Vátryggingafélag Íslands hf.

Consolidated Financial Statements

2017

Vátryggingafélag Íslands hf.
Ármúli 3
108 Reykjavík
Reg no. 690689-2009

Vátryggingafélag Íslands hf.

Consolidated Financial Statements

2017

Table of Contents

Report and Endorsement of the Board of Directors and the CEO

The consolidated financial statements of Vátryggingafélag Íslands hf. ("the Company" or "VÍS") for the year 2017 consist of the financial statements of the Company and its subsidiary, Líftryggingafélag Íslands hf., together referred to as "the Group". The Company's main operations consist of insurance and investment activities. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and the additional requirements for companies listed on a regulated securities market.

2017 Operations and Financial Position

According to the statement of profit or other comprehensive income the Group´s profits before taxes for the year amounted to ISK 1,739 million, which is a 48% increase from 2016 when profits before taxes amounted to ISK 1,176 million. The Group's profit for the year amounted to ISK 1,326 million (2016: 1,459) and total comprenshive income amounted to ISK 1,609 million (2016: 1,459). According to the balance sheet, the Group's assets at year-end amounted to ISK 46,405 (2016: 46,323) million, debts amounted to ISK 29,638 (2016: 29,952) million and equity at year end amounted to ISK 16,766 (2016: 16,371) million. The Group's solvency ratio net of planned dividends was 1.59, but was 1.42 at year end 2017 taking planned dividend payments and repurchasing of shares into account. In 2017, the average number of full-time equivalent positions at the company was 197, an increase of 5 from the previous year.

The Company's insurance operations improved somewhat during the year. The combined ratio was 95.3% compared to 101.7% in 2016. There was a considerable increase in premiums or 12.4% and pricing of risk was positive. Costs due to loss or damage increased by 3.6% between years despite the increase in premium payments. As a result, the performance of most insurance fields was positive.

The Company's investment income in the year amounted to ISK 1,350 million. In the fourth quarter, a new investment manager was hired and the Company's investment policy was subsequently revised. As a result, all of the Company's financial assets listed in a regulated securities market are carried at fair value. Due to this change, a fair-value change of ISK 283 million, net of taxes, is recorded in the consolidated statement of comprehensive income. In addition, the Company's unlisted assets were re-evaluated.

At the beginning of 2017, the Company purchased a 21.8% share in Kvika banki hf. for approximately ISK 1,655 million. In April, the Company purcahased 3.06% share and utilised in September its pre-emptive rights in Kvika's increase in share capital, after which it owned a 25.1% share. In December, shares in Kvika were issued pursuant to agreements on subscription rights, after which VÍS's shareholding decreased to 23.1%. In the annual financial statements, a share in Kvika's profits amounting to ISK 327 million is recorded.

In March, it was announced that an agreement had been reached to settle the legal proceedings regarding the liability insurance of the Board and management of Lífsverk. Compensation amounting to ISK 835 million was paid to settle the case. Due to reinsurance, VÍS's share of the total compensation was 15%, or ISK 125 million, which was within the cost recorded in the Company's claim provision.

Share Capital and Disposal of Profits

The Company's listed shares amounted to ISK 2,223 million at year end, with each share having a nominal value of ISK 1. The shares are in a single class, listed for trading at Nasdaq OMX Iceland. All shares are in the same class and carry the same rights. There were 806 shareholders at the beginning of the year and 696 at year end. Approximately 44% of shares are owned by pension funds, 18% by overseas funds, 17% by other legal entities and 21% by individuals.

Ten largest shareholders at year end were:

Name of shareholder	Ownership
Lífeyrissjóður verzlunarmanna	9,9%
Landsdowne Icav Landsdowne Euro	6,8%
Frjálsi lífeyrissjóðurinn	5,5%
Lífeyrissjóður starfsmanna ríkisins A-deild	5,2%
Hedda eignarhaldsfélag ehf.	4,5%
CF Miton UK Multi Cap Income	4,5%
Arion banki hf.	4,2%
Brú Lífeyrissjóður starfsmanna sveitafélaga	3,6%
Stefnir - ÍS 15	3,4%
Stapi lífeyrissjóður	3,0%

Report and Endorsement of the Board of Directors and the CEO

In September 2017, the Company initiated a buy-back programme, as agreed at the annual general meeting. A total of 17 million shares, at a price of ISK 191 million, were purchased during the year and the Company had 0.75% treasury shares at year end.

At the annual general meeting, the Board of Directors will propose that the Company pay shareholders a dividend of ISK 0.60 per share for the year of 2017, or approximately ISK 1,322 million. In the previous year, dividend payments to shareholders amounted to ISK 1,023 million. Information on changes in equity and disposal of profits can be found in the annual financial statements.

Board of Directors

The Company's Board of Directors is elected at the annual general meeting. The Board consists of Svanhildur Nanna Vigfúsdóttir, Chairman, Helga Hlín Hákonardóttir, Vice-Chairman, Gestur Breiðfjörð Gestsson and Valdimar Svavarsson. Board Members shall fulfil the requirements laid down in the Act on Public Limited Companies, and the Act on Insurance Activities. Care must be taken to ensure that the gender ratio of Board members and alternates is as equal as possible and that the proportion of either gender is never lower than 40%. There are three Board sub-committees: An Audit Committee, Remuneration Committee and Risk Committee.

The Company's CEO, Helgi Bjarnason, is responsible for the day-to-day operation of the Company and must follow the policies and instructions laid down by the Board and provide the Board with information. Day-to-day operations do not include measures which are unusual or extraordinary. Such measures may only be taken by the CEO pursuant to special authorisation from the Board of Directors. The CEO shall also ensure that accounts and finances are managed in accordance with statutory law and accepted practices and that the handling of the Company's assets is secure.

Model company in good corporate governance

Corporate governance of insurance companies is discussed in the Act on Insurance Activities, the Act on Limited Liability Companies, the Company's Articles of Association and the Rules of Procedure of the Company's Board of Directors. VÍS has complied with the aforementioned but in addition thereto, the Board of Directors of VÍS believes that the Company's corporate governance is in accordance with the Guidelines on Corporate Governance issued by the Iceland Chamber of Commerce, NASDAQ OMX Iceland hf. and the Confederation of Employers, with the exception that a specific nomination committee has not been appointed. The Company did not hold electronic shareholders' meetings in 2017. In accordance with the aforementioned Guidelines on Corporate Governance and the Icelandic Financial Statements Act, the Company's Board of Directors has prepared a Statement of Corporate Governance which will be included in the Company's Annual Report and in an appendix to the financial statements. From 2014, VÍS has been named a Model Company in Good Corporate Governance by the Corporate Governance Research Centre at the University of Iceland.

Risk management

Coordinated and powerful risk management is the basis for the Company's decision-making in investments and operations. Calculations of the solvency capital requirement are risk-based and extend to all of the Company's main risk factors. The Company has implemented a coordinated risk management policy, as approved by the Company's Board of Directors. The policy details the organisation and execution of risk management within the Group, identifies risk factors and specifies reporting requirements and the obligations of employees to carry out the policy. The Board determines the Company's risk appetite, in accordance with which operations are conducted.

Digital Services Are the Future

A new CEO was appointed in July, and in September, the Company's organisational chart was amended and simplified and the number of executive managers reduced. The number of Company directors was also reduced. Four new departments were introduced: A Service Department, Core operations, Investments and Operations and Digital Development. These changes are intended to increase service to customers and introduce digital solutions. With the advent of new technology, society has undergone a rapid transformation and these changes are intended to prepare the company for the challenges ahead. VÍS intends to provide the best insurance services available and make it more accessible and simple by way of digital solutions.

Report and Endorsement of the Board of Directors and the CEO

VÍS in the Community

Social responsibility is a key factor in all of the Company's operations. The Company's most important role is supporting customers in the event of accidents or damages. VÍS is one of the listed companies taking part in shaping procedures for the listing of non-financial information based on NASDAQ's ESG criteria. VÍS has been working on recording the environmental and social impact of the Company's operations.

VÍS strongly emphasises preventative measures, both for businesses and individuals, with the goal of reducing accidents and damages among customers and in society as a whole. The Company's preventative officers work closely with businesses in improving safety at their place of work, as well as regularly relaying statistical information on accidents and damages from the Company's database to customers and the media. A conference on preventative measures, where a wide range of safety issues are discussed, is held every year.

The management places emphasis on VÍS being a sought-after workplace with quality staff where employees are entrusted with suitable tasks that allow them to display their talents and strengths while taking on interesting and demanding challenges. VÍS employees enjoy all major rights offered in the general labour market. The Company operates according to a health and safety policy to ensure the safety and good health of employees. The Company supports its staff in obtaining further education to increase job development and ensure that each employee has the skills and experience to succeed at their job and advance their career. VÍS has the aim of ensuring equality so that all employees are valued on their own merit regardless of gender. VÍS has received a wage equality certification from the Equal Opportunities Agency and there is no significant gender-based wage difference at the Company. Our active equality policy enables the Company to benefit from the talents and skills of all its employees. VÍS is party to the Equal Rights Convention of UN Women.

All VÍS employees agree to a code of ethics when they are hired and confirm their intention to comply with it on an annual basis. The Company's ethics council reviews the code of ethics annually and acts on any reported violations. The code of ethics is a guide for employees on how to interact with customers, colleagues, regulatory authorities, shareholders, competitors and, as appropriate, society as a whole.

VÍS supports and respects international human rights conventions and requires that human rights be respected in all of the Company's operations. The Company intends for all of its partners to respect the rights of their employees.

VÍS places great importance on minimising any negative environmental impact from the Company's operations and promoting environmental concerns among all employees and service providers. In 2017, VÍS began monitoring the environmental impact of the Company's operations. Total greenhouse emissions from the Company's operations in 2017 amounted to 71 tonnes of carbon dioxide equivalents, with fuel use accounting for approximately 56%. Emissions from the heating of the company headquarters amounted to 20 tonnes of carbon dioxide equivalents, or 31% of the Company's carbon footprint. Energy use, taking into account all use of gasoline, diesel oil, hot water and electricity was 12 GWh. The majority of this power was used to heat the Company's headquarters in Reykjavík. In addition, all of VÍS's waste is sorted, and waste resulting from damages must be disposed of in an environmentally friendly manner in order to reduce the Company's carbon footprint. It is also the Company's intention to reduce paper use in its operations by way of increased automation and self-service.

The annual financial statements have more details on non-financial information on the operations of VÍS pertaining to environmental, social and governance policies.

Statement by the Board of Directors and the CEO

According to our best knowledge it is our opinion that the consolidated financial statements of Vátryggingafélag Íslands hf. give a true and fair view of the consolidated financial performance of the Group for the year 2017, its assets, liabilities and consolidated financial position as at 31 December 2017. Further, in our opinion, the consolidated financial statements and the report and endorsement by the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position at year end and describe the principal risks faced by the Group. Further information on risk management may be found in Note 27 in the financial statements.

The Board of Directors and the CEO of Vátryggingafélag Íslands hf. have today discussed the Company's consolidated financial statements for the year 2017 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements be confirmed at the Company's annual general meeting.

