of the Bank. In November of 2016 the share capital was increased by a nominal amount of 52 million shares as holders of outstanding subscription rights exercised their rights to purchase new shares in the Bank.

c. Share capital increase authorizations

The Board of Directors is authorized to increase the class A share capital of the Bank in stages by up to ISK 50,000,000 in nominal value, for the purposes of fulfilling share option agreements in accordance with the Bank's share incentive scheme. The Board of Directors is also authorized to increase the class B share capital of the Bank by up to ISK 10,000,000 shares, by issuance of new class B shares. Both of these authorizations are based on temporary provision I to the Articles of Association and are valid until 30 November 2021. Temporary provision III to the Articles of Association moreover authorises the Board of Directors to issue new class A share capital to serve warrants which have been issued in the maximum amount of ISK 130,000,000 nominal value, each of which contains the right to subscribe for one new class A share in the Bank. A copy of the Bank's Articles of Association, including the temporary provisions, is available on the Bank's website, www.kvika.is.

Notes to the Consolidated Financial Statements

37. Warrants

All the subscription rights which were sold in December 2014 were exercised in November 2016, refer to note 36.b for further information. Later in the same month, the Bank sold new subscription rights in the nominal amount of 130,000,000. The strike price is equal to 3.84 per share with a 5% annual increase. The warrants had not been exercised at year end 2016, and will lapse in November 2019.

38. Capital adequacy ratio (CAD)

Equity at the end of the year was ISK 7,397 million (31.12.2015: 6,531 million), equivalent to 12.4% (31.12.2015: 10.6%) of total assets according to the statement of financial position. The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 20.6% (31.12.2015: 23.5%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

	31.12.2016	31.12.2015
Capital base		
Total equity	7,396,876	6,531,154
Goodwill and intangibles	(41,530)	(45,924)
Deferred tax asset	(189,429)	(106,557)
Tier 1 capital	7,165,917	6,378,672
Subordinated liabilities	572,385	562,339
Accrued interests	(10,503)	(10,251)
Tier 2 capital	561,881	552,088
Shares in financial institutions	(90,798)	(121,806)
Subordinated fixed income securities	(155,786)	(120,415)
Total capital base	7,481,214	6,688,539
Capital requirements	31.12.2016	31.12.2015
Credit risk	1,912,501	1,290,773
Market risk	336,155	418,946
Operational risk	654,211	568,427
Total Capital requirements	2,902,868	2,278,146
Surplus capital	4,578,346	4,410,393
Capital adequacy ratio (CAD)	20.6%	23.5%
Minimum capital requirements	11.8%	11.8%

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

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

Notes to the Consolidated Financial Statements

Risk management

39. Risk management framework

- a. Board of Directors
The Bank's Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite setting. Risk management policies are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.
- b. Board of Directors sub-committee
The Bank's Board of Directors has established a sub-committee, Risk, Audit and Remuneration committee. The Committee oversees how management monitors compliance with the Group's risk management policies and procedures. The Risk, Audit and Remuneration Committee is assisted in its oversight role by the Internal Audit.
- c. CEO
The CEO is responsible for the effective implementation through the corporate governance structure and committees. The CEO has established three committees, which are responsible for developing and monitoring risk management policies in their specified areas.
- d. Committees
The Bank operates three committees that are involved in risk management: an Asset and Liability Committee (ALCO), a Credit Committee and a Quality and Security Committee.

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

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

The Quality and Security Committee is responsible for supervision and implementation of the Bank's security and quality policies. The security policy mainly addresses data security and operational security in IT systems, physical security for the personnel and proper access controls and monitoring in the Bank's premises. The quality work is aimed at upholding proper quality in work processes, IT systems and services to support performance and profitability, lower operational risk and increase the customer experience.
- e. Risk management
The purpose of the Bank's risk management unit is to identify, quantify, control and report on the risks that the Group is exposed to in its daily activities. The unit also participates in drafting the overall risk policy and has representatives on the ALCO committee, Credit committee and the Quality and Security committee. The unit's main activities include monitoring and managing credit risk, market risk, liquidity risk and operational risk. The Board of Directors sets the rules and guidelines regarding the Group's risk policy and the obligations of risk management and credit control. The division reports regularly on the Group's positions and exposure to risk to the Board of Directors, the CEO and to the ALCO committee.
- f. Compliance Officer
The Compliance unit ensures that the Group adheres to its rules on securities trading and insider trading and operation comply with the Act on Securities Transactions, the Act on Actions to Combat Money Laundering and Terrorist Financing and other relevant legislation and regulations.
- g. Internal Audit
Internal audit has the role to give objective opinion on the Group's operations and advisory that aims to increase its value, and to strengthen risk management and internal control. The tasks of internal audit and main emphasis are to estimate whether processes and systems are in place, and whether they are relevant and efficient. Internal auditor is recruited by the Board of Directors and is located accordingly in the hierarchy. It's operations cover all units of operations, including subsidiaries.

40. Hedging

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

Notes to the Consolidated Financial Statements

41. Credit risk - overview

a. Definition

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

b. Management

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

c. Credit approval process

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

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

d. Collateral

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

The Group places emphasis on pricing loans according to the value and quality of pledged collateral. The Group applies appropriate haircuts on all collateral in order to ensure proper risk mitigation. For all collateral in listed securities, the Group maintains the right to liquidate collateral in case its market value falls below a predefined limit.

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

e. Credit rating, control and provisioning

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

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

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

f. Loan portfolio management

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

g. Impairment

The Group's impairment policy is discussed in notes 80-81.

h. Renegotiation of terms and forbearance

The Group's forbearance policy is discussed in note 81.

i. Derivatives

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

j. Securities used for hedging

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

Notes to the Consolidated Financial Statements

Risk management

42. Maximum exposure to credit risk

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

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2016
Cash and cash equivalents	8,768,932	3,263,947			12,032,879
Fixed income securities	2,005,306	1,940,472			3,945,778
Securities used for hedging	5,298,637	21,243			5,319,880
Loans to customers		192	23,870,342	2,144,787	26,015,321
Derivatives		197,160	340,307	15,026	552,493
Other assets	901	81,402	742,796		825,099
	16,073,777	5,504,417	24,953,444	2,159,813	48,691,450
Loan commitments	100	249,794	3,114,935	571,296	3,936,125
Financial guarantee contracts			448,970	1,410	450,380
Total	16,073,877	5,754,211	28,517,349	2,732,519	53,077,954

