4Q20 Financial Results

islandsbanki.is

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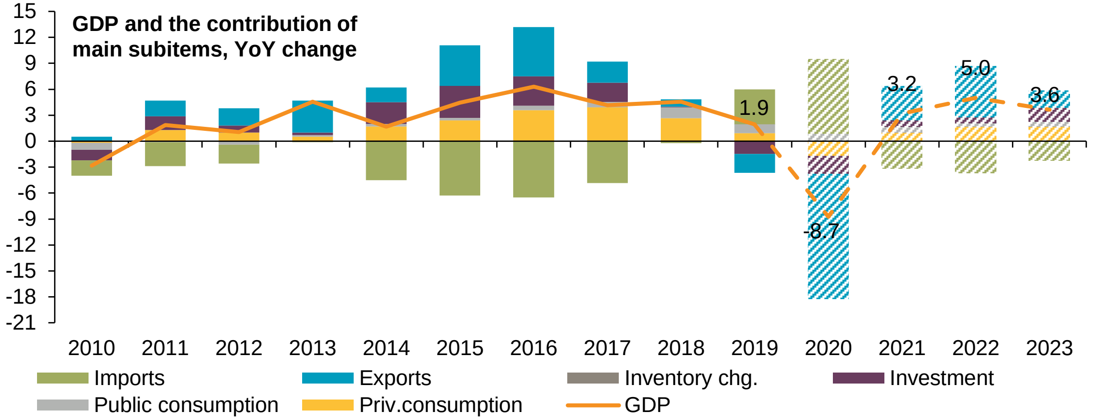
10 February 2021

1. 4Q20 highlights and key takeaways

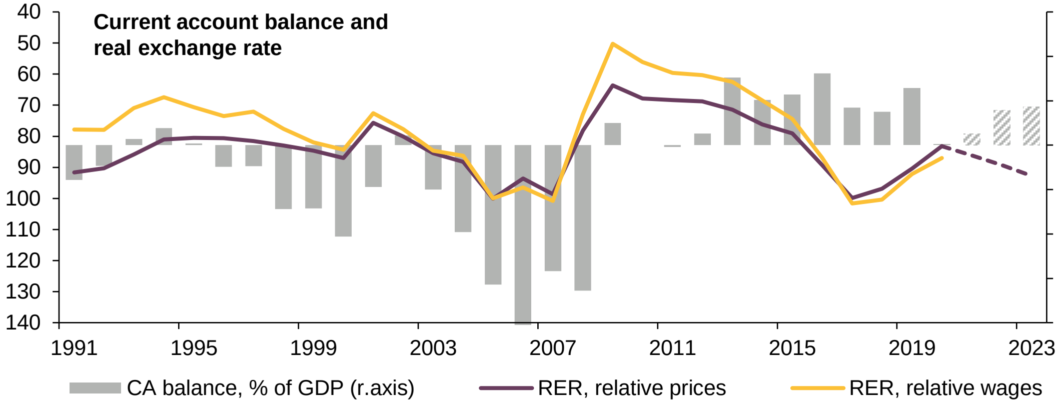
A return to growth is likely in 2021 following deep recession

Strong foundations facilitate a robust recovery when world-wide pandemic impact fades

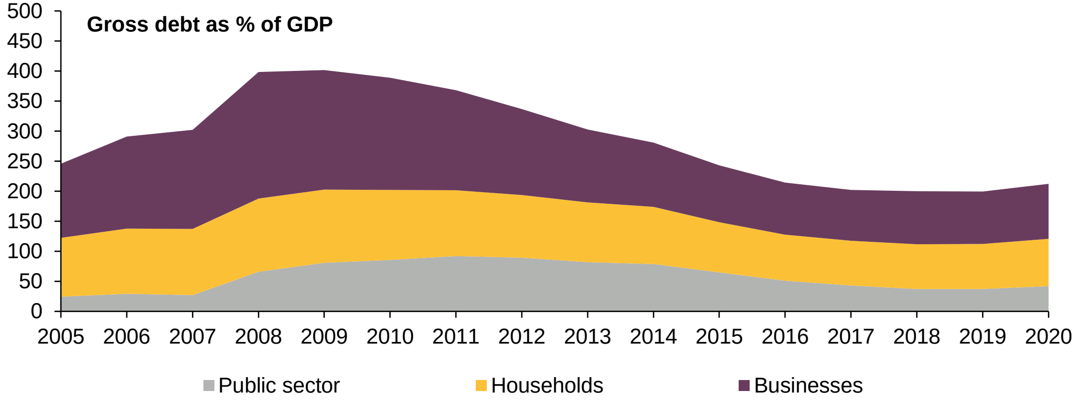
Following a deep recession in 2020, the economy is likely to return to growth..