Report and Endorsement of the Board of Directors and the CEO

Reykjavík, 28 February 2018

Board of Directors

Svanhildur Nanna Vigfúsdóttir
Chairman of the Board

Helga Hlín Hákonardóttir
Vice-chairman of the Board

Gestur Breiðfjörð Gestsson

Valdimar Svavarsson

CEO

Helgi Bjarnason

Independent Auditor's Report

To the Board of Directors and Shareholders of Vátryggingafélag Íslands hf.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of Vátryggingafélag Íslands hf., which comprise the consolidated balance sheet as at 31 December 2017, and the consolidated statement of profit or loss comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and 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 financial position of the Group as at 31 December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

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 the Group in accordance with the Code of ethics for Icelandic auditors, which are based on the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have also fulfilled other ethical requirements of that rules. 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 judgment, 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 the audit
Assessment of claims provision Claims provision amonted to ISK 16,244 million at year end 2017 and is the Group´s most significant individual liability. Claims provision is due to reported and unreported claims. Reference is made to notes 31.6-7 for disclosure of accounting policies and note 24 for financial information. Management estimates of unsettled claims, whether reported or not, is að key audit matter due to the significant inherent risk when estimating likely future payments due to incurred losses. Settlement of claims can take a few years and final cost may depend on factors not known at year end 2017 or not under the control of the Group. Most significant estimation uncertainty is due to incurred but unreported losses.	Our audit procedures focused on assessing the assumptions made by management in their calculation of the Group´s claims provision. This included: • Assessing and testing the Group´s internal controls with respect to filing of claims and the data used to determine amounts of unsettled claims at year end. • Testing of controls, covering segregation of duties of filing, determination of validity and payments of claims, as well as management review of controls with respect to payments of claims. • Testing and assessment of computer and information systems used for filing of claims and information transfer between claims and financial systems, as well as testing of the systems´ automatic controls.

	• Support by KPMG actuaries in independent assessment of claim provision, as well as reviewing the Group´s management methods applied when assessing claims provision and our assessment as to whether its carrying amount is appropriate. • Analytical review of claims development of individual insurance types via comparison to prior years where deviations are assessed and explanations requested.
Existence and valuation of securities The carrying amount of securities was to ISK 34,466 million at year end 2017 and is 74.3% of total carrying amount of the Group´s assets. Reference is made to note 31.13 with respect to accounting policies and notes 15 and 26.2 for financial information. The Group holds and manages a portfolio of securities so as to be able to fulfil its obligations due to unpaid claims. The Group has established an investment policy in which composition of securities and maximum risk exposures are specified. The securities are generally in custody of banks and securities companies. Confirmation of the Group´s ownership of securities as well as their existence is a key audit matter. Management needs to measure listed and unlisted securities. For the most part securities are recognised at fair value. The majority of those securities is listed and therefore fair value information is readily available. However, some uncertainty prevails regarding the valuation, in particular with respect to listed securites if transactions have been sparse. The same applies to unlisted securities. In those cases assumptions are required with respect to various inputs applied in determination of fair value. Therefore, valuation of securities is a key audit matter.	Our audit procedures were focused on assessing the assumptions upon which management based its calculation of value of the Group´s securities. This e.g. consisted of: • Confirmation of existence and ownership of securities at year end via third-party confirmation. • Confirmation of management assessment of value of listed and unlisted securities at year end. • We assessed the Group management´s methods and computation when valuing listed and unlisted securities with assistance from valuation experts of our team. • Observing acquisition and sale of securities during the year by means of sampling methods and confirm that transactions are recognised as appropriate.

Other information

The Board of Directors and CEO are responsible for the other information. The other information comprises the information included in the annual report of the Group, but does not include the consolidated financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. The annual report is not available at our reporting date but is expected to be made available to us after that date.

Independent Auditor's Report

Responsibilities of the Board of Directors and CEO for the Consolidated Financial Statements
The Board of Directors and CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors and CEO are responsible for assessing the Group'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 they either intend to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor's 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 judgment and maintain professional skepticism 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 the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- 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 Group'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 Group 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 Group to express an opinion on the consolidated 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 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 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.

Independent Auditor's Report

From the matters communicated with The Board of Directors and 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.

Report on Other Legal and Regulatory Requirements

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

The engagement partner on the audit resulting in this independent auditor's report are Sigríður Soffía Sigurðardóttir and Sæmundur Valdimarsson.

Reykjavík, 28 February 2018

KPMG ehf.

Sigríður Soffía Sigurðardóttir

Sæmundur Valdimarsson

Statement of profit or loss and other comprehensive income 2017

	Notes	2017	2016
Premiums earned		20.527.603	18.319.033
Premiums earned, reinsurers' share		(687.381)	(671.771)
Premiums earned, net of reinsurance	6	19.840.222	17.647.262
Interest income		691.553	617.959
Foreign exchange difference		(46.322)	(637.883)
Fair value changes of financial assets		377.091	2.017.015
Share in profit of associate		327.443	0
Investment income	7	1.349.766	1.997.090
Other income		137.571	170.625
Total income		21.327.559	19.814.977
Claims incurred		(13.996.121)	(14.865.825)
Claims incurred, reinsurers' share		(558.976)	821.058
Claims incurred, net of reinsurance	8	(14.555.096)	(14.044.767)
Changes in risk margin	24	196.313	24.838
Operating expenses	9	(4.948.472)	(4.474.765)
Interest expenses		(187.088)	(173.187)
Impairment of accounts receivable	10	(94.870)	28.631
Total expenses		(19.589.213)	(18.639.249)
Profit before income taxes		1.738.346	1.175.728
Income taxes	11	(412.527)	283.685
Profit for the year		1.325.819	1.459.413
Other comprehensive income that are or may be reclassifed subsequently to profit or loss			
Fair value changes of financial for sale		354.284	0
Income taxes		(70.857)	0
Other comprehensive income		283.427	0
Total comprehensive income		1.609.246	1.459.413
Earnings per share:			
Basic and diluted earnings per share	12	0,60	0,65

The notes on pages 14-39 are an integral part of the financial statements.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 10 Amounts are in ISK thousand

Balance Sheet as at 31 December 2017

	Notes	2017	2016
Assets			
Operating assets	13	326.423	184.406
Goodwill and other intangible assets	14	758.098	809.972
Tax asset	11	91.311	618.535
Equity accounted investees	15	2.642.231	0
Financial assets at fair value through profit or loss	15	24.684.818	28.669.835
Financial assets held-for sale	15	4.759.952	0
Financial assets held-to-maturity	15	0	4.357.527
Bonds and other long-term receivables	15	2.379.069	41.461
Investments where investment risk is borne by life-insurance policyholders	16	1.330.365	1.232.526
Accounts receivable	17	6.178.620	5.706.473
Reinsurance assets	18	421.977	1.897.983
Other receivables	19	1.737.267	1.740.968
Cash and cash equivalents	20	1.094.394	1.063.335
Total assets		46.404.524	46.323.020
Equity			
Share capital		2.206.874	2.223.498
Statutory reserve		625.620	625.620
Other reserves		1.822.896	1.093.461
Retained earnings		12.111.064	12.428.163
Total equity	21	16.766.454	16.370.742
Liabilities			
Subordinated bonds	23	2.623.981	2.573.693
Technical provision	24	24.405.660	24.936.072
Technical provision for life-insurance policies where investment risk is borne by the policyholders	16	1.330.365	1.232.526
Accounts payable and other liabilites	25	1.278.064	1.209.987
Total liabilities		29.638.070	29.952.279
Total equity and liabilities		46.404.524	46.323.020

The notes on pages 14-39 are an integral part of the financial statements.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 11 Amounts are in ISK thousand

Statement of Changes in Equity for the year 2017

	Share capital	Statutory reserve	Other reserves	Retained earnings	Total equity
Equity 1.1.2016	2.296.437	625.620	0	14.629.991	17.552.048
Dividends paid, ISK 0.90 per share				(2.066.793)	(2.066.793)
Own shares purchased	(72.939)			(500.987)	(573.926)
Total comprehensive income for the year				1.459.413	1.459.413
Unrealised fair value changes of securities			1.093.461	(1.093.461)	0
Equity 31.12.2016	2.223.498	625.620	1.093.461	12.428.163	16.370.742
Dividends paid, ISK 0.46 per share				(1.022.809)	(1.022.809)
Own shares purchased	(16.624)			(174.101)	(190.724)
Total comprehensive income for the year			283.427	1.325.819	1.609.246
Unrealised fair value changes of securities			118.565	(118.565)	0
Unrealised profit of associate			327.443	(327.443)	0
Equity 31.12.2017	2.206.874	625.620	1.822.897	12.111.064	16.766.454

The notes on pages 14-39 are an integral part of the financial statements.

Consolidated financial statements of Vátryggingafélag Íslands hf.. 2017 12 Amounts are in ISK thousand

Statement of Cash Flows for the year 2017

	Notes	2017	2016
Operating activities			
Profit for the year		1.325.819	1.459.413
Operating items not affecting cash flows:			
Financial income and expenses		(379.610)	193.111
Fair value changes of financial assets		(377.091)	(2.017.015)
Share of profit of associate		(327.443)	0
Gain (loss) on sale of operating assets		2.253	(1.873)
Other obligations		332	(92)
Depreciation and amortisation		168.545	131.205
Changes in operating assets and liabilities:			
Tax asset, decrease (increase)		530.898	(257.685)
Financial assets, decrease		3.810.772	584.899
Bonds and other receivables, (increase) decrease		(2.337.608)	6.970
Accounts receivable, (increase)		(525.818)	(166.974)
Reinsurance assets, decrease (increase)		1.476.006	(642.774)
Other assets, decrease		5.622	13.317
Technical provision, (decrease) increase		(530.413)	1.470.113
Accounts payable and other liabilities, increase (decrase)		158.550	(36.941)
Cash flows from opearating activities before interest and tax		3.000.813	735.674
Interest income received		821.162	432.207
Dividend received		199.673	153.018
Financial expenses paid		(136.799)	(99.493)
Income taxes paid		(42.728)	(1.325.924)
Cash flows from (to) operating activities		3.842.121	(104.518)
Investing activities			
Aquisition of associates		(2.314.788)	0
Purchase of operating assets	13	(230.232)	(75.929)
Sale of operating assets		8.000	6.000
Purchase of software	14	(38.708)	(6.793)
		(2.575.728)	(76.722)
Financing activities			
Purchase of treasury shares		(190.724)	(573.926)
Dividends paid		(1.022.809)	(2.066.793)
Issue of subordinated bonds		0	2.500.000
		(1.213.533)	(140.719)
Increase (decrease) in cash and cash equivalents		52.860	(321.959)
Cash and cash equivalents at the beginning of the year		1.063.335	1.428.183
Effect of movements in exchange rates on cash held		(21.801)	(42.890)
Cash and cash equivalents at the end of the period		1.094.394	1.063.335

The notes on pages 14-39 are an integral part of the financial statements.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 13 Amounts are in ISK thousand

Notes

1. Reporting entity

Vátryggingafélag Íslands hf., hereafter referred to as "the Company", "the Group" or "VÍS", is a limited liability company and operates according to law no. 100/2016 on insurance operations and law no. 2/1995 on limited liability companies. The Company´s headquarters are at Ármúli 3, Reykjavík.

The consolidated interim financial statements of Vátryggingafélag Íslands hf. comprise the financial statements of the Company and its subsidiary, Líftryggingafélag Íslands hf. ("Lífís"). The Group's operations consist of casualty insurance, life insurance and investment activities. The Icelandic Financial Supervisory Authorities supervises the operations of the Group according to law no. 87/1998 on the official supervision of financial operations.

2. Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Icelandic law on annual accounts. The financial statements were approved and authorised for issue at a board meeting on 28 February 2018. A summary of significant accounting poicies is provided in note 31.