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2015
Cash and cash equivalents	16,440,893	3,476,080			19,916,973
Fixed income securities	1,758,550	2,741,719	148,833		4,649,103
Securities used for hedging	1,612,202				1,612,202
Loans to customers	3,997	374,228	16,019,757	5,194,757	21,592,738
Derivatives		210,462	112,745	4,785	327,993
Other assets	41,995	54,173	525,489	3,534	625,190
	19,857,637	6,856,662	16,806,825	5,203,075	48,724,199
Loan commitments	100	155,949	2,377,348	581,524	3,114,921
Financial guarantee contracts			537,941	2,380	540,321
Total	19,857,737	7,012,611	19,722,114	5,786,980	52,379,441

43. Credit quality of financial assets

a. Breakdown

Credit quality of financial assets is specified as follows:

	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Less specific impairment allowance	Less collective impairment allowance	Carrying amount
31.12.2016							
Cash and cash equivalents	12,032,879			12,032,879			12,032,879
Receivables from Central Bank				0			0
Fixed income securities	3,945,778			3,945,778			3,945,778
Securities used for hedging	5,319,880			5,319,880			5,319,880
Loans to customers	25,034,535	1,233,180	54,217	26,321,932	(44,404)	(262,208)	26,015,321
Derivatives	552,493			552,493			552,493
Other assets	817,194		12,978	830,172	(73)	(5,000)	825,099
Total	47,702,759	1,233,180	67,195	49,003,135	(44,477)	(267,208)	48,691,450

Notes to the Consolidated Financial Statements

43. Credit quality of financial assets (cont.)

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

b. Past due but not individually impaired

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

	31.12.2016	31.12.2015
Past due 1-30 days	779,818	742,618
Past due 31-60 days	76,763	25,053
Past due 61-90 days	34,066	120,224
Past due 91-180 days	254,053	21,544
Past due 180-360 days	86,645	62,660
Past due more than 360 days	1,835	11,054
Total	1,233,180	983,153

c. Individually impaired

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

	Impaired but not Past due	Past due 1-30 days	Past due 31-60 days	Past due 60-90 days	Past due over 90 days	Claim value
31.12.2016						
Corporate						
Services					33	33
Holding companies						0
Retail		11,795			409	12,204
Real estate, construction and industry						0
Individuals	332		741		53,886	54,959
Total	332	11,795	741	0	54,328	67,195

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

Notes to the Consolidated Financial Statements

44. Breakdown of loans to customers

a. By industry

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

	Claim value	Impairment allowance	Carrying amount	%
31.12.2016				
Public entities	0	0	0	0.0%
Financial institutions	194	(2)	192	0.0%
Corporate				
Services	9,854,258	(98,138)	9,756,120	37.5%
Holding companies	8,007,463	(79,674)	7,927,789	30.5%
Retail	2,050,827	(26,533)	2,024,294	7.8%
Real estate, construction and industry	2,934,062	(29,220)	2,904,842	11.2%
Other	1,269,944	(12,647)	1,257,297	4.8%
Individual	2,205,183	(60,397)	2,144,787	8.2%
Total	26,321,932	(306,611)	26,015,321	100.0%

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

b. By seniority

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

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

The breakdown of loans by categories is as follows:

	Senior I	Senior II	Junior	Mezzanine	31.12.2016
Neither past due nor individually impaired	7,508,171	9,453,015	5,272,486	2,595,227	24,828,899
Past due but not individually impaired	103,068	850,635	34,232	188,674	1,176,609
Individually impaired			5,092	4,722	9,813
Total	7,611,239	10,303,650	5,311,810	2,788,623	26,015,321

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

Notes to the Consolidated Financial Statements

45. Collateral and other credit enhancements

a. Valuation

The Group applies the same valuation methods to collateral held as other comparable assets held by the Group. The methods used for financial assets are outlined in note 59. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2016
Financial institutions	1,613		4,593	139,100			145,307
Corporate customers	1,131,224	158,720	8,876,706	9,187,516	79,110	2,291,118	21,724,394
Individuals	596,001	3,717	900,443	1,690,500		72,861	3,263,522
Total	1,728,838	162,437	9,781,742	11,017,116	79,110	2,363,979	25,133,223

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

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

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2016
Financial institutions	121,270	62,716	1,104,215				1,288,201
Corporate customers	425,072	27,040	161,865				613,977
Individuals	12,461	23,435	7,362				43,258
Total	558,804	113,190	1,273,442	0	0	0	1,945,436

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

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

46. Foreclosed assets

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

	31.12.2016	31.12.2015
Buildings and land	0	32,395
Total	0	32,395

Notes to the Consolidated Financial Statements

47. Loan-to-value

a. General

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

b. Breakdown

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

	31.12.2016	%	31.12.2015	%
Less than 50%	10,532,850	40.5%	5,631,820	26.1%
51-70%	8,883,928	34.1%	8,478,930	39.3%
71-90%	2,921,438	11.2%	3,189,633	14.8%
91-100%	580,677	2.2%	613,606	2.8%
More than 100%	1,912,570	7.4%	2,404,247	11.1%
No collateral	1,183,858	4.6%	1,274,503	5.9%
Total	26,015,321	100.0%	21,592,738	100.0%

48. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 625/2013 on financial institutions' large exposures, total exposure towards a customer is classified as a large exposure if it exceeds 10% of the Bank's capital base (see note 38).

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

	31.12.2016		31.12.2015	
	Number	Amount	Number	Amount
Large exposures before risk adjusted mitigation				
10-20% of capital base	9	8,371,512	7	6,476,091
20-25% of capital base	0	0	0	0
Exceeding 25% of capital base	0	0	1	1,680,741
Total	9	8,371,512	8	8,156,833
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	1	1,066,824	3	1,777,595
Large exposures net of risk adjusted mitigation	4	3,539,017	2	1,774,606

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

49. Liquidity risk

a. Definition

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

b. Management

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

The Group was in compliance with internal and external liquidity requirements throughout the years 2016 and 2015. At year-end 2016 the liquidity coverage ratio (LCR) was 152%.