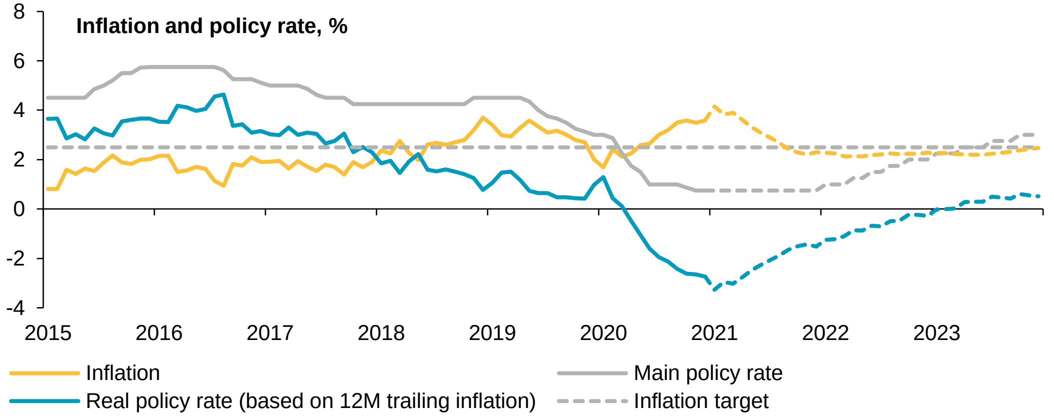
...supported by a lower real exchange rate and robust external balance



Moderate leverage throughout the economy increases resilience to shock..



...and loose monetary conditions are supporting households and businesses



Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Key takeaways

A robust 4Q20 to end an extraordinary year

1. Steady underlying operations

- Universal relationship banking strategy delivered a strong quarter with ROE at 7.6% following a 7.4% ROE in Q320
- NIM holds firm at 2.5% despite lower rates environment
- Continuous digital uptake during the C-19 period contributes to improved cost to income ratio beating the Bank´s target at 51.7%

2. Enhanced business position

- #1 in brokerage at NASDAQ OMX Iceland and #1 in M&A in 2020
- AUM rises to a record high, with a 35% market share
- Low rates propel significant profitable growth and increased market share in residential mortgages to 19%

3. Significant balance sheet strength

- Stable NPLs and diversified loan portfolio with solid collateral coverage
- Temporary increase in stage 2 loans due to C-19 impact on tourism
- Rock solid liquidity and capital metrics with total capital ratio at 23% with high REA density at 69% and low leverage ratio at 13.6%

4. A catalyst for a postitive sustainable development

- First Icelandic bank to publish a Sustainable Financing Framework
- First sustainable and first green bond by an Icelandic bank
- 50% of sustainable bond proceeds already allocated to eligible environmental and social projects

Financial targets

ROE at 7.6% in the fourth quarter – all other targets met in 2020

	Target		2020	Guidance
ROE in excess of risk-free rate	4-6%		2.6%	— Target of 4-6% on top of risk-free rate. Risk-free rate is currently 0.5% — 8-10% ROE is based on average expected risk-free rates through the business cycle. Based on the risk-free rate of 0.5% the ROE target in the very short term is 4.5-6.5% — The COVID-19 pandemic had a material adverse effect on the Bank's earnings in 2020 and therefore the ROE target will not be met this year. The Bank will strive to get back on track to reach its ROE targets from 2021 onwards
Return on equity	8-10%		3.7%	
Cost / Income ratio[1]	<55%	✔	54.3%	— The Bank continues to invest in IT infrastructure and process efficiency to improve the C/I ratio in the medium to long term
Tier 1 capital ratio	>13.2-14.7%	✔	20.1%	— Based on a management buffer of 50-200bp, the CET1 target range is currently 13.2-14.7% — Long term CET1 target is >16%. In line with the target range, the Bank expects to maintain a CET1 ratio of over 16% in the medium to long term — The Bank is substantially over capitalized with regard to the current regulatory requirement, which is a favourable position to be in in light of the economic uncertainties relating to COVID-19
Total capital ratio	> 17.5-19.0%	✔	23.0%	— Based on the regulatory capital requirement with a management buffer of 50-200 bp — Current capital requirement is 17.0% including recent suspension of the countercyclical capital buffer in March 2020
Dividend payout ratio	40-50%	✔	50%	— The Board of Directors proposes that ISK 3.4bn will be paid in dividends to shareholders, which is 50% of profits in 2020 and is in line with the Bank's policy of paying dividends of 40-50% of the profit of the year — The Board may convene a special shareholders' meeting later in the year to propose payment of additional dividends if the Bank's accumulated capital reserves are considered to exceed its long-term capital requirements