3. Functional and presentation currency

These consolidated financial statements are presented in Icelandic Krona (ISK), which is the Company´s functional currency. All amounts are presented in ISK thousand unless otherwise stated.

4. Accounting estimates

Preparing financial statements in accordance with IFRS requires management to make assumptions, estimates and apply judgement that affect the assets and liabilities at the reporting date, disclosures in notes and income and expenses. Estimates and judgements are based on experience and various other factors that are considered appropriate and form the basis of decisions made regarding the reported amounts of assets and liabilities not evident by other means.

Estimates and assumptions are reviewed regularly. Changes in accounting estimates are recognised in the period when they are revised.

Management has made assumptions and accounting estimates regarding the following items that materially impact the Group's financial statements:

- technical provision, see note no. 24
- financial assets, see notes no. 15 and 26.2
- intangible assets, see note no. 14
- impairment of account receivables, see note no. 10

5. Operating segments

The Group´s operations are, in accordance with its organisation and internal reporting, divided into three operating segments: Casuality insurance, life insurance and financial activities.

The operating segments' results for the year 2017 are specified as follows:

	Casuality insurance	Life insurance	Financial activities	Total
Premiums earned	19.331.406	1.196.197	0	20.527.603
Premiums earned, reinsurers' share	(488.655)	(198.726)	0	(687.381)
Investment income	964.742	33.396	351.628	1.349.766
Other income	137.571	0	0	137.571
Total income	19.945.064	1.030.867	351.628	21.327.559
Claims incurred	(13.526.049)	(470.071)	0	(13.996.121)
Claims incurred, reinsurers' share	(697.336)	138.360	0	(558.976)
Change in risk margin	202.952	(6.639)	0	196.313
Operating expenses	(3.983.417)	(343.407)	(621.648)	(4.948.472)
Interest expenses	0	0	(187.088)	(187.088)
Impairment of accounts receivable	0	0	(94.870)	(94.870)
Operating segment result	1.941.213	349.110	(551.977)	1.738.346
Income taxes				(412.527)
Profit for the year				1.325.819

Depreciation and amortisation in the amount of ISK 110 million and ISK 2 million are included in the operating results of casuality insurance and financial activities, respectively. Investments of the operating segment of casuality insurance amounted to ISK 269 million.

5. Operating segments (contd.)

The operating segments' results for the year 2016 are specified as follows:

	Casuality insurance	Life insurance	Financial activities	Total
Premiums earned	17.234.285	1.084.748	0	18.319.033
Premiums earned, reinsurers' share	(488.862)	(182.909)	0	(671.771)
Investment income	1.168.697	31.690	796.703	1.997.090
Other income	170.625	0	0	170.625
Total income	18.084.746	933.529	796.703	19.814.978
Claims incurred	(14.379.236)	(486.589)	0	(14.865.825)
Claims incurred, reinsurers' share	671.739	149.320	0	821.058
Change in risk margin	22.593	2.246	0	24.838
Operating expenses	(3.575.241)	(333.267)	(566.257)	(4.474.765)
Interest expenses	0	0	(173.187)	(173.187)
Reversal of impairment of accounts receivable	0	0	28.631	28.631
Operating segment result	824.600	265.238	85.890	1.175.728
Income taxes				283.685
Profit for the year				1.459.413

Depreciation and amortisation in the amount of ISK 73 million and ISK 2 million are included in the operating results of casuality insurance and financial activities, respectively. Investments of the operating segment of casuality insurance amounted to ISK 83 million.

Insurance activities consist of casualty and life insurance, and are specified as follows for the year 2017:

	Property insurance	Marine insurance	Mandatory vehicle insurance	Other vehicle insurance	General liability insurance	Accident and health insurance
Premiums earned	4.394.773	573.898	6.914.743	3.094.930	1.147.186	2.283.028
Claimes incurred	(2.767.158)	(363.398)	(5.536.051)	(2.251.412)	(124.376)	(1.796.832)
Change in risk margin	25.515	8.016	59.945	8.372	42.161	32.180
Operating expenses	(969.991)	(122.813)	(1.376.990)	(587.017)	(263.475)	(477.977)
Reinsurance cost, net	(252.509)	(79.565)	(39.019)	(2.657)	(762.941)	(47.703)
Investment income	124.307	14.996	457.323	68.721	113.218	174.724
Other income	74.736	3.933	45.871	6.130	2.144	4.757
Profit	629.673	35.067	525.822	337.067	153.918	172.176

	Life-insurance	Health and critical illness insurance	Total direct insurance	Foreign reinsurance	Total
Premiums earned	610.919	585.278	19.604.755	922.848	20.527.603
Claimes incurred	(145.146)	(324.925)	(13.309.298)	(686.822)	(13.996.120)
Change in risk margin	(3.645)	(2.993)	169.550	26.763	196.313
Operating expenses	(184.004)	(159.403)	(4.141.670)	(185.154)	(4.326.824)
Reinsurance cost, net	(28.951)	(31.415)	(1.244.760)	(1.597)	(1.246.357)
Investment income	15.820	17.575	986.684	11.453	998.137
Other income	0	0	137.571	0	137.571
Profit	264.993	84.116	2.202.832	87.490	2.290.323

Insurance activities consist of casualty and life insurance, and are specified as follows for the year 2016:

	Property insurance	Marine insurance	Mandatory vehicle insurance	Other vehicle insurance	General liability insurance	Accident and health insurance
Premiums earned	4.034.572	477.657	5.969.053	2.564.143	987.161	2.062.436
Claimes incurred	(3.155.947)	(202.068)	(5.380.750)	(2.284.903)	(1.302.188)	(1.611.642)
Change in risk margin	(14.285)	791	(8.367)	(12.537)	23.364	(15.078)
Operating expenses	(899.764)	(116.181)	(1.210.409)	(502.233)	(250.841)	(413.304)
Reinsurance cost, net	(218.987)	(75.860)	2.448	(2.107)	558.571	(44.987)
Investment income	131.155	16.327	520.681	67.055	130.845	208.688
Other income	83.212	3.592	71.688	5.670	2.223	4.240
Profit (loss)	(40.044)	104.259	(35.656)	(164.912)	149.136	190.353

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 15 Amounts are in ISK thousand

Notes

5. Operating segments (contd.)

	Life-insurance	Health and critical illness insurance	Total direct insurance	Foreign reinsurance	Total
Premiums earned	577.232	507.515	17.179.770	1.139.263	18.319.032
Claimes incurred	(197.944)	(288.645)	(14.424.088)	(441.737)	(14.865.825)
Change in risk margin	2.544	(298)	(23.867)	48.705	24.838
Operating expenses	(178.140)	(155.127)	(3.725.999)	(182.509)	(3.908.508)
Reinsurance cost, net	(24.952)	(8.638)	185.489	(36.202)	149.287
Investment income	15.642	16.048	1.106.443	93.945	1.200.387
Other income	0	0	170.625	0	170.625
Profit	194.382	70.855	468.373	621.464	1.089.838

6. Premiums earned, net of reinsurance

	2017	2016
Premiums written	21.311.858	18.826.878
Premiums written, reinsurers' share	(695.960)	(677.851)
Change in unearned premiums	(784.255)	(507.845)
Change in unearned premiums, reinsurers' share	8.579	6.080
Premiums earned, net of reinsurance	19.840.222	17.647.262

7. Financial income

	2017	2016
Interest income on bank accounts	50.697	77.016
Interest income on bonds	78.534	0
Interest income on financial assets held-to-maturity	185.349	201.107
Other interest income	376.974	339.836
Financial income	691.554	617.959
Foreign currency exchange differences	(46.322)	(637.883)
Fair value change of shares	(495.204)	1.088.076
Fair value change of other financial assets	872.295	928.938
Fair value change of financial assets	377.091	2.017.015

Fair value change of financial assets includes dividend income from shareholding amounting to ISK 200 (2016:153) million.

Share in profit of associate	327.443	0

8. Claims incurred, net of reinsurance

	2017	2016
Claims incurred	15.114.475	13.878.719
Claims incurred, reinsurers' share	(917.540)	(198.714)
Change in claims provision	(1.118.354)	987.106
Change in claims provision, reinsurers' share	1.476.516	(622.344)
Claims incurred, net of reinsurance	14.555.096	14.044.767

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 16 Amounts are in ISK thousand

Notes

9. Operating expenses

	2017	2016
Administrative expenses	2.136.908	2.056.840
Salaries and salary-related expenses	2.643.019	2.286.720
Depreciation and amortisation	168.545	131.205
Operating expenses	4.948.472	4.474.765

Auditors´ fee for the audit of the annual financial statements amounted to ISK 29.8 (2016: 27.8) million. Fee for review of interim financialstatements and other services amounted to ISK 4.3 (2016: 5.0) million. The aforementioned amounts include VAT of 24%.

Salaries and salary-related expenses are specified as follows:

	2017	2016
Salaries	2.122.463	1.837.522
Contribution to pension funds	226.281	182.737
Special financial activities tax on salaries	121.463	107.679
Other salary-related expenses	172.812	158.783
Salaries and salary-related expenses	2.643.019	2.286.720
Number of employees in full-time equivalent units	197	192

Salaries, benefits and contribution to pension funds due to the CEO, board members and key management personnel are specified as follows:

	2017		2016	
	Salaries and benifits	Contributes to pension fund	Salaries and benifits	Contributes to pension fund
Svanhildur N. Vigfúsdóttir, chairman of the board of VÍS *	8.013	757	0	0
Gestur B. Gestsson, board member of VÍS and chairman of Lífís *	6.440	611	0	0
Helga Hlín Hákonardóttir, board member *	5.818	542	3.870	323
Valdimar Svavarsson, board member *	4.215	397	0	0
Margrét V. Bjarnadóttir, board member of Lífís*	3.480	323	2.690	224
Ingunn Svala Leifsdóttir, board member of Lífís*	1.925	186	0	0
Sandra Hlíf Ocares, alternative board member of VÍS	2.019	195	0	0
Andri Gunnarsson, alternative board member of VÍS	1.100	97	850	70
Herdís Dröfn Fjeldsted, former chairman of the board of VÍS *	1.892	161	7.770	640
Jostein Sörvoll, former board member of VÍS and Lífís*	1.750	149	6.450	535
Reynir F. Grétarsson, former board member *	1.900	162	2.500	213
Helga Jónsdóttir, former board member of VÍS and Lífís *	1.120	95	5.190	423
Soffía Lárusdóttir, former alternative board member of VÍS	0	0	350	28
Benedikt Gíslason, former board member of VÍS *	0	0	2.580	217
Bjarni Brynjólfsson, former board member of VÍS *	0	0	1.840	147
Guðmundur Þórðarson, former board member of VÍS *	0	0	1.400	112
Davíð Guðmundsson, former board member of Lífís	0	0	660	53
Áslaug Rós Guðmundsdóttir, audit committee of VÍS and Lífís	1.883	182	0	0
Vignir Rafn Gíslason, audit committee of VÍS and Lífís	560	47	2.880	237
Helgi Bjarnason, CEO of VÍS and Lífís	35.494	5.441	0	0
Jakob Ó. Sigurðsson, former CEO of VÍS and Lífís	24.202	3.518	13.163	1.998
Former Executive directors and director of investments***	133.237	17.073	119.474	14.009
Executive directors, director of human resources and director of investments were 7 in 2016 but in the end of 2017 they were 6**	76.051	11.136	48.708	5.909
Sigrún Ragna Ólafsdóttir, former CEO of VÍS and Lífís****			40.771	5.903
	311.099	41.072	261.146	31.041

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 17 Amounts are in ISK thousand

Notes

9. Operating expenses (contd.)

* Payments for committee work for audit- and/or pay remuneration committee are included.
Members of the board of directors and management do not receive any other consideration in addition to salaries and benefits.