Notes to the Consolidated Financial Statements

49. Liquidity risk

Maturity analysis of financial assets and financial liabilities

31.12.2016	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Financial assets by type							
<i>Non-derivative assets</i>							
Cash and cash equivalents	12,032,879					12,032,879	12,032,879
Fixed income securities	3,796,989	155,786				3,952,775	3,945,778
Shares and other variable income securities	2,347,676	108,784	398,787			2,855,248	3,154,466
Securities used for hedging	12,386,983					12,386,983	12,389,392
Loans to customers	2,651,812	2,317,530	14,134,985	7,351,537	2,093,201	28,549,065	26,015,321
Other assets	189,555	406,096	229,448			825,099	825,099
	33,405,894	2,988,195	14,763,221	7,351,537	2,093,201	60,602,049	58,362,935
<i>Derivative assets</i>							
Inflow	3,313,749	1,400,801	61,736	14,656		4,790,942	
Outflow	(3,004,761)	(1,310,430)	(4,874)	(295)		(4,320,359)	
	308,989	90,371	56,862	14,361	0	470,583	552,493
Financial liabilities by type							
<i>Non-derivative liabilities</i>							
Deposits from customers	(28,279,499)	(4,971,818)	(128,723)	(24,616)		(33,404,656)	32,478,933
Deposits from credit institutions						0	
Borrowings	(863,954)	(7,730,163)	(4,881,445)			(13,475,562)	13,498,785
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,922,918
Subordinated liabilities	(30,409)		(30,892)	(123,566)	(685,232)	(870,099)	572,385
Short positions held for trading	(80,366)					(80,366)	80,186
Short positions used for hedging	(2,733)					(2,733)	
Other liabilities	(262,314)	(655,445)	(182,653)	(19,885)		(1,120,297)	1,101,679
	(29,519,275)	(15,357,426)	(7,223,713)	(168,067)	(685,232)	(52,953,713)	51,654,885
<i>Derivative liabilities</i>							
Inflow	11,102,030	107,974	76,717			11,286,721	
Outflow	(11,630,563)	(114,400)	(80,457)			(11,825,420)	
	(528,533)	(6,426)	(3,740)	0	0	(538,699)	498,769
Unrecognized financial items							
<i>Loan commitments</i>							
Inflow	159,202	411,530	2,357,881	1,168,847		4,097,461	
Outflow	(3,936,125)					(3,936,125)	
<i>Financial guarantee contracts</i>							
Inflow	450,380					450,380	
Outflow	(450,380)					(450,380)	
	(3,776,922)	411,530	2,357,881	1,168,847	0	161,336	
Summary							
Non-derivative assets	33,405,894	2,988,195	14,763,221	7,351,537	2,093,201	60,602,049	
Derivative assets	308,989	90,371	56,862	14,361		470,583	
Non-derivative liabilities	(29,519,275)	(15,357,426)	(7,223,713)	(168,067)	(685,232)	(52,953,713)	
Derivative liabilities	(528,533)	(6,426)	(3,740)			(538,699)	
Net assets (liabilities) excluding unrecognized items	3,667,075	(12,285,286)	7,592,631	7,197,831	1,407,970	7,580,221	
Net unrecognized items	(3,776,922)	411,530	2,357,881	1,168,847		161,336	
Net assets (liabilities)	(109,847)	(11,873,756)	9,950,512	8,366,678	1,407,970	7,741,557	

Notes to the Consolidated Financial Statements

49. (cont.)

31.12.2015	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Financial assets by type							
<i>Non-derivative assets</i>							
Cash and cash equivalents	19,929,033					19,929,033	19,916,973
Fixed income securities	4,456,504	192,598				4,649,103	4,649,103
Shares and other variable income securities	2,369,818	102,144	534,080			3,006,042	3,006,042
Securities used for hedging	11,057,833					11,057,833	11,057,833
Loans to customers	3,131,621	1,912,750	7,082,554	8,683,177	7,093,109	27,903,210	21,592,738
Other assets	53,638	187,331	384,221			625,190	625,190
	40,998,447	2,394,823	8,000,856	8,683,177	7,093,109	67,170,411	60,847,879
<i>Derivative assets</i>							
Inflow	6,790,416	1,464,205		51,312		8,305,932	
Outflow	(6,594,796)	(1,377,726)		(5,418)		(7,977,940)	
	195,620	86,479	0	45,894	0	327,993	327,993
Financial liabilities by type							
<i>Non-derivative liabilities</i>							
Deposits from customers	(23,441,881)	(3,687,399)	(2,450,025)	(1,031,159)	(99,059)	(30,709,523)	30,544,407
Deposits from credit institutions	(714,134)					(714,134)	714,134
Borrowings	(3,037,419)	(9,237,150)	(3,116,222)			(15,390,791)	15,220,126
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,908,480
Subordinated liabilities			(30,008)		(701,495)	(731,504)	562,339
Short positions held for trading	(783,662)					(783,662)	783,662
Short positions used for hedging	(1,024,390)					(1,024,390)	1,024,390
Other liabilities		(1,310,733)				(1,310,733)	1,310,733
	(29,001,486)	(16,235,282)	(7,596,255)	(1,031,159)	(800,555)	(54,664,736)	54,068,271
<i>Derivative liabilities</i>							
Inflow	9,036,198	541,918				9,578,116	
Outflow	(9,829,366)	(736,236)				(10,565,602)	
	(793,168)	(194,319)	0	0	0	(987,486)	987,486
Unrecognized financial items by type							
<i>Loan commitments</i>							
Inflow	296,910	1,120,322	1,788,736	2,099		3,208,067	
Outflow	(3,114,921)					(3,114,921)	
<i>Financial guarantee contracts</i>							
Inflow	540,321					540,321	
Outflow	(540,321)					(540,321)	
	(2,818,011)	1,120,322	1,788,736	2,099	0	93,146	
Summary							
Non-derivative assets	40,998,447	2,394,823	8,000,856	8,683,177	7,093,109	67,170,411	
Derivative assets	195,620	86,479		45,894		327,993	
Non-derivative liabilities	(29,001,486)	(16,235,282)	(7,596,255)	(1,031,159)	(800,555)	(54,664,736)	
Derivative liabilities	(793,168)	(194,319)				(987,486)	
Net assets (liabilities) excluding unrecognized items							
Net unrecognized items	(2,818,011)	1,120,322	1,788,736	2,099		93,146	
Net assets (liabilities)	8,581,403	(12,827,977)	2,193,338	7,700,011	6,292,555	11,939,328	

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

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

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

Notes to the Consolidated Financial Statements

50. Market risk

- a. Definition
Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk. Notes 51-56 relate to market risk exposure.
- b. Management
The Group has a strict policy on controlling market risk and to keep the exposure within set limits. The risk management unit monitors market risk limits on a daily basis and reports regularly to the ALCO committee and to the CEO.