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one-off items)

Operational highlights in 4Q2020

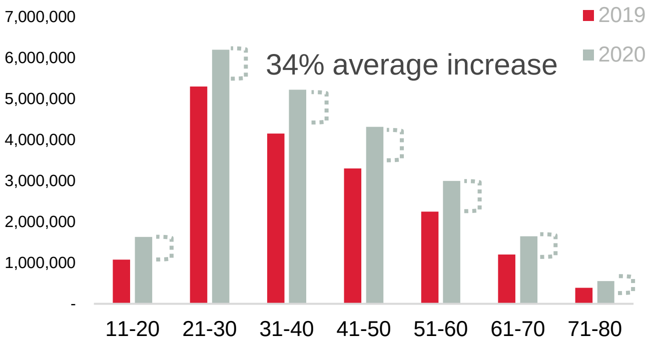
First sustainable bond by an Icelandic bank issued in the quarter

- Íslandsbanki was involved in large projects undertaken by the three listed real estate companies. Bonds were issued for Eik and Reginn and the Bank advised on during Reitir's stock share offering.
- 14 projects received a total of ISK 30.5 million from the Íslandsbanki Entrepreneurship Fund.
- Íslandsbanki issued the first sustainable bond by an Icelandic bank for EUR 300 million with a maturity of 3 years. The issue was more than 3 times oversubscribed and was placed to investors across Europe. The proceeds of the issue were used for loans that meet the conditions set out in Íslandsbanki's Sustainable Financing Framework.
- For the second year in a row, Íslandsbanki received the Icelandic Association of Business Women (FKA) Equality Scale in 2020.
- The Norwegian asset management company Storebrand Asset Management partnered with Íslandsbanki to offer three green investment funds in Iceland. The funds are open to both general investors and institutional investors in Iceland.
- Íslandsbanki became a member of PCAF, a global partnership of financial institutions whose objective is to develop and implement metrics for measuring greenhouse gas emission for loan and asset portfolios. PCAF (Partnership for Carbon Accounting Financials) handles the development and use of climate metrics that financial institutions can use to analyse carbon emissions in their loan and asset portfolios. Participation in the project is part of Íslandsbanki's Sustainability Policy and the Bank's initiative for extensive co-operation on responsible business practices.
- Íslandsbanki continued to be a leader in financial education and hosted educational sessions on various issues, such as finance at retirement, finances during maternity leave and savings. Due to the COVID-19 pandemic, educational meetings were held online with significant participation.

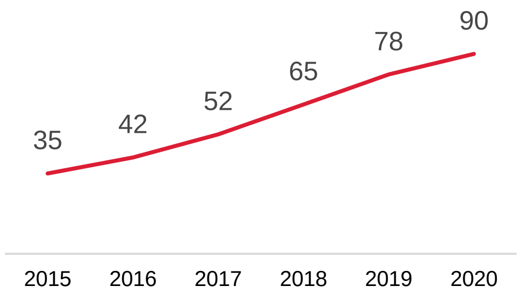
Major progress on the digital front

Quick time to market for digital products supported all business units navigating through COVID-19

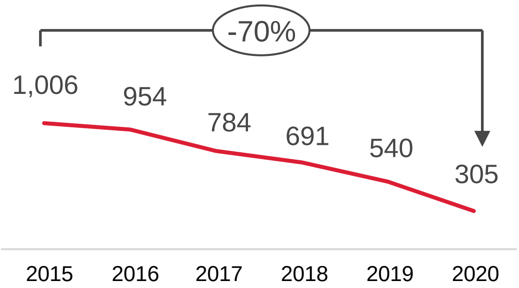
App visits by age categories



App users
Thousands



Branch visits
Thousands



A series of value-added digital initiatives in 2020 supported accelerating customer digital adoption rates while reducing fixed costs

Over 31 million visits to the app and online bank. Crucial infrastructure improvements in 2020