** Auður Björk Guðmundsdóttir, Guðný Helga Herbertsdóttir, Ólafur Lúther Einarsson and Valgeir M. Baldursson are executive directors. Anna Rós Ívarsdóttir is director of human resources and Arnór Gunnarsson is director of investments.

*** Agnar Óskarsson, Guðmar Guðmundsson, Friðrik Bragason and Þorvaldur Jacobsen former executive directors. Tryggvi Guðbrandsson former director of investments.

****Estimated salaries and salary-related expenses due to employment termination of former CEO have been expensed at the year-end 2016, ISK 39 million and that was paid in 2017.

Estimated salaries and salary-related expenses due to employment termination of former executive directors and director of investments have been expensed. ISK 54 million are unpaid at year-end 2017.

Board members´ shareholding in the Company at year-end is specified as follows: Svanhildur Nanna Vigfúsdóttir 155,082,711 shares, Gestur Breiðfjörð Gestsson 45,136,943 shares. Helgi Bjarnason held 448,430 shares and 4 managing directors, director of human resources and director of investments owned 1,751,855 shares in total. A party related to one member of the board has made a forward contract to buy 90,000,000 shares with settlement date at 8 June 2018.

Shares of spouses and financial independent children and shares held by companies in majority ownership by board members and and management are considered as shares of board members.

10. Impairment of account receivables

	2017	2016
Account receivables written off as uncollectible	72.870	21.369
Impairment, change	22.000	(50.000)
Impairment of account receivables	94.870	(28.631)

11. Income taxes

11.1 Calculated income taxes

Income taxes are calculated and recognised in the financial statements.

Effective tax rate:

	2017		2016	
	Amount	%	Amount	%
Profit before income taxes	1.738.346		1.175.728	
Income tax according to domestic tax rate	347.669	20,0%	235.146	20,0%
Special financial activity tax	9.469	0,5%	0	0,0%
Fair value changes of financial assets	99.041	5,7%	(219.251)	-18,6%
Share in profit of associate	(65.489)	-3,8%	0	0,0%
Reversal of write-down of tax asset*	0	0,0%	(222.183)	-18,9%
Share of profit of non-taxable companies	(10.582)	-0,6%	(77.403)	-6,6%
Other changes	32.418	1,9%	7	0,0%
Income taxes according to the statement of profit or loss	412.527	23,7%	(283.685)	-24,1%

*Tax asset due to finalisation of winding-up of bankrupt companies.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 18 Amounts are in ISK thousand

Notes

11.2 Deferred taxes

Tax asset (deferred tax liability) is specified as follows:

	2017	2016
Tax asset at the beginning of the year	618.535	360.850
Tax expense of the year	(412.527)	283.685
Income tax in other comprehensive income	(70.857)	0
Influence of joint taxation for prior year	(42.728)	0
Taxes to be paid for the year	9.469	42.728
Other items	(10.581)	(68.728)
Tax asset at the end of the year	91.309	618.535

The most signifcant items of tax asset (deferred tax liability) are specified as follows:	2017	2016
Operating assets and software	109.162	177.917
Customer relationships	(45.077)	(56.347)
Financial assets	(35.469)	(34.823)
Other items	48.702	90.154
Carry-forward tax losses	13.993	441.635
Tax asset at the end of the year	91.311	618.535

12. Earnings per share

Earnings per outstanding share is calculated based on the following assumptions:

	2017	2016
Profit for the year attributable to shareholders of the Parent Company	1.325.819	1.459.413
Weighted average number of outstanding shares	2.218.365	2.250.877
Earnings per share	0,60	0,65

Diluted earnings per share is the same as basic earnings per share since neither share-based payment contracts nor convertible bonds have been issued.

13. Operating assets

	Buildings and land	Computer, equipment and vehicles	Total
Cost			
Total value as at 1.1. 2016	71.669	376.352	448.021
Additions during the year	0	75.929	75.929
Sold and disposed of during the year	0	(6.000)	(6.000)
Total value 1.1. 2017	71.669	446.281	517.950
Additions during the year	0	230.232	230.232
Sold and disposed of during the year	0	(8.000)	(8.000)
Total value 31.12. 2017	71.669	668.513	740.182
Depreciation			
Depreciated 1.1 2016	43.718	238.040	281.758
Depreciation of the year	1.701	51.958	53.659
Sold and disposed of during the year	0	(1.873)	(1.873)
Depreciated 1.1 2017	45.419	288.125	333.544
Depreciation of the year	1.701	76.261	77.962
Sold and disposed of during the year	0	2.253	2.253
Depreciated 31.12. 2017	47.120	366.639	413.759
Carrying amount			
Carrying amount at beginning of the year 2016	27.951	138.312	166.263
Carrying amount at beginning of the year 2017	26.250	158.156	184.406
Carrying amount at end of the year 2017	24.549	301.874	326.423
Depreciation rates	3%	10-33%	

Tax value of buildings at year end 2017 amounted to ISK 69 million. Asset value for fire insurance of buildings amounted to ISK 197 million at year end 2017.
Asset value for insurance of operating assets amounted to ISK 428 million at year end 2017.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 19 Amounts are in ISK thousand

Notes

14. Intangible assets

	Goodwill	Customer relationship	Software	Total
Cost				
Total value as at 1.1.2016	474.599	563.467	1.570.046	2.608.113
Additions during the year	0	0	6.793	6.793
Total value as at 1.1.2017	474.599	563.467	1.576.839	2.614.906
Additions during the year	0	0	38.708	38.708
Total value as at 31.12.2017	474.599	563.467	1.615.547	2.653.614
Amortisation				
Accumulated amortisation as at 1.1.2016	0	225.388	1.502.000	1.727.388
Amortisation of the year	0	56.347	21.199	77.546
Accumulated amortisation as at 1.1.2017	0	281.735	1.523.199	1.804.934
Amortisation of the year	0	56.347	34.236	90.582
Accumulated amortisation as at 31.12.2017	0	338.082	1.557.435	1.895.516
Carrying amount				
Carrying amount at beginning of the year 2016	474.599	338.079	68.046	880.725
Carrying amount at beginning of the year 2017	474.599	281.732	53.640	809.972
Carrying amount at end of the year 2017	474.599	225.386	58.112	758.098
Amortisation rates	0%	10%	10-33%	

The Group's goodwill is due to VÍS's acquisition of Lífís in 2012. At year-end an annual impairment test was carried out, based on discounted future cash flows. According to the test there is no need to reduce the carrying amount of goodwill.

15. Investment securities

Financial assets designated at fair value through profit or loss are specified as follows:	2017	2016
Shares in other companies		
Listed on domestic stock exchange	6.268.010	7.996.255
Listed on foreign stock exchanges	0	119
Other companies	3.159.936	3.091.245
	9.427.946	11.087.619
Other securities		
Government backed securities, indexed	364.953	2.903.069
Government backed securities, non-indexed	5.467.603	1.465.295
Other bonds	4.902.936	9.194.104
Bond funds	2.391.392	1.829.796
Institutional investor funds	2.129.989	2.189.952
	15.256.873	17.582.216
Financial assets for sale		
Listed government backed securities	4.759.952	0
Total financial assets at fair value	29.444.770	28.669.835
Financial assets held-to-maturity		
Listed government backed securities *	0	4.357.527
Bonds and other long-term receivables		
Loans pledged by real estate	2.379.069	41.461
Equity accounted investments		
Kvika hf.	2.642.231	0
Investment securities	34.466.070	33.068.822
* Estimated fair value of financial assets held-to-maturity	0	4.365.621

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 20 Amounts are in ISK thousand

16. Investments where investment risk is borne by the life-insurance policyholders

Lífís has offered life-insurance policies which consist of life insurance and contribution to investments funds. The cost of the life insurance decreases as the amount in the investment fund increases and ceases by the time the amount in the investment fund exceeds the life-insured amount. Life-insurance policyholders bear the investment risk.

17. Account receivables

	2017	2016
Receivables due to domestic operations	5.032.943	4.519.520
Receivables due to foreign operations	1.145.677	1.186.953
Account receivables	6.178.620	5.706.473

Changes in allowance of account receivables

	2017	2016
Balance at the beginning of the year	88.440	138.440
Impairment of account receivables (reversal)	94.870	(28.631)
Account receivables written-off	(72.870)	(21.369)
Balance at the end of the year	110.440	88.440

18. Reinsurance assets

	2017	2016
Reinsurers' share in unearned permiums	117.257	108.679
Reinsurers' share in claims provision	287.818	1.764.334
Claims on reinsurers	16.901	24.970
Reinsurance assets	421.977	1.897.983

19. Other receivables

	2017	2016
Prepaid taxes	332.022	463.590
Cash in escrow accounts due to foreign operations	1.272.028	927.443
Restricted cash due to foreign operations	74.658	202.799
Accrued interest income and prepaid expenses	58.558	147.137
Other receivables	1.737.267	1.740.968

20. Cash and cash equivalents

Cash and cash equivalents at year-end is specified as follows:

	2017	2016
Cash	173	861
Deposits in Icelandic Krona	903.526	1.057.977
Deposits in foreign currencies	190.695	4.497
Cash and cash equivalents	1.094.394	1.063.335

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 21 Amounts are in ISK thousand

Notes

21. Equity

Share capital of Vátryggingafélag Íslands hf. is specified as follows at year end:

	2017		2016	
Share capital according to the Company's article of association	2.223.498	100,00%	2.296.437	100,00%
Treasury shares	(16.624)	-0,75%	(72.939)	-3,18%
Share capital according to the annual financial statements	2.206.874	99,25%	2.223.498	96,82%

One vote is attached to each share of the nominal value of one Icelandic Krona in the Company. At the Company's Annual General Meeting for the year 2017 it was approved to decrease the nominal value of shares by ISK 73 million, i.e. to ISK 2,223 million

According to the Limited Liability Companies Act the Company is required to retain amounts corresponding to 25% of the nominal value of shares in a statutory reserve that is prohibited to be distributed as dividends to shareholders. Amounts in excess of 25% of the nominal value of shares are at the Company´s disposal.

According to the Annual Accounts Act the Company is to recognise unrealised fair value income of financial assets designated at fair value through profit or loss in a restricted reserve among equity which is not distributable as dividend.

According to the Annual Accounts Act the Company is to restrict the share of profit of a subsidiary and associate in excess of dividends received.

Retained earnings consist of profit and loss of the Company not distributed as dividend or contributed to statutory reserve. Retained earnings can be distributed to shareholders as dividends. However, solvency requirements limit the amounts the Company can pay as dividends.

22. Capital position

22.1 Own funds

The Group´s solvency is based on its equity less intangible assets, expected dividend payments and share buy-back but with subordinated bond added.

The board of directors´ dividend proposal is in the amount of ISK 1,322 million.