51. Interest rate risk

- a. Definition
The Group's exposure to interest rate risk is twofold. On the one hand, the Group has a proprietary portfolio of bonds, where market rates affect prices and any fluctuations are recognised in the income statement. On the other hand, the Group has mismatch in assets and liabilities with fixed interest terms. These include loans and swap contracts for securities on the asset side and borrowings and deposits on the liability side. This mismatch does not create an immediate effect on the income statement but nevertheless affects the Group's economic value.
- Proprietary positions which are subject to interest rate risk fall under the scope of the Group's market risk management.
- b. Management
The Group takes measures to minimise interest rate risk by matching the interest rate profile and duration of assets with the Group's liabilities as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Group's earnings.

52. Interest rate risk associated with trading portfolios

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

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2016
Fixed income securities			60,943	2,355,274	1,581,206	3,997,424
Short positions - fixed income securities				(80,366)	(497,965)	(578,331)
Net imbalance	0	0	60,943	2,274,908	1,083,242	3,419,093
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2015
Fixed income securities			426,664	2,897,702	1,324,736	4,649,103
Short positions - fixed income securities					(783,662)	(783,662)
Net imbalance	0	0	426,664	2,897,702	541,074	3,865,441

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

	Shift in basis points	31.12.2016 Downward	31.12.2016 Upward	31.12.2015 Downward	31.12.2015 Upward
Indexed	50	43,866	(43,866)	(7,915)	7,915
Non-indexed	100	29,431	(29,431)	121,360	(121,360)
Total		73,297	(73,297)	113,445	(113,445)

53. Interest rate risk associated with non-trading portfolios

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

31.12.2016						
Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	11,643,171	389,709				12,032,879
Loans to customers	24,479,523	987,649	266,547	226,797	54,804	26,015,321
Financial assets excluding derivatives	36,122,694	1,377,358	266,547	226,797	54,804	38,048,200
Effect of derivatives	13,719,544	18,544	500,000	520,000		14,758,087
Total	49,842,237	1,395,902	766,547	746,797	54,804	52,806,287

Notes to the Consolidated Financial Statements

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

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	32,459,684	4,398			14,851	32,478,933
Deposits from credit institutions						0
Borrowings	858,746	7,861,950	4,778,090			13,498,785
Issued bills		1,975,136	1,947,782			3,922,918
Subordinated liabilities					572,385	572,385
Financial liabilities excluding derivatives	33,318,429	9,841,484	6,725,872	0	587,236	50,473,020
Effect of derivatives	1,528,157	500,000				2,028,157
Total	34,846,586	10,341,484	6,725,872	0	587,236	52,501,177
Total interest repricing gap	14,995,651	(8,945,582)	(5,959,324)	746,797	(532,432)	305,110

31.12.2015

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

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	30,428,269	522	97,118		18,498	30,544,407
Deposits from credit institutions	714,134					714,134
Borrowings	3,037,948	9,154,793	3,027,386			15,220,126
Issued bills						0
Subordinated liabilities					562,339	562,339
Financial liabilities excluding derivatives	34,180,351	9,155,315	3,124,504	0	580,837	47,041,006
Effect of derivatives	3,583,064	1,144,293				4,727,357
Total	37,763,414	10,299,608	3,124,504	0	580,837	51,768,363
Total interest repricing gap	9,950,748	(5,247,235)	(1,854,867)	1,575,007	(453,061)	3,970,593

b. Sensitivity analysis

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

Currency	Shift in basis points	Downward	31.12.2016 Upward	Downward	31.12.2015 Upward
ISK, indexed	50	(2,987)	2,987	(194)	194
ISK, non-indexed	100	39,081	(39,081)	(11,541)	11,541
Other currencies	20	42	(42)	159	(159)
Total		36,137	(36,137)	(11,575)	11,575

Notes to the Consolidated Financial Statements

54. Exposure towards changes in the CPI

a. Definition

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

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

b. Management

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

c. Balance of CPI linked assets and liabilities

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

	31.12.2016	31.12.2015
Assets	6,124,041	6,991,287
Liabilities	(4,882,993)	(5,497,903)
Total	1,241,048	1,493,384

d. Sensitivity to changes in CPI

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

	31.12.2016		31.12.2015	
	-1%	1%	-1%	1%
Government bonds	(9,783)	9,783	(658)	658
Other fixed income securities	(13,328)	13,328	(8,173)	8,173
Loans to customers	(27,930)	27,930	(50,883)	50,883
Derivatives	(10,200)	10,200	(10,200)	10,200
Short positions	3,200	(3,200)	7,295	(7,295)
Deposits	40,130	(40,130)	42,184	(42,184)
Subordinated debt	5,500	(5,500)	5,500	(5,500)
	(12,410)	12,410	(14,934)	14,934

The effect on equity would be the same.

55. Currency risk

a. Definition

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

b. Management

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

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2016 and 31 December 2015 the Group's position in foreign currencies was within those limits.

c. Exchange rates

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

	Closing 31.12.2016	Average 2016	Closing 31.12.2015	Average 2015
EUR/ISK	119.1	133.6	141.3	146.3
USD/ISK	112.8	120.7	129.6	131.9

Notes to the Consolidated Financial Statements

55. Currency risk (cont.)

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

31.12.2016

Financial assets

	EUR	USD	GBP	NOK	Other currencies	Total
Cash and cash equivalents	1,640,515	479,221	394,601	117,095	202,072	2,833,504
Fixed income securities		389,709				389,709
Shares and other variable income securities	1,887					1,887
Loans to customers	1,197,770	296,109			146,062	1,639,941
Other assets		22,925				22,925
Financial assets excluding derivatives	2,840,173	1,187,963	394,601	117,095	348,134	4,887,966
Derivatives	502,160	169,531				671,691
Total	3,342,333	1,357,494	394,601	117,095	348,134	5,559,657

Financial liabilities

	EUR	USD	GBP	NOK	Other currencies	Total
Deposits from customers	1,355,102	789,223	392,095	71,152	118,460	2,726,032
Borrowings	35,978					35,978
Financial liabilities excluding derivatives	1,391,080	789,223	392,095	71,152	118,460	2,762,010
Derivatives	1,906,080	564,100			111,888	2,582,068
Total	3,297,160	1,353,323	392,095	71,152	230,348	5,344,078