- Ensured high customer satisfaction all year[1]

Digital onboarding & app access now available for retail, SMEs and large corporates

- Leading to 47% increase in customer onboarding through digital channels

Open banking policy developed, open API portal for developers made accessible and account aggregation added to the app

- Íslandsbanki customers are now able to access their account balance from other local banks via Íslandsbanki´s app

New features added to digital channels e.g. electronic signatures for all main applications

- Improved customer experience instantly

Automated application and credit scoring for mortgages to households introduced

- Supported a record breaking 67% increase in mortgages

Conversational AI chatbot launched in 4Q20 and online reservation system for advisory services implemented

- Over 20 thousand conversations successfully completed to date

1. As measured by Gallup Iceland tracking survey monthly

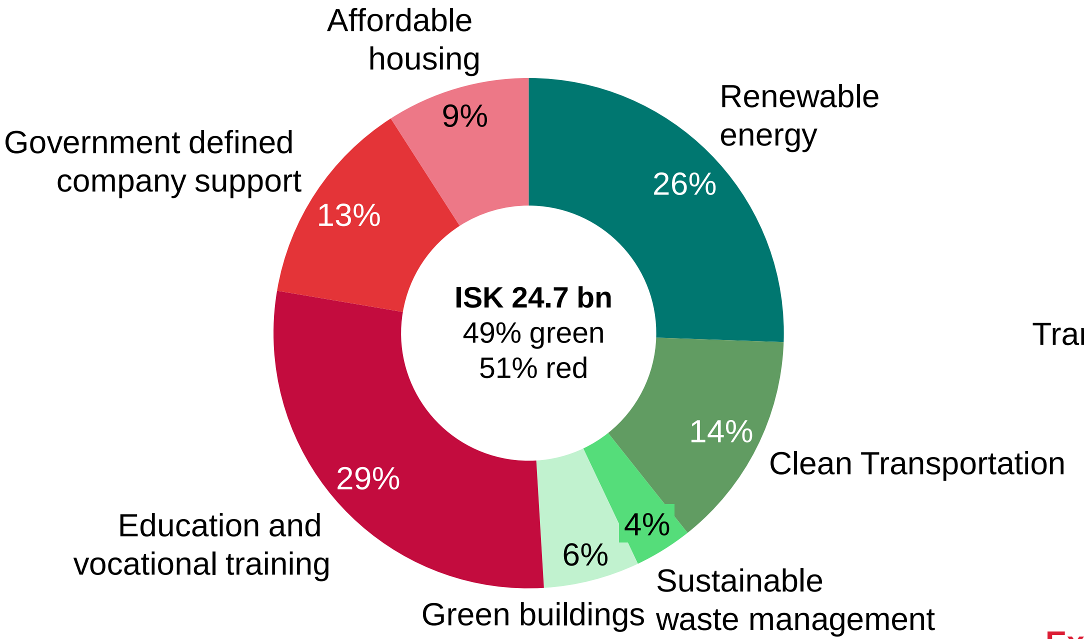
Sustainable Financing Framework: Allocation and impact

50% of proceeds from sustainable and green bonds issued in 2020 has been allocated to eligible projects