	2017	2016
Equity according to the annual report	16.766.454	16.370.742
Intangible assets	(758.098)	(809.972)
Subordinated bond	2.623.981	2.573.693
Shares in Kvika bank	(2.642.231)	0
Dividend proposal	(1.322.000)	(1.023.000)
Share buy-back plan	(406.170)	0
Own funds	14.261.937	17.111.463
Solvency capital requirement (SCR)	10.066.967	9.950.562
Solvency ratio	1,42	1,72

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 22 Amounts are in ISK thousand

22.2 Solvency capital requirement (SCR)

The Company´s minimum solvency means that certain capital, equity, is required due to the Company's risk. Standard rule according to law no. 100/2016 is applied, whereas calculation is based on all measurable risks. How solvency requirement is divided into subcomponents of risk is specified in the following tables.

Diversification effects are deducted since it is not assumed that all risks realize simultaneously. Adjustment for the loss-absorbing capacity of deferred taxes is deducted upon realization of risks.

Solvency capital requirement (SCR)	2017	2016
Basic Solvency capital requirement (BSCR)	10.411.612	10.769.290
Operational risk	682.171	692.274
Adjustment due to deferred taxes	(1.026.816)	(1.511.002)
Total minimum solvency	10.066.967	9.950.563
Basic Solvency capital requirement (BSCR)		
Market risk	5.689.957	6.579.468
Counterparty risk	1.553.796	1.709.330
Life underwriting risk	358.150	357.427
Health underwriting risk	1.614.145	1.491.443
Non-life underwriting risk	5.792.005	5.253.510
Diversification effects	(4.596.442)	(4.621.889)
Total BSCR	10.411.612	10.769.290

Market risk		
Interest rate risk	429.019	223.497
Equity risk	4.956.088	5.433.195
Property risk	81.606	46.101
Spread risk	552.642	812.275
Foreign currency risk	218.674	236.777
Concentration risk	1.360.343	2.279.804
Diversification effects	(1.908.415)	(2.452.183)
Total market risk	5.689.957	6.579.468

23. Subordinated bonds

At the end of February 2016 the Company issued subordinated bonds in the nominal amount of ISK 2,500 million. The bonds are classified as Tier II equity and is included in the Company's own funds. They bear a fixed inflation-indexed interest rate of 5.25%. Their maturity is 30 years but with a prepayment option and a step-up in interest rate to 6.25% ten years after issue date.

Changes in subordinated loan from the beginning to the end of the year.

	2017	2016
Balance at 1.1.	2.573.693	0
Amount of issued subordinated loan	0	2.470.000
Accrued interest and price indexation	184.979	171.043
Paid interests	(134.691)	(67.350)
Balance at 31.12.	2.623.981	2.573.693

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 23 Amounts are in ISK thousand

24. Technical provision

Technical provision at year-end is determined as best estimate in accordance with provisions of chapter XIV. in law on insurance operations no. 100/2016.

Technical provision is the sum of best estimate of financial liabilities for insurance contracts plus risk premium. Technical provision at the end of the yar 2016 was estimated by same method.

	2017	2016
Technical povision (total):		
Unearned premiums	7.139.130	6.354.875
Claims provision	16.243.919	17.362.273
Risk margin	1.022.611	1.218.923
Total claims provision	24.405.660	24.936.071
Reinsurers´ share:		
Unearned premiums	117.258	108.679
Claims reported	287.818	1.764.333
Total reinsurers´ share	405.076	1.873.012

	2017	2016
Technical provision, net of reinsurance:		
Unearned premiums	7.021.872	6.246.196
Claims provision	15.956.101	15.597.940
Risk margin	1.022.611	1.218.923
Total technical provision, net of reinsurance	24.000.584	23.063.059

Unearned premiums represent the Company's estimated amounts of the proportion of the duration of each policy issued that extends into periods beyond the reporting date.

Claims provision is estimated by actuarial methods based on unsettled claims at year-end. There is calculated expected cash flow for unsettled claims plus settling cost, estimated price changes and discounting future cash flow for claim settling using interest rate issued by supervision authorities. Claims provision covers claims which have been reported to the Company and as well as for claims incurred but not reported at year-end to the Company or not reported adequately.

Risk margin is designed to ensure that the value of technical provisions are sufficient for another insurer to take over and meet the insurance obligations. It is calculated by determining the cost of providing an amount of eligible own funds equal to the SCR necessary to support the obligations over their lifetime.

Claims provision development of prior years during the year 2017	Total	Reinsurers' share	Own share
Claims provision from prior year	17.362.273	(1.764.333)	15.597.940
Paid due to claims from prior years	(8.423.214)	798.223	(7.624.991)
New claims due to claims for prior year	(9.715.007)	272.359	(9.442.648)
Financial income net of unwinding of present value of claims	745.754	0	745.754
Fair value change due to claims from prior years	(30.194)	(693.751)	(723.945)

Development of claims provision due to prior years was negative during the year and amounted to ISK 30 millions or -0,2% of claims provision as at the end of prior year. Development of claims provision net of reinsurance was negative during the year and amounted to ISK 724 millions or -4,6% of claims provision as at the end of prior year.

Claims during the year 2017	Total	Reinsurers' share	Own share
Paid due to claims incurred during the year	6.691.262	(119.317)	6.571.945
Claims provision due to claims incurred during the year	6.528.839	(15.459)	6.513.380
Total claims incurred during the year	13.220.101	(134.776)	13.085.325

Claims provision due to claims incurred during the year is the present value of the best estimate according to chapter XIV. in law no. 100/2016 on insurance operations.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 24 Amounts are in ISK thousand

24. Technical provision (contd.)

Financial income from insurance operation in 2017

Calculated financial income from insurance operation	998.137
Financial income net of unwinding of present value of claims provision	(745.754)
Financial income from insurance operation due to claims incurred during the year	252.383

Financial income from insurance operation is calculated every month. It is calculated as weighted average required rate of each month according to yield curve from regulator, on own technical provision. Financial income net of unwinding of present value of prior years claims are calculated as interest on cash flows of claims from prior years with additional interest on average claims provision for the year due to claims from prior years.

Claims provision development of prior years during the year 2016

	Total	Reinsurers' share	Own share
Claims provision from prior year	16.375.168	(1.141.990)	15.233.178
Paid due to claims from prior years	(7.431.092)	116.983	(7.314.109)
New claims due to claims for prior year	(10.721.403)	1.510.039	(9.211.364)
Financial income net of unwinding of present value of claims	946.058	0	946.058
Fair value change due to claims from prior years	(831.269)	485.032	(346.237)

Development of claims provision due to prior years was negative during the year and amounted to ISK 831 million or -5,1% of claims provision as at the end of prior year. Development of claims provision net of reinsurance was negative during the year and amounted to ISK 346 million or -2,3% of claims provision as at the end of prior year.

Claims during the year 2016	Total	Reinsurers' share	Own share
Paid due to claims incurred during the year	6.447.570	(81.731)	6.365.839
Claims provision due to claims incurred during the year	6.640.869	(254.294)	6.386.575
Total claims incurred during the year	13.088.439	(336.025)	12.752.414

Claims provision due to claims incurred during the year is the present value of the best estimate according to chapter XIV. in law no. 100/2016 on insurance operations.

Financial income from insurance operation in 2016

Calculated financial income from insurance operation	1.200.387
Financial income net of unwinding of present value of claims provision	(946.058)
Financial income from insurance operation due to claims incurred during the year	254.329

Financial income from insurance operation is calculated every month. It is calculated as weighted average required rate of each month according to yield curve from regulator, on own technical provision. Financial income net of unwinding of present value of prior years claims are calculated as interest on cash flows of claims from prior years with additional interest on average claims provision for the year due to claims from prior years.

25. Accounts payable and other liabilities

	2017	2016
Accounts payable	470.199	457.080
Current tax	9.469	0
Liability from reinsurance operation	66.983	75.280
Other liabilities	731.414	677.627
Accounts payable and other liabilites	1.278.065	1.209.987

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 25 Amounts are in ISK thousand

26. Financial instruments

26.1 Classification of financial instruments

The Group´s financial assets pertain to the following categories of financial instruments:

31 December 2017 **Financial assets**	Financial assets at fair value	Loans and receivables	Financial assets held-to-maturity	Total	Fair value
Shares and share funds	9.610.514			9.610.514	9.610.514
Debt instruments and other securities	19.834.256			19.834.256	19.834.256
Accounts receivable and other receivables		8.948.270		8.948.269	
Cash in escrow accounts and restricted cash		1.346.686		1.346.686	
Cash and cash equivalents		1.094.394		1.094.394	
Total financial assets	29.444.770	11.389.349	0	40.834.119	
31 December 2016					
Financial assets					
Shares and share funds	11.423.180			11.423.180	11.423.180
Debt instruments and other securities	17.246.655		4.357.527	21.604.182	21.612.276
Accounts receivable and other receivables		6.358.661		6.358.661	
Cash in escrow accounts and restricted cash		1.130.241		1.130.241	
Cash and cash equivalents		1.063.335		1.063.335	
Total financial assets	28.669.835	8.552.237	4.357.527	41.579.598	

The carrying amount of other financial assets reflects their fair value.

26.2 Fair value hierarchy

The following table discloses financial assets at fair value or held-to-maturity according to valuation techniques. The valuation techniques are separated into three levels based on the significance of the assumptions made in determining fair value. The levels are as follows:

Level 1: Quoted price in an active market for identical assets.

Level 2: Fair value is not based on quoted price in an active market (level 1) but on inputs that are observable for the asset, either directly (i.e. asprices) or indirectly (i.e. derived from prices). Financial assets for which there is not an active market are classified into level 2. The fair value assessment is based on recent transactions between unrelated parties or bid prices of unrelated parties. Comparison to smiliar financial assets is also applied.

Level 3: Fair value measurement is based on significant inputs other than market input. Fair value measurement of financial assets classified as level 3 is based on inputs such as valuation from fund managers of investment or institutional investment funds, put options or the Company's valuation based on financial results or comparison to other similar financial assets.

Group 31 December 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets at fair value	17.416.365	1.494.925	5.773.528	24.684.818
Fair value of held-to-maturity financial assets	1.877.043	2.882.909	0	4.759.952
Financial assets total	19.293.408	4.377.834	5.773.528	29.444.770

Group 31 December 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets at fair value	22.836.979	342.312	5.490.544	28.669.835
Fair value of held-to-maturity financial assets	1.752.326	2.613.295	0	4.365.621
Financial assets total	24.589.305	2.955.607	5.490.544	33.035.456

Changes that fall under level 3 in the year are specified as follows:	2017	2016
Balance at 1.1.	5.490.544	5.740.556
Purchased	1.353.865	1.543.352
Sold / Repayments	(1.434.912)	(2.703.592)
Interest and fair value changes	364.030	910.228
Balance at 31.12	5.773.528	5.490.544

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 26 Amounts are in ISK thousand

27. Risk Management

27.1 General on Risk management

Risk management is one of four key functions of an insurance company according to Act no. 100/2016. Risk management departement of VÍS executes the clauses on management of risk. The Group has, in accordance with the law, prepared policy on enterprise risk management. The policy has been approved by the Board of Directors and applies both to the Parent Company and its subsidiary, Lífís. The policy includes the organization and proceedings of risk management, specification of the main risks of the company, reporting and information and duties of employees to promote the policy. The policy defines market risk, insurance risk and operational risk as three key risks in the operation. Additionally, concentration and counterparty risk are also considered important risks. The following notes includes information on these risks.

The Group´s own funds consists of its shareholders equity, adjusted for items that are not permanently accessible capital in its operations, e.g. intangible assets and expected dividend payments, but with subordinated loan capital added.