Net currency position

	EUR	USD	GBP	NOK	Other currencies	Total
Financial assets	3,342,333	1,357,494	394,601	117,095	348,134	5,559,657
Financial liabilities	(3,297,160)	(1,353,323)	(392,095)	(71,152)	(230,348)	(5,344,078)
Financial guarantee contracts	32,165					32,165
Total	77,338	4,171	2,506	45,943	117,786	247,744

31.12.2015

Financial assets

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

Financial liabilities

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

Net currency position

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

Notes to the Consolidated Financial Statements

55. Currency risk (cont.)

e. Sensitivity to currency risk

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

	31.12.2016		31.12.2015	
	-10%	+10%	-10%	+10%
Assets and liabilities denominated in foreign currencies				
EUR	7,734	(7,734)	(4,759)	4,759
USD	417	(417)	4,583	(4,583)
GBP	251	(251)	(6,218)	6,218
NOK	4,594	(4,594)	1,009	(1,009)
Other currencies	11,779	(11,779)	21,522	(21,522)
Total	24,774	(24,774)	16,138	(16,138)

The effect on equity would be the same.

56. Other price risk

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

	31.12.2016			31.12.2015		
	Average	Max	Exposure	Average	Max	Exposure
Listed shares	1,179,342	1,706,461	1,145,862	550,031	1,373,262	725,822
Unlisted shares	623,585	819,213	567,776	417,564	692,292	527,601
Unlisted unit shares	1,396,410	3,216,784	1,442,194	751,839	1,206,151	1,102,037
Total			3,155,832			2,355,461

57. Operational risk

a. Definition

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

b. Management

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

Notes to the Consolidated Financial Statements

Financial assets and liabilities

58. Accounting classification of financial assets and liabilities

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

31.12.2016

Financial assets	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Cash and cash equivalents			12,032,879		12,032,879
Fixed income securities	3,945,778				3,945,778
Shares and other variable income securities	2,719,252	435,213			3,154,466
Securities used for hedging	12,389,392				12,389,392
Loans to customers			26,015,321		26,015,321
Derivatives	552,493				552,493
Other assets			825,099		825,099
Total	19,606,915	435,213	38,873,299	0	58,915,428

Financial liabilities	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Deposits from customers				32,478,933	32,478,933
Deposits from credit institutions					0
Borrowings				13,498,785	13,498,785
Issued bills				3,922,918	3,922,918
Subordinated liabilities				572,385	572,385
Short positions held for trading	80,186				80,186
Short positions used for hedging					0
Derivatives	498,769				498,769
Other liabilities				1,101,679	1,101,679
Total	578,955	0	0	51,574,699	52,153,654

31.12.2015

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

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

Notes to the Consolidated Financial Statements

59. Financial assets and liabilities measured at fair value

a. Fair value hierarchy

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

- Level 1

Inputs are quoted market prices (unadjusted) in active markets for identical instruments.

- Level 2

Inputs are not quoted market prices but are observable either directly, i.e. as prices, or indirectly, i.e. derived from prices. This category includes financial instruments valued using quoted prices in active markets for similar instruments, quoted prices for similar or identical instruments in markets that are considered less than active and other instruments which are valued using techniques which rely primarily on inputs that are directly or indirectly observable from market data.

- Level 3

Inputs are not observable or unobservable inputs have a significant effect on the valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments are required to reflect the differences between the instruments.

b. Valuation process

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

c. Valuation techniques

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

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

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

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

Notes to the Consolidated Financial Statements

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

d. Fair value hierarchy classification

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

31.12.2016

Financial assets

	Level 1	Level 2	Level 3	Carrying amount
Held for trading				
Fixed income securities	3,945,778			3,945,778
Shares and other variable income securities	2,597,078	18,950	103,224	2,719,252
Securities used for hedging	12,389,392			12,389,392
Derivatives		477,199	75,294	552,493
Designated at fair value				
Fixed income securities				0
Shares and other variable income securities		287	434,926	435,213
Total	18,932,248	496,436	613,444	20,042,129

Financial liabilities

	Level 1	Level 2	Level 3	Carrying amount
Held for trading				
Short positions held for trading	80,186			80,186
Short positions used for hedging				0
Derivatives		498,769		498,769
Total	80,186	498,769	0	578,955

There were no transfers between levels during the year.

31.12.2015

Financial assets

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

Financial liabilities

	Level 1	Level 2	Level 3	Carrying amount
Held for trading				
Short positions held for trading	783,654	7		783,662
Short positions used for hedging	1,024,390			1,024,390
Derivatives		987,486		987,486
Total	1,808,045	987,494	0	2,795,538

There were no transfers between levels during the year.

Notes to the Consolidated Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

	Fixed income securities	Shares and other var. income securities	Derivatives	Total
31.12.2016				
Balance as at 1 January 2016	0	533,838	0	533,838
Total gains and losses in profit or loss		107,783		107,783
Additions through a merger		0		0
Purchases		447,321	75,294	522,615
Sales		(550,791)		(550,791)
Balance as at 31 December 2016		538,151	75,294	613,444

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

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

	Fixed income securities	Shares and other var. income securities	Total
Net financial income - 2016			
Financial assets designated at fair value through profit or loss		107,783	107,783
Total	0	107,783	107,783

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

g. Fair value measurements for Level 3 financial assets

Level 3 assets consist primarily of highly illiquid, unlisted bonds, shares and share certificates. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2016:

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2016
Unlisted shares	P/B multiplier	Equity	0.5-1.5	533,716
Unlisted unit shares	Investment multiplier	Original investment	0.04	4,434
Derivatives	Discounted cash flow	Equity	-	75,294
Total				613,444

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2015
Unlisted shares	P/B multiplier	Equity	1.0-1.5	527,358
Unlisted unit shares	Investment multiplier	Original investment	0.05	6,480
Derivatives				
Total				533,838

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

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

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

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

	+10%	-10%
Shares and other variable income securities	7,529	(7,529)
Total	7,529	(7,529)

Notes to the Consolidated Financial Statements

60. Financial assets and liabilities not measured at fair value

The Group holds financial instruments which are not measured at fair value. Except for loans to customers, the Group believes that the best estimate of the fair value of these financial instruments is equal to the carrying amount at the reporting date and does therefore not report a fair value for these financial instruments. Loans to customers are classified as level 3, in the fair value hierarchy, and have a book value of ISK 26,015,320 thousand at end of December 2016. The estimated fair value of loans to customers at end of December 2016 is ISK 25,248,591 thousand.