Calculation of the Company‘s solvency capital requirement (SCR) is risk based and takes into account all the main risks applicable to insurance companies. The model (standard formula), upon which the calculations are based, assesses these risks based on 99.5% value at risk (VaR). That means that the probability of companies not being able to fulfil their capital requirement in the next 12 month period is 0.5% or one year of every 200.

27.2 Own risk- and solvency assessment (ORSA)

According to law insurance companies shall conduct its own risk- and solvency assessment (ORSA) where total capital requirements shall be assessed based on risk profile, risk tolerance and its business plan. The ORSA can be defined as "the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long term risks an insurance undertaking faces or may face and to determine the own funds necessary to ensure that the undertaking's overall solvency needs are met at all times".

The Group has implemented an ORSA-policy which has been approved by the Board. The outcomes of the process gives the Board and management information about the risk profile and the capital requirements of the Group based on specified presumptions. The Board and management have the outcome as a consideration for all strategic decisions for the Group, in preparing business and budget planning, capital management and development of new products.

27.3 Market risk

Market risk is the risk of loss or unforeseen change in financial position, which arise from fluctation of market value of assets, provisions and financial instruments.

Strategy for controlling market risk is done predominantly by revision of investment strategy and composition of assets in a portfolio. The strategy is based on the risk appetite of the Group, expectation of return from assets and historical analyses on return. Current portfolio, environment and restriction are taken in to account. With systematic management of the portfolio it is possible to even fluctuation and minimise risk related to change in market value of the Group's assets.

Primary market risk which are specially monitored:

• Interest rate risk
• Price risk of equity instruments
• Inflation risk
• Foreign exchange rate risk

27.4 Interest rate risk

Interest rate risk is risk of loss from fluctuations in fair value of financial instruments from change in interest (required rate of return). Duration of portfolio is in most cases not the same as duration of technical provision and therefore interest rate risk can occur in the operation of the Group.

Sensitivity analysis

The following table discloses the effect that 50 and 100 bp increase of interest on interest bearing assets would have on income and equity at the reporting date. The sensitivity analysis is presented for interest bearing assets with floating rate interest and is based on the presumption that all other variables remain constant. The sensitivity is presented post-tax and therefore reflects the effect on profit or loss and equity.

The effect on profit or loss and equity is the same since value changes of the underlying financial instruments is in no instances recognised directy in equity. A positive number indicates an increase in profit and equity. Decrease of interest rates would have the same effect in the opposite direction.

	31.12.2017		31.12.2016	
	50 bp	100 bp	50 bp	100 bp
Inpact on profit or loss and equity	42.942	85.884	54.250	108.500

27.5 Equity risk securities and other risk of market securities

Equity risk is the risk of potential loss of capital due to changes in price of equities.

The company invests in equities to enhance expected returns and diversify risk. Limits are defined in the company‘s investment policy to establish diversification in the equity portfolio and limit equity risk. Maximum limit is set on weight on equities as total of investment assets, limits on both listed and unlisted equities, limits on industry sectors, limits on funds as percentage of equity portoflio and limits on specific investments.

The Group also sets limits for investments in share funds to ensure spread of risk.

The Group also invests in market debt securities to spread risk and even fluctuations which takes aim of the Group policy on investments.

	31.12.2017	31.12.2016
Shares and share funds at fair value through profit or loss	9.610.513	11.423.180
Debt instruments and other securities at fair value through profit or loss	19.834.257	17.246.655

The effect of 5% and 10% increase in the market value of shares and debt securities on profit or loss and equity is disclosed below, net of 20% income tax. 5% and 10% decrease in market value would have the same effect but in the opposite direction.

	31.12.2017		31.12.2016	
	5%	10%	5%	10%
Shares - impact on profit or loss	480.526	961.051	571.159	1.142.318
Debt securities - impact on profit or loss	793.370	1.586.741	689.866	1.379.732

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 28 Amounts are in ISK thousand

27.6 Inflation risk

Inflation risk is the risk of loss which can arise from fluctuations in inflation on indexing balance. Indexing balance is the difference between indexed assets and liabilities. Big part of technical provision is inherently indexed and part of the Groups assets are indexed. The risk is that the portfolio of the Group is not correlated with changes in indexes in the same way as technical provision.

In investment policy minimum limits are set for indexed assets. The Group aims to invest in securities which are indexed or have the qualitative to increase in real value.

27.7 Foreign exchange rate risk

Foreign exchange rate risk is the risk of loss from fluctuations in exchange rates of foreign currencies. It arises if there is a mismatch in position of assets and liabilities in individual foreign currencies. Part of the Groups securities and technical provision are in foreign currencies. When limits are set for weight of assets in currencies in investment policies the foreign exchange rate risk of the Group is taken into the account.

The majority of the Group's assets and liabilities are denominated in ISK. However, the Group holds some foreign financial assets. Following is information regarding those foreign currencies that have most impact on the Group´s operations. Exchange rates and calculation of volatility disclosed is based on the average exchange rates of the Central Bank of Iceland during the year. Year-end rate is according to mid-exchange rate according to Íslandsbanki.

	Year-end exchange rates		Average exchange rates		Annual change
Currency	2017	2016	2017	2016	2017
USD	104,43	113,30	106,78	120,67	-7,8%
EUR	125,05	119,35	120,54	133,59	4,8%
GBP	141,03	139,16	137,45	163,80	1,3%
DKK	16,80	16,05	16,20	17,94	4,6%
NOK	12,70	13,15	12,93	14,37	-3,4%
SEK	12,71	12,49	12,52	14,13	1,7%

Foreign exchange rate risk as at 31.12.2017	Assets	Liabilities	Net position
USD	889.015	808.812	80.203
EUR	580.134	313.907	266.227
GBP	1.384.131	518.662	865.469
DKK	50.399	0	50.399
NOK	37	0	37
SEK	7	0	7
Total	2.903.723	1.641.381	1.262.342

Foreign exchange rate risk as at 31.12.2016	Assets	Liabilities	Net position
USD	943.100	1.061.144	(118.044)
EUR	545.412	328.743	216.669
GBP	1.255.200	439.177	816.023
DKK	19.279	0	19.279
NOK	39	0	39
SEK	7	0	7
Total	2.763.037	1.829.064	933.973

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 29 Amounts are in ISK thousand

27.7 Foreign exchange rate risk (contd.)

Sensitivity analysis

The following table discloses the effect of 5% and 10% strengthening of ISK to the respective foreign currencies on profit or loss and equity. The analysis is based on the carrying amount of assets and liabilities denominated in those currencies at the reporting date. A table above discloses those foreign assets and liabilities on which the sensitivity analysis is based, which are mainly foreign denominated securities. The sensitiviy analysis is based on the presumption that all other variables remain constant. It is based on post-tax amounts, 20% income tax, and reflects the impact on profit or loss and equity. The impact on profit or loss and equity is the same since value changes of the underlying financial instruments are in no instances recognised directly in equity.

Impact on profit or loss and equity

	31.12.2017		31.12.2016	
	5%	10%	5%	10%
USD	3.208	6.416	(4.722)	(9.444)
EUR	10.649	21.298	8.667	17.334
GBP	34.619	69.238	32.641	65.282
DKK	2.016	4.032	771	1.542
NOK	1	3	2	3
SEK	0	1	0	1

Weakening of ISK to the above foreign currencies would have increased profit and equity.

27.8 Counterparty risk

Operation of the Group is based on two foundations, insurance- and financial operation and counterparty risk can be found in both.

Primary counterparty risk components are:

• Risk of lowering of spread risk.
• Risk that counterparty can't comply with the obligation that contracts specify.

The main source counterparty risk are:

• Primary insurance.
• Reinsurance.
• Lending.
• Investments in debt securities.
• Bank deposits.

The Group regularly monitors its counterparty risk

Counterparty risk is as follows:

	31.12.2017	**31.12.2016**
Securities, credit rating A	3.791.229	0
Securities, credit rating BBB +	2.529.451	3.452.219
Securities, credit rating BBB	0	5.299.024
Securities, credit rating BB+	2.003.205	0
Securities, credit rating BB	66.228	916.144
Securities, credit rating BB -	0	462.233
Financial assets held-for-sale A	4.759.952	0
Financial assets held-to-maturity BBB +	0	2.794.727
Financial assets held-to-maturity BB	0	1.562.800
Other market securities	6.684.193	7.117.034
Collateralised loans and other loans	2.379.069	41.461
Account receivables	6.178.620	5.706.473
Claims on reinsurers	16.901	24.970
Other receivables	1.737.267	1.740.968
Cash and cash equivalents	1.094.394	1.063.335
	31.240.508	30.181.389

The Group´s maximum exposure to counterparty risk corresponds to the carrying amounts disclosed above.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 30 Amounts are in ISK thousand

27.9 Liquidity risk

Liquidity risk is the risk that the Group will not have enough liquid assets or not being able to sell assets in time and therefore encounter difficulty in meeting its financial obligations when due.

Liquidity position, its development as well as the impact of market conditions and future outlook is monitored on a regular basis. Particular emphasis is placed on that there are always adequate liquid assets to meet expected payments of both claims and other liabilities. The Group's expected payments are very well secured by its liquidity position. The Group's policy on liquid assets is to have minimum cash and cash equivalents at each time and that large part of assets can be sold immediately.

Expected cash flows of financial liabilities is specified as follows:

	Within one year	2019	2020 +	Total
31.12.2017				
Claims provision	7.993.039	4.157.298	4.093.509	16.243.846
Subordinated bond	136.628	136.628	6.158.956	6.432.212
Accounts payable and other short-term liabilities	1.201.613	0	0	1.201.613

	Within one year	2018	2019 +	Total
31.12.2016				
Claims provision	7.809.868	2.773.399	6.779.006	17.362.273
Subordinated bond	131.250	131.250	6.145.000	6.407.500
Accounts payable and other short-term liabilities	1.134.707	0	0	1.134.707

27.10 Insurance risk

Insurance risk is the risk of loss or unforeseen increase of insurance liabilities due to unadequate pricing or measurement of claims provision.

The main elements of insurance:

- Contract risk
- Sales- and risk assessment.
- Product management.
- Product development and new products.
- Technical provision.
- Handling and settlement of claims.
- Reinsurance protection.

Insurance classes - premiums earned	**2017**		**2016**	
Property insurance	4.394.773	21,4%	4.034.572	22,0%
Marine and cargo insurance	573.896	2,8%	477.657	2,6%
Mandatory vehicle insurance	6.914.743	33,7%	5.969.053	32,6%
Other vehicle insurance	3.094.930	15,1%	2.564.143	14,0%
General liability insurance	1.147.186	5,6%	987.161	5,4%
Accident and health insurance	2.283.030	11,1%	2.062.436	11,3%
Life insurance	1.196.197	5,8%	1.084.748	5,9%
Reinsurance	922.848	4,4%	1.139.264	6,2%
	20.527.603	100,0%	18.319.034	100,0%
Domestic and foreign operations - premiums earned				
Domestic operations	19.604.755	95,5%	17.179.770	93,8%
Foreign operations	922.848	4,5%	1.139.264	6,2%
	20.527.603	100,0%	18.319.034	100,0%

Contract risk is a risk connected to insurance contracts that contain wrong or misleading information on insurance policy or in other legalised form. The risk can also arise from the scope of the terms being unclear. Risk from reinsurance contracts arises if there is no protection for a claim.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 31 Amounts are in ISK thousand

27.10 Insurance risk (contd.)

Risk connected to sales, renovate and risk assessment is that insurance cover that the Group sells is under-priced or risk assessment is inadequate. Risk of employees mistakes, insurance consultants, sales employees and insurance brokers is included. The same apply to use of personal information and competition law.

Risk from product management is that monitoring of development and results of specified insurance classes of the Group is not adequate and that action is not taken with change in price or in other ways.

Risk connected to product development and new products arises if preparation is not done properly, with consequences that plans will not be met and there will be loss from operation.

Technical provision risk is the risk that the obligation of the Group related to its insurance contracts is underestimated, both for unearned premiums and claims provision. Unearned premiums liability is the estimated amounts due to unexpired policies. Claims provision is the estimated liability due to incurred but unsettled losses, both reported and unreported. Estimated value of technical provision is based on the methods of Solvency II.

Sensitivity analysis

The following table discloses the impact of 1% change in loss amounts, claims provision and unearned premiums on the Group's profit or loss and equity.

	2017	2016
Loss amounts	116.441	112.538
Claims provision	127.649	124.784
Premiums, based on no change in loss or cost ratios	18.323	10.322

The main risk factors are mistakes in handle of and settlement of claims, wrong decision making or fraud by emploees. There is also risk that claimant gives wrong information or exaggerates the claim, i.e. insurance fraud. This also includes administration of sensitive personal information and contractors will go beyond their purview.

Reinsurers' risk is the risk of reinsurers not paying their share of losses, the amount of reinsurance is not adequate, there is a mismatch between primary insurance and reinsurance, and different intrepretation between insurer and reinsurer on reinsurance agreement. The Group's reinsurance policy stipulates that its reinsurers shall have a rating from an international rating agency. Limits are applied regarding reinsurance from each individual reinsurer. Ratings requirements depend on the estimated settlement period of losses in each contract. In addition to that the number of reinsurers in each contract and maximum risk exposure of each reinsurer is based on that reinsurer's rating. The following table discloses the disaggregation of premiums to reinsurers based on their rating for the year 2017and an estimation for the year 2018.

	2018	2017
AA+	4,9%	4,9%
AA-	78,7%	80,5%
A+	10,8%	9,3%
A	1,0%	0,8%
A-	4,6%	4,5%
	100,0%	100,0%

27.11 Operational risk

Operational risk consists of all risks that are related to regular operations of the Group and is defined as a risk of direct or indirect loss due to internal factors of the Company, such as employees, structure, contracts and filing, processes, working procedures, external factors, such as legal risk and customer relationships. It is the Company's policy to reduce operational risk, taking the cost of preventive measures into account.

The main factors of operational risk are:

• Organisational structure.
• Filing and contracts.
• Information technology.
• Employees.
• External events.

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 32 Amounts are in ISK thousand

27.12 Internal management and monitoring

The Group´s policy is to have well organized and reliable internal control framework that is intergrated part of its enterprise risk management. The framework is articulated by the Board, management and employees and designed to give reasonable assurance of the achivevement of the Groups´s objectives on:

• Effectiveness and efficieny of oparations
• Reliability of reporting
• Compliance with laws and regulations

To achive those objectives in the Group´s effective Internal control system the following five components work to support it´s mission, strategies and business objectives:

• Control Environment
• Risk Assessment
• Control Activites
• Information & Communication
• Monitoring Activities

The policy is based on COSO´s (Committee of Sponsoring Organisations of the Treadway Commission) framework on Internal Control (Internal Control – Integrated Framework) published in may 2013.

The Internal Control can be witnessed in all practices, methods, codes of conduct and policies on human resources and is at the same time an intergrated part of daily business and operation.

27.13 Combined ratio and operating ratio

Combined ratio is the sum of incurred losses, operating expenses and net reinsurance cost as a proportion of earned premiums. Operating ratio is calculated as the combined ratio, except that the ratio's denominator also includes investment income and other income from insurance operations. Claims ratio, operating ratio and reinsurers' cost ratio are calculated as proportion of premiums for the year.

Ratios from 2013 are calculated according to older legislation.

The following table discloses combined ratio, operating ratio and other key figures of the insurance operations for the past five years. Lífís became a part of the Group on 1 April 2012.

	2017	2016	2015	2014	2013
Net claims ratio	73,4%	79,6%	79,4%	82,4%	75,5%
Claims ratio	68,2%	81,1%	76,7%	80,4%	78,7%
Operating cost ratio	21,1%	21,4%	21,5%	21,4%	21,4%
Reinsurers' cost ratio	6,0%	-0,9%	3,3%	2,7%	-2,3%
Combined ratio	**95,3%**	**101,7%**	**101,5%**	**104,5%**	**97,8%**
Investment income ratio	4,9%	6,6%	6,9%	6,4%	7,3%
Ratio of other income from insurance operations	0,7%	0,9%	1,0%	1,0%	1,0%
Operating ratio	**90,3%**	**94,6%**	**94,1%**	**97,3%**	**90,3%**

28. Related parties

Related parties are those parties, or their companies, that have an influence on the Group, whether directly or indirectly. Related parties are largeshareholders, board members and members of the boards sub-committees, key management personnel and their families, as well as other parties directed by or under the influence of the Group. Transactions with related parties have been on the same terms as with unrelated parties. Salaries and benefits of the board and management personnel is disclosed in note 9.

Transactions and balances with related parties are specified as follows:

2017	Income	Expenses	Assets	Liabilities
Related companies	0	2.820	0	0
Board of directors and key management personnel	19.156	24.402	17.343	563
	19.156	27.222	17.343	563
2016				
Board of directors and key management personnel	6.443	13.016	10.758	1.508
	6.443	13.016	10.758	1.508

Consolidated financial statements of Vátryggingafélag Íslands hf. 2017 33 Amounts are in ISK thousand

29. Guarantees and other matters

The Group is the lessee in a number of leases of premises in various places in Iceland. Montly lease payments amounts to ISK 13 million at year end 2017. Total future committment is ISK 1,260 millions as at the same time. The lease contracts are for a specified lease periods, more specifically to the years 2019 - 2027.

According to these contracts lease payments for the next year amounts to ISK 159 million and ISK 149 million annually for the years 2019-2021.

Paid lease according to these contracts was 166 millions for the year 2017 and 202 millions for the year 2016.

30. Events after the reporting date

On the 18th of February the Company announced its Board decision to withdraw from its buy-back plan. At that time it already had bought 37,92% of then agreed by-back.
Determining the Own funds at year-end, as noted in note 22, the remainder of the buy-back plan is fully deducted and thus lowering the eligible own funds covering company´s SCR. As a consequence of mentioned decision the company estimates the effect to be 4 point rise on its Solvency Ratio.

31. Significant accounting policies

The accounting policies as set out below have been applied consistently for all periods to the financial statements and for all the Group's entities. The Group has adopted all international financial reporting standards, interpretations and changes to standards adopted by the European Union that are applicable to the Group and effective as at 1 January 2017. The Group has not adopted standards, amendments to standards or interpretations effective for periods starting later than 1 January 2017 where early adoption is permitted.

New standards, interpretations and amendments to standards

The International Accounting Standards Board has issued a few new standards and interpretations as well as amendmends to previously issued standards. Following is a discussion regarding those standards, interpretations and amendments relevant for the Company.

Amendments effective for the year 2017

According to IAS 7 Statement of Cash Flows entities are, as from the year 2017, to provide disclosures that enable investors and other users of the financial statements to understand better than before changes in liabilities in the balance sheet, i.e. from the beginning to end of the reporting period, arising from financing activities. Reference is made to note 23 for information on changes in liabilities from the beginning to the end of the year due to financing activities.

Standards that are not effective yet

IFRS 9 Financial Instruments becomes effective as from the year 2018. It replaces the currently effective standard, IAS 39 Financial Instruments: Recognition and Measurement and also affects other standards, in particular IFRS 7 Financial Instruments: Disclosures. According to IFRS 9 the most important factor in classification of financial assets and liabilities will be the applicable business model but the characteristics of the instruments are also of importance. The standard will have a limited effect on the Company´s financial statements. The vast majority of its financial assets at year-end 2017, or 72.1%, are measured at fair value through profit or loss and will continue to be accounted for in that manner. Trade receivable and held-to-maturity financial assets will continue to be accounted for at amortised cost. The impairment model of IFRS 9 is based on expected loss while the impairment model of IAS 39 is based on incurred loss. Therefore impairment recognition might change. However management believes that the impact will be immaterial.

IFRS 15 Revenue from Contracts with Customers is effective as from the year 2018. The standard provides more detailed rules and guidance on sale of goods and services than the standards and interpretations it replaces. According to the standard revenue is to be recognised as or when a company fulfils its obligations via transfer of promied goods and services to its customer, i.e. as the customer obtains control. Prior to IFRS 15 revenue recognition was more based on transfer of risks and rewards. Management believes that the new standard will have immaterial effect on the Company since the portion of its total revenue that is within its scope is immaterial.

31. Significant accounting policies (contd.)

IFRS 16 Leases is effective as from the year 2019. According to the standard all lease contract are to be recognised in the balance sheet of lessees, except that lessees can apply an exception made for leases where the leased item´s value is immaterial or if the lease term is shorter than or equal to 12 months. The present value of contractual lease payments of lease contracts currently classified as operating leases will be recognised as liabilities but a corresponding right of use of the leased items capitalised among assets in the balance sheet. The right of use assets will be amortised and interest expense recognised on the lease liability. The Company is the lessee in lease contracts for housing. The lease contracts are, in accordance with currently effective guidance, classified as operating leases. The impact of IFRS 16 on current lease contracts has not been fully assessed. However, the lease liability and right of use asset to be recognised in the balance sheet as at the beginning of 2019 is estimated to be approximately ISK 786 million.

IFRS 17 Insurance Contracts was issued on 18 May 2017. The standard is effective as from the year 2021, if endorsed by the EU. Due to the short period of time since the standard was issued it is not yet clear how much effect it will have on the Company´s financial statements, i.e. its impact has not been fully assessed.

The notes to the financial statements are prepared based on relevance and materiality with respect to the needs of users of the financial statements. Therefore information that is considered neither relevant nor material for the user of the annual financial statements is not disclosed.

31.1 Group

The Group´s financial statements include the financial statements of the Parent Company and its subsidiary. Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to or has rights to variable returns from its involvement with the entity and has ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

The financial results of subsidiaries acquired or sold during the year are included in the financial statements from the date of acquistion to the date of disposal, as applicable.

The consolidated financial statements include the revenue, expenses, assets and liabilities of the Group from transactions with third parties. Intercompany transations are eliminated in the consolidated accounts. When applicable the financial statements of subsidiaries are modified to align them with the accounting policies of the Group.

If shareholding in a subsidiary is less than 100% a non-controlling interest in profit or loss and equity is recognised. However, since noncontolling interest is immaterial it is not presented separately in the financial statements.

31.2 Subsidiaries

Acquisition of subsidiaries are recognised in accordance with the acquisition method. Accordingly assets, liabilities and equity instruments issued as consideration to obtain control are measured at fair value at the acquisition date. Acquition-related cost is recognised in profit or loss as incurred.

Contingent assets or liabilities related to the acquisition are measured at fair value at the acquisition date. Subseqent changes to the fair value of those assets and liabilities are recognised as an adjustment to the acquisition cost if they qualify as period adjustment. All later adjustments to fair value of contingent assets and liabilities are recognised in accordance to applicable standards. Changes to contingent payments classified as equity are not recognised.