Cash and cash equivalents includes several components as detailed in note 13. Cash equivalent assets are either balances available on-demand or on very short notice, or other assets easily converted to cash. Other financial assets consist primarily of short-term receivables. The carrying amount of these assets is therefore a reasonable approximation of their fair value.

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

Notes to the Consolidated Financial Statements

Segment information

61. Geographical information

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

Net operating income	2016	2015
Iceland	5,657,840	4,654,901
Other regions	(26)	(28,219)
Eliminations	(339,578)	(194,570)
Total	5,318,236	4,432,112
Total assets	31.12.2016	31.12.2015
Iceland	61,092,429	65,153,797
Other regions	24,856	26,328
Eliminations	(1,553,926)	(3,566,369)
Total	59,563,359	61,613,757

62. Business segments

Segment reporting is based on the same principles and structure as internal reporting to senior management and the board of directors. Segment performance is evaluated on earnings before tax.

a. Reportable segments

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

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

Information about other divisions of the Bank, e.g. non-revenue generating divisions, is presented under the heading Other operations.

Following the merger with Straumur fjárfestingabanki hf. the Bank's organizational chart and operating segments were changed, beginning from 1 January 2016. The change involved, among other things, the transfer of certain products and revenue streams between segments. As a result no comparative information is available for the year 2015.

Notes to the Consolidated Financial Statements

62. Business segments (cont.)

	Corporate Banking	Corporate Finance	Capital Markets	Proprietary trading and Treasury	Asset Management	Support functions and eliminations	Total
2016							
Net interest income	1,015,606	5,759	149,789	(109,857)	3,580	(597)	1,064,281
Net fee and commission income	494,249	288,834	839,063	81,973	1,204,196	(68,127)	2,840,188
Net financial income	361,432	0	2,225	910,423	8,610	0	1,282,690
Share in loss of discontinued operations	(13,488)						(13,488)
Share in profit of associates	148,985						148,985
Other operating income	(11,581)	4,887	1,964	100	3,870	(3,659)	(4,420)
Total operating income	1,995,202	299,481	993,040	882,639	1,220,256	(72,383)	5,318,236
Salaries and related expenses	(182,151)	(177,542)	(330,036)	(155,420)	(482,714)	(746,016)	(2,073,879)
Other operating expenses	(289,309)	(44,745)	(150,284)	(50,360)	(177,262)	(433,566)	(1,145,528)
Impairment of loans and receivables	(228,349)					2,000	(226,349)
Loss from assets held for sale	(3,395)						(3,395)
Profit (loss) before cost allocation and tax	1,295,393	77,194	512,720	676,858	560,280	(1,249,964)	1,869,086
Net segment revenue from external customers	1,514,525	299,481	1,569,854	786,501	1,220,256	(72,383)	5,318,235
Net segment revenue from other segments	480,677	0	(576,815)	96,138	0	0	0

Internal reporting is based on the results of the Bank, which accounts for around 88% of the net operating income of the Group, and do not take into account the effects of consolidation. As a result, elimination entries are needed to reconcile internal reporting with consolidated results. Elimination entries arise primarily from interest calculated on internal balances, share in the results of subsidiaries and fees charged for services the parent provides to subsidiaries.

Notes to the Consolidated Financial Statements

Other information

63. Operating lease commitments

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

	31.12.2016	31.12.2015
Up to 1 year	59,067	83,525
1-5 years	228,944	229,199
Later than 5 years	235,649	289,525
Total	523,659	602,248

64. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland to the amount of ISK 2.6 billion as at 31 December 2016 (2015: 3.0 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 0.5 billion as at 31 December 2016 (2015: 1.7 billion).

65. Related parties

a. Definition of related parties

The Group has a related party relationship with the board members of the Bank, the CEO of the Bank and key employees (together referred to as management), associates as disclosed in note 21, shareholders with significant influence over the Bank (defined as holding 10% or greater of the shares in the Bank as disclosed in note 69), close family members of individuals identified as related parties and entities under the control or joint control of related parties.

b. Arm's length

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

c. Effects on statement of financial position

	Loans & receivables	Deposits & payables
31.12.2016		
Shareholders	70	136,567
Management	15,066	720,184
Associates	416,056	63,536
Total	431,192	920,287

	Loans & receivables	Deposits & payables
31.12.2015		
Shareholders	1,291	61,950
Management	7,136	727,446
Associates	0	0
Total	8,426	789,397

e. Effects on income statement

	Interest income	Interest expense	Fees received	Fees paid
2016				
Shareholders	15	5,972	16,463	18,530
Management	508	18,031	4,724	69,341
Associates	11,790	197	8,973	0
Total	12,312	24,200	30,160	87,871

	Interest income	Interest expense	Fees received	Fees paid
2015				
Shareholders	4	3,305	7,559	14,280
Management	134	22,448	2,569	12,183
Associates	0	0	0	0
Total	138	25,753	10,128	26,463

Further information about salaries and benefits paid to the Board of Directors, the CEO and Managing Directors is provided in note 9.

Notes to the Consolidated Financial Statements

66. Remuneration policy

The Board of Directors has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy was approved by the Bank's Annual General Meeting in March 2016.

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

67. Incentive scheme

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

a. Description

The incentive scheme conforms to the Icelandic FSA's directive No. 700/2011 on Incentive Schemes. Payments according to the scheme are based on key performance indicators (KPIs) that reflect the goals of the Bank, the division and the employee. The basis for performance based pay reflects sound risk management and does not induce excessive risk taking. Performance based pay to individual employees does not exceed 25% of their annual base salary, and payment of 40-60% of the performance based pay is deferred for three years. Performance based pay can be in the form of cash payments or share options. Share based payments are discussed in note 68.

b. Performance based payments

	2016	2015
	Cash	Cash
Non-deferred	0	9,669
Deferred	(10,846)	2,400
Total	(10,846)	12,069

c. On-balance sheet deferred performance based payments

	31.12.2016	31.12.2015
Deferred cash payments	3,117	38,957
Deferred cash payments, acquired via merger	16,768	31,570
Total	19,885	70,527

68. Share-based payments

The remuneration policy approved by the Board of Directors of the Bank includes a share-based incentive scheme. The Board of Directors is authorised to increase the share capital of the Bank, in accordance with the Articles of Association, to fulfil any obligations arising from the scheme.