31.3 Goodwill

Goodwill that arises from acquisitions is recognised on the date the Company achieves control of the acquired company. Goodwill is the difference between the acquision price of a subsidiary and the acquirer´s interest in the net assets of the subsidiary, at fair value at the acquisition date. Goodwill is not amortised but tested annually for impairment or more often if there is any indication of impairment. For the purpose of impairment testing goodwill is allocated to cash-generating units. Those cash-generating units to which goodwill has been allocated are tested for impairment. Impairment has occured if carrying amount exceeds recoverable amount. Impairment is first recognised by the expense of goodwill and thereafter as a reduction of the carrying amount of other assets of that cash-generating unit. Impairment losses of goodwill is not reversed in later periods.

31.4 Customer relationships

Customer relationships, recognised upon acquisition of operations, are amortised over the estimated useful life, which is 10 years.

31.5 Revenue

Premiums

Premiums recognised as income in profit or loss comprise the premiums contracted during the year including premiums transferred from prior year but excluding next year's premiums, which are recognised as unearned premiums. Unearnd premiums in the balance sheet form the part of premiums due to insurance risk during the period which belongs to unexpired insurance policies at year end.

Dividend and interest income

Dividend income from investments are recognised on the date when the right to dividend is established.

Interest income is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Interest income is recognsied as accrued based on effective interest rate. Effective interest rate is the rate of interest that discounts the expected cash flows or revenue over its estimated life so as to equal the carrying amount of the financial asset.

31.6 Expenses from insurance operations

Claims expensed in profit or loss consist of claims incurred during the year as well as the effect of reassessment of claims from previous years. Claims provision in the balance sheet consists of total amount of reported unsettled claims as well as actuarial estimation of incurred but unreported claims.

31.7 Insurance contracts

The Company issues contracts that transfer both financial and insurance risk from its customers to the Company.

Definition of insurance contracts

Insurance contracts are contracts under which the insurer accepts, in accordance with contractual provisions, to compensate the policyholder for

The insured event is uncertain, it is not known if or when it occurs, and generally its financial consequences are not known beforehand.

Classification of insurance contracts

Casualty insurance contracts consist of third party liability contracts, accident contracts and property insurance contracts including marine insurance contracts.

Third party liability contracts protect the customer for the risk of causing harm to third parties as a result of their legitimate activities.

Accident insurance contracts compensate the insured own bodily injuries in accordance to contractual provisions.
Property insurance contracts compensate the Group´s customers for damage suffered to their properties or for the value of property lost. Customers operating in businesses could also receive compensation for the loss of earnings caused by the inability to use the insured properties in

Life insurance contracts are related to life of human beings, for instance death or living beyond the insurance period. Premiums are recognied as revenue during the policy life. Damages are expensed when the insured event occurs.

Investments where investment risk is borne by the life-insurance policyholder

Investments where the investment risk is borne by the policyholder are financial assets of the Company selected by the investment and lifeinsurance policyholders. The policyholders bear the investment risk in those investment life-insurance policies. Investment for the benefit of lifeinsurance policyholders is recognsied as a liability in the balance sheet to the same amount.

Technical provision

At each reporting date the Group evaluates its technical provision so as to conclude on if it is sufficient to cover the Group´s liabilites due to written insurance contracts. The evaluation is based on estimated future cash flows of the technical provision. All changes in technical provision are recognised in profit or loss. The evaluation takes into account all expected contractual cash flows due to claims and claims expenses.

31.7 Insurance contracts (contd.)

Reinsurance contracts

The Group enters into reinsurance contracts with the purpose of mitigating its risk. Reinsurance contracts are either proportionl or bearing all risk if insurance loss amount due to a loss event exceeds prior determined contractual amount.

Claims on reinsurers due to premiums and claims are recognised as reinsurance assets. It consists of claims on reinsurers due to their portion of claims in accordance with reinsured insurance contracts as well as their portion of the claims provision. Liabilities due to reinsurance consist of reinsurers's share of premiums due to reinsurance contracts, expensed in profit or loss on renewal of reinsurance contracts.

31.8 Foreign currencies

Foreign exchange difference is recognised in profit or loss as incurred.

31.9 Financial expenses

Financial expenses are expensed in profit or loss as incurred.

31.10 Income taxes

Income taxes expensed consists of current taxes and deferred tax.

Current taxes

Current taxes are the expected taxes payable on taxable income for the year, and any adjustment to taxes payable in respect of previous years.Taxable income for the year is generally different from profit or loss for the year according to the financial statements. Calculated tax is based on tax rates enacted at the reporting date.

Deferred tax

Deferred tax is due to temporary difference between taxable income and profit or loss according to the financial statements. The reason is that the Group´s tax base is based on premises different from the financial statements. Deferred tax is not recognised on non-deductible goodwill. Deferred tax is calculated based on the tax rate enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the tax asset can be utilised in the future.

Deferred tax is expensed in profit or loss unless it is related to items recognised directly in equity. If so the tax is also recognised in equity.

31.11 Operating assets

An operating asset is recognised when it is probable that economic benefits embodied in the asset will flow to the Group and its cost can be measured reliably. Operating assets are recognised at cost value less accumulated depreciation and impairment. The cost of operating assets consists of the purchase price and all directly attributable cost necessary to make the asset capable of generating revenue.

Equipment is recognised at cost less accumulated depreciation and impairment.

Depreciation is recognised on a systematic bases over the expected useful life of the asset, taking into account its estimated residual value. Depreciation method, expected useful life and residual value is reviewed at least annually.

Gain on sale of operating assets is calculated as the difference between the sale price and carrying amount. It is recognised in profit or loss as part of other income.

31.12 Software

Software is recognized at cost less accumulated amortisation and impairment. The cost price consist of the purchase price and all direct cost to get the software in to use. Software is amortised using the straight-line method over 3 to 10 year from the date it was taken in to use.

31.13 Financial assets

The Group´s financial assets consist of financial assets at fair value through profit or loss, financial assets held-to-maturity and loans and receivables. Financial assets are recognised initially at fair value, taking into acount transaction cost incurred in the case of financial assets not recognised subsequently at fair value. Subsequent to initial recognition fiancial assets at fair value through profit or loss are recognised at fair value but financial assets held-to-maturity as well as loans and receibables are recognised at amortised cost based on the effective interest ratemethod.

Fair value is the price in an orderly transaction to sell an asset or to transfer a liability at the measurement date. More specifically it is the price obtained on sale of assets or paid to transfer a liability in an orderly transaction between market participants.

Effective interest rate

Effective interest method consist in calculating the repayment value of a financial asset or liability and allocating interest income or expenses over the life of the instrument. Effective interest rate is the rate that discounts the expected cash flows or income over the estimated life of a financial instrument, or a shorter period if relevant, so as to equal the carrying amount of the financial asset or liability in the balance sheet.

Interest income is recognised in accordance with effective interest rate for all interest bearing financial instruments except for those designated as financial assets at fair value through profit or loss.

Financial assets at fair value through profit or loss

Financial assets are classified as at fair value through profit or loss if they are acquired with the intention of short-term profit taking. The same applies for all other financial assets the Group designates as at fair value through profit or loss.

Fair value changes of financial assets consist of changes in fair value, dividend income, interest income and indexation.

A financial asset can be designated as at fair value through profit or loss at initial recognistion if one of the following conditions are fulfilled:

- the designation reduces or eliminates measurement or recognistion mismatch.
-the financial asset is a part of a portfolio of financial assets or liabilities, or both, and is recognised at fair value in accordance with the Group's documented risk management policy or investment policy.
- the financial asset is a part of a contract containing one or more embedded derivatives and it is permitted to recognise the hybrid instrument (asset or liability) at fair value through profit or loss.

Financial assets held-to-maturity

Financial assets are classified as held-to-maturity investments when the Group has the positive intent and ability to hold investments in debt securities to maturity. Held-to-maturity investments are recognised at amortised cost based on effective interest rate, less any impairment.

Loans and receivables

Accounts receivable, loans and other receivables with fixed payments and not quoted in an active market, are classified as loans and receivables. Loans and receivables are recognised at amortised cost based on effective interest rate, less any impairment. Interest income on loans and receivables are recognised based on effective interest rate.

Impairment of financial assets

Carrying amount of financial assets, other than those recognised as at fair value through profit or loss, are at each reporting date reviewed for any indication of impairment. Impairment has occured if the estimated future cash flows, based on the initial effective interest rate, is lower than carrying amount. If impairment no longer exists it is reversed but only to the extent of previously recognised impairment.

If it is not possible to review individual financial assets for impairment, the portfolio to which they pertain is reviewed for impairment.

At each reporting date financial assets not at fair value through profit or loss are reviewed for possible indication of impairment. A financial asset is considered impaired if an objective event, subsequent to initial recognistion, reveals that the expected future cash flows of the financial assets will be lower than previously estimated and the effect of the loss event can be objectively determined.

Impairment assessment of each portfolio of financial assets is based on historical experience with respect to those assets, the date on which the loss could possibly be recovered and the amount of the loss. The asssessments includes management estimation as to whether current economic and loan conditions are such that the loss will be more or less than would be expected based on historical experience.

31.13 Financial assets (contd.)

Derecognition of financial assets

The Group derecognises a financial asset if, and only if, the contractual right to the cash flows of the asset no longer exists or the risk and reward

31.14 Impairment of other assets

At each reporting date management reviews the carrying amount of tangible and intangible assets for indications of impairment. If any such indication exists the recoverable amount of the asset is estimated. The recoverable amount of a cash-generating unit to which the asset belongs, is estimated if it is not possible to test the asset individually for impairment.

Recoverable amount is the higher of fair value less cost to sell and value in use. Value in use is based on estimated future cash flows, discounted at pre-tax rate of interest, where the interest rate reflects the market assessment of time value of money at each time and the risk embodied in the asset.

Intangible assets with indefinite useful life and intangible assets not ready for use are tested for impairment annually and more often if there is any indication of impairment.

If the recoverable amount of an asset is lower than its carrying amount the carrying amount is reduced to the recoverable amount. Impairment loss is recognised in profit or loss.

A recovery of the asset, subsequent to impairment recognition, is reversed. However reversal is limited to the amount of the asset not being recognised at an amount higher than its carrying amount prior to the impairment recognition. Reversal of impairment of goodwill is prohibited.

31.15 Obligations

An obligation is recognised when the Group has legal or constructive obligation due to a past event, payment is probable and the amount of the obligation can be reliably determined.

The amount of the obligation is based on the best possible estimation of the liability at the reporting date. If the amount of the obligation is based on estimated future cash flows it is recognised at present value.

If the obligation is recoverable from a third party, the amount is recognised as an asset.

31.16 Financial liabilities and equity instruments

Classification as liabilties and equity
Liabilities and equity instruments are classified in accordance with their contractual provisions.

Equity instruments
An equity instrument is a contract of difference, were the value of the equity instrument is were total debt is subtracted from total assets of the issuer.

Guarantees related to financial liabilities are initially recognised at fair value. Guarantees are subsequently, except for those classified as at fair value through profit or loss, recognied at the higher of:

- the amount of the underlying liability, estimated in accordance with IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets* ,
- the amount of the original contract less accumulated amortisation in accordance with rules on revenue recognition.

Financial liabilities
The Group´s financial liabilities consist of trade and other payables. Financial liabilities are initially recognised at fair value less transaction cost. They are derecognised if the Group´s liabilities, as contractually defined, are paid, expire, discharged or cancelled.