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

As at 31 December 2016, the Bank had enrolled 4 employees in the share-based incentive scheme, based on the share-based incentive scheme from 2012, with a total number of options granted equalling 17 million shares in the bank. Options vested as at 31 December 2016 amounted to 11 million shares, no options were exercised in 2016.

No options were granted during the years 2015 and 2016.

Notes to the Consolidated Financial Statements

69. Shareholders of the Bank

Ownership in the Bank is specified as follows:

Shareholder	Country	31.12.2016	31.12.2015	Beneficial owners
		%	%	
Lífeyrissjóður verzlunarmanna	Iceland	9.53%	9.90%	
Brimgarðar ehf	Iceland	8.31%	1.95%	Eggert Árni Gíslason (10%), Halldór Páll Gíslason (10%), Guðný Edda Gísladóttir (10%), Gunnar Þór Gíslason (10%), Cold Rock Investments Ltd. (60%)
K2B fjárfestingar ehf.	Iceland	8.00%	-	Svanhildur Nanna Vigfúsdóttir (100%)
Varða Capital ehf.	Iceland	7.69%	7.99%	Grímur Alfreð Garðarsson (50%), Edward Schmidt (25%), Jónas Hagan Guðmundsson (25%)
Sigla ehf.	Iceland	7.27%	7.55%	Tómas Kristjánsson (50%), Finnur Reyr Stefánsson (25%), Steinunn Jónsdóttir (25%)
Títan B ehf.	Iceland	7.27%	7.23%	Skúli Mogensen (100%)
Grandier ehf.	Iceland	7.00%	-	Sigurður Bollason (50%), The Don McCarthy Legacy Trust (50%)
Ingimundur hf.	Iceland	6.61%	6.86%	Ármann Ármannsson (99.71%)
Mízar ehf.	Iceland	6.60%	6.86%	Guðmundur Steinar Jónsson (100%)
Fagfjárfestasjóðurinn Norðurljós	Iceland	5.77%	5.99%	Investment fund managed by Júpiter rekstrarfélag hf.
Tryggingamiðstöðin hf.	Iceland	3.60%	3.74%	
Eignasafn Seðlabanka Íslands ehf.	Iceland	3.06%	3.18%	Central Bank of Iceland
MP Canada Iceland Ventures Inc.	Canada	2.40%	2.49%	Robert Raich (100%)
Kvika banki hf.	Iceland	1.98%	0.87%	
Alkor ehf.	Iceland	1.94%	2.01%	Berglind Björk Jónsdóttir (100%)
Eiríks ehf.	Iceland	1.80%	-	Stefán Eiríks Stefánsson (100%)
P 126 ehf.	Iceland	1.20%	1.25%	Einar Sveinsson (100%)
Stekkur fjárfestingarfélag ehf	Iceland	1.20%	1.25%	Kristinn Aðalsteinsson (100%)
Others, each less than 1%		8.76%	30.89%	2016: 36, 2015: 56
		100.00%	100.00%	

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

70. Other matters

In November 2016 the Bank announced that the Board of Directors of the Bank and Virðing hf. had signed a letter of intent concerning preparations for the merger of the two companies under the name Kvika. In the letter of intent it is revealed that before the merger, the Bank's equity will be reduced by ISK 600 million and the reduction distributed to its shareholders. Following the merger, Kvika shareholders will own 70% in the merged company and Virðing shareholders 30%. Work related to the preparations for the merger is still ongoing. The Kvika-Virðing merger will create a strong financial institution that will play a leading role in the Icelandic investment banking market. The merged company will be one of Iceland's largest asset management firms, with about ISK 220 billion under management, including number of mutual funds, investment funds, private equity funds, real estate funds, credit funds, and various institutional investment funds. In addition, the merged company will provide strong capital markets, corporate finance, specialised lending, and private banking services.

71. Events after the reporting date

There are no material events after the reporting date.

Notes to the Consolidated Financial Statements

Significant accounting policies

72. Basis of consolidation

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

a. Subsidiaries

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

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

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

b. Non-controlling interest

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

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

c. Fiduciary services

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

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

d. Transactions eliminated on consolidation

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

e. Structured entities

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

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

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

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

Notes to the Consolidated Financial Statements

73. Foreign currency

a. Foreign currency transactions

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

Foreign currency differences are posted as a separate line item under net financial income as disclosed in notes 5 and 84.

b. Foreign operations

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

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

74. Recognition and derecognition of financial assets and liabilities

a. Recognition

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

b. Derecognition

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

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

75. Offsetting

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

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

76. Amortised cost measurement of financial assets and liabilities

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

77. Financial guarantees

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

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

Notes to the Consolidated Financial Statements

78. Financial instruments - accounting classification

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

a. Held for trading

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

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

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

b. Designated at fair value

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

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

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

c. Available for sale

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

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

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

d. Loans and receivables

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

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

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

e. Other at amortised cost

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

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

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

Notes to the Consolidated Financial Statements

79. Determination of fair value

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

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. For further information on valuation techniques, refer to notes 59 - 60.

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

80. Impairment

a. General principle

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

b. Reversal of impairment

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

c. Calculation of recoverable amount

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

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

81. Impairment of loans

a. Indications of impairment

Objective evidence of impairment includes information about one or more of the following:

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

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

b. Calculation of impairment losses

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

c. Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. This procedure is applied to all loans that are considered individually significant. In making the assessment, the following factors are considered:

- The Group's aggregate exposure towards the customer
- The amount and timing of expected receipts and recoveries
- The likely recovery upon liquidation or bankruptcy
- Complexity and uncertainty related to ranking of creditor claims and legal standing
- The realisable value of securities or other credit mitigants and the likelihood of successful repossession
- The likely deduction of any costs involved in recovery of amounts outstanding

Notes to the Consolidated Financial Statements

81. Impairment of loans (cont.)

d. Collectively assessed loans

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

The collective impairment loss is determined after taking into account the following:

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

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

e. Loan write-offs

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

f. Forbearance

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

82. Interest income and expense

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

Interest income and expense presented in the income statement includes interest on:

- financial assets classified as loans and receivables
- financial assets classified as available for sale
- financial liabilities carried at amortised cost
- derivatives

Further information about the accounting classification of financial assets and liabilities is provided in notes 58 and 78.

83. Fee and commission income and expense

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

Fee and commission income and expense comprises the following:

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

84. Net financial income

Net financial income comprises the following:

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

85. Dividend income

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

Notes to the Consolidated Financial Statements

86. Administrative expenses

Administrative expenses comprise expenses other than interest expenses, fee and commission expenses and expenses related to fair value changes. A breakdown of administrative expenses is provided in note 7.

87. Employee benefits

a. Short-term employee benefits

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

b. Defined contribution plans

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

c. Shared-based payments

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

88. Income tax

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

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

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

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

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

89. Cash and cash equivalents

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

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

90. Fixed income securities

Fixed income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

91. Shares and other variable income securities

Shares and other variable income securities consist of equity investments and unit shares in mutual funds. Shares and other variable income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

92. Securities used for hedging

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Group's risk exposure arising from derivative contracts with customers. Securities used for hedging are measured at fair value as discussed in note 78.

Notes to the Consolidated Financial Statements

93. Loans to customers

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

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

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

94. Derivatives

A derivative is a financial instrument or another contract that falls under the scope of IAS 39 and has the following three characteristics:

- Its value changes due to changes in an underlying variable, such as bond price, share price, security or price index (including CPI), foreign currency exchange rate or interest rate
- The contract requires no initial investment or an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors
- Settlement takes place at a future date

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

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

95. Investment properties

Investment properties is an asset which is specified for leasing to third parties, for returns or for both purposes.

Investment properties are initially recognised at cost, later on, on fair value. Changes in fair values are recognised as gains or loss in income statement. All gains are unrealised.

96. Intangible assets

a. Asset categories

The Group groups intangible assets into three categories:

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

The Group has not defined any internally generated intangible assets.

b. Initial recognition

Intangible assets are initially recognised at cost.

c. Subsequent measurement

The Group uses the cost model for measurement after recognition and intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognised in accordance with the accounting policy for non-financial assets described in note 81.

d. Amortisation

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

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

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 7. Further breakdown is provided in notes 24-25.

Notes to the Consolidated Financial Statements

97. Property and equipment

- a. Asset categories
The Group groups tangible assets into two categories:
- Real estate, which includes office and residential buildings, land and building rights
 - Other property and equipment, which includes automobiles, furniture and fixtures, computers and other office equipment
- b. Initial recognition
Property and equipment is initially recognised at cost, which includes direct expenses related to the purchase.
- c. Subsequent measurement
The Group uses the cost model for the measurement after recognition and property and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. Property and equipment is reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognized in accordance with the accounting policy for non-financial assets described in note 81.
- d. Subsequent cost
The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The decision, if subsequent costs are added to the acquisition cost of property and equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are expensed in the income statement when incurred.
- e. Depreciation
Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

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

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

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 7. Further breakdown is provided in notes 24-25.

98. Investments in associates

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

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

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

99. Other assets

Other assets are measured at amortised cost.

100. Assets classified as held for sale

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

101. Deposits from customers

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

Notes to the Consolidated Financial Statements

102. Borrowings

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

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

103. Issued bills

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

104. Subordinated liabilities

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

105. Short positions held for trading

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

106. Short positions used for hedging

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

107. Other liabilities

Other liabilities are measured at amortised cost.

108. Share capital

- a. Treasury shares
Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity. Incremental transaction costs of treasury share transactions are accounted for as a deduction from equity, net of any related income tax benefit.
- b. Share premium
Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Group.
- c. Dividends on share capital
Dividends on share capital are deducted from equity in the period in which they are approved by the Group's shareholders meetings.

109. Nature and purpose of equity reserves

- a. Option reserve
The option reserve represents the cumulative charge to the income statement for options to purchase shares in the Bank granted under the Bank's Remuneration policy, which is discussed in notes 66-68.
- b. Warrants reserve
The warrants reserve represents the consideration received for outstanding warrants, as disclosed in note 37.
- c. Deficit reduction reserve
The deficit reduction reserve was created as a part of a share capital reduction approved by the Bank's Annual General Meeting in April 2014, as discussed in note 36. The reserve has no specified purpose and can only be used with the approval of a shareholders' meeting.
- d. Equity instrument reserve
The equity instrument reserve represents the consideration received for financial instruments issued by the Bank, which meet the definition of an equity instrument.
- e. Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations, until the operations are sold, dissolved or abandoned.

Notes to the Consolidated Financial Statements

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

- f. Fair value reserve
The fair value reserve comprises the cumulative net change in the fair value of available for sale financial assets, until the assets are derecognised or impaired.
- f. Restricted retained earnings
According to the Financial Statements Act No. 3/2006 the difference between share of profit of subsidiary or associate in excess of dividend payment or dividend payment pending, shall be transferred to a restricted retained earnings reserve, net of tax, which is not subject to dividend payments. When shareholding in subsidiary or associate is sold or written off the restricted retained earnings reserve shall be released and the amount transferred to retained earnings.
- g. Accumulated deficit - retained earnings
Accumulated deficit (Retained earnings if positive) consists of undistributed profits and losses accumulated, less transfers to other reserves.

110. New standards and interpretations

The Group has adopted amendments to existing standards which became effective for the first time in 2016. The amendments did not have a material effect on these financial statements.

A number of new standards, amendments to standards and interpretations were not yet effective for the year ended 31 December 2016 and have not been applied in the preparation of these financial statements. Early adoption of new standards and amendments is not planned.

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

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

IFRS 16 leases, which will become effective for annual reporting periods beginning on or after 1 January 2019, establishes a comprehensive framework for lease agreements. The new revenue standard will supersede all current revenue recognition requirements under IFRS.

111. Use of estimates and judgements

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

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

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

- a. Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets is determined using valuation techniques which are reviewed regularly as discussed in note 59.
- b. Impairment of financial assets
As outlined in notes 80-81, the use of estimates and judgement is an important component of the calculation of impairment losses. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Unforeseen events could, however, result in further impairment losses which would have a material effect on the income statement and statement of financial position.
- c. Deferred tax assets
Judgement is required to determine the extent to which deferred tax assets are recognised in the statement of financial position, based on the likely timing and level of future taxable profits.