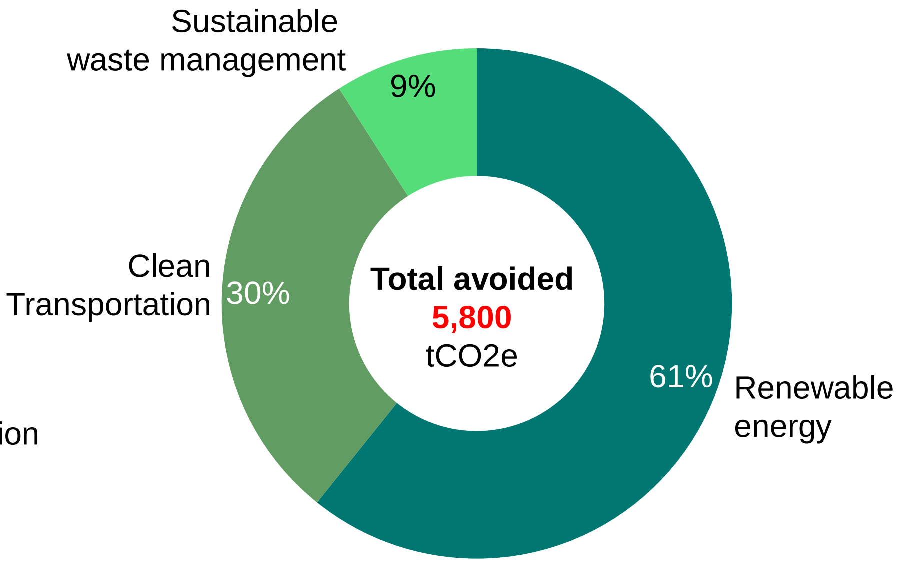
Comments

- 49% of eligible assets are in the green (environmental) categories and led e.g., to a total of 5,800 tCO2e in avoided greenhouse gas emissions
- Among social impact indicators was government defined company support related to COVID-19 was provided to 342 SMEs

Use of proceeds as of 31.12.2020



Avoided greenhouse gas emissions in 2020



Examples of other impact indicators

87 GWh of clean energy produced

342 SMEs supported with government defined COVID-19 loans

2. Income statement

A robust quarter with strong underlying operations[1]

Majority of net impairments in Q420 and FY20 are C-19 related

Comments

- Universal relationship banking strategy delivered a strong quarter with ROE at 7.6% .following a 7.4% ROE in Q320
- NIM holds firm at 2.5% despite lower rates environment
- Continuous digital uptake during the C-19 period contributes to improved cost to income ratio beating the Bank´s target at 51.7%

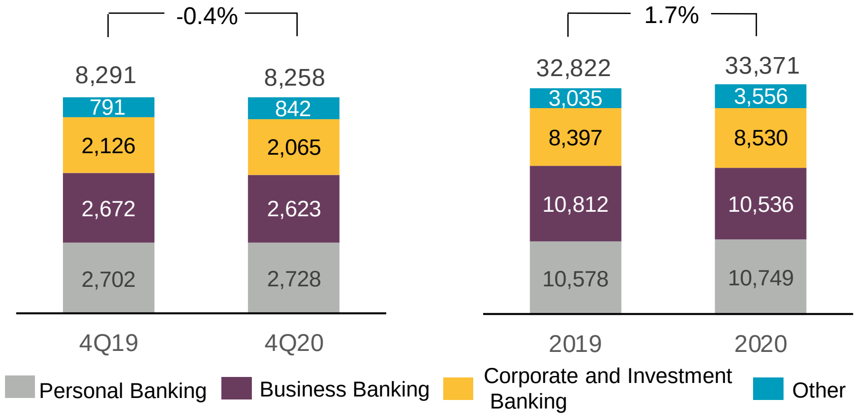
ISKm	4Q20	4Q19	Δ	Δ%	2020	2019	Δ	Δ%
Net interest income	**8,258**	8,291	(33)	-0.4%	**33,371**	32,822	549	1.7%
Net fee and commission income	**2,865**	2,945	(80)	-2.7%	**10,525**	10,899	(374)	-3.4%
Net financial income (expense)	**783**	(840)	1,623	-193.2%	**(1,391)**	(820)	(571)	69.6%
Net foreign exchange gain	**87**	116	(29)	-25.0%	**451**	139	312	224.5%
Other operating income	**63**	920	(857)	-93.2%	**197**	2,125	(1,928)	-90.7%
Total operating income	**12,056**	11,432	624	5.5%	**43,153**	45,165	(2,012)	-4.5%
Salaries and related expenses	**(3,381)**	(3,624)	243	-6.7%	**(12,917)**	(14,019)	1,102	-7.9%
Other operating expenses	**(2,692)**	(2,823)	131	-4.6%	**(9,829)**	(10,469)	640	-6.1%
Administrative expenses	**(6,073)**	(6,447)	374	-5.8%	**(22,746)**	(24,488)	1,742	-7.1%
Contribution to the Depositor's and Investors' Guarantee Fund	**(154)**	(216)	62	-28.7%	**(679)**	(936)	257	-27.5%
Bank tax	**(414)**	(814)	400	-49.1%	**(1,588)**	(3,528)	1,940	-55.0%
Total operating expenses	**(6,641)**	(7,477)	836	-11.2%	**(25,013)**	(28,952)	3,939	-13.6%
Profit before net impairment on financial assets	**5,415**	3,955	1,460	36.9%	**18,140**	16,213	1,927	11.9%
Net impairment on financial assets	**(1,829)**	(1,463)	(366)	25.0%	**(8,816)**	(3,480)	(5,336)	153.3%
Profit before tax	**3,586**	2,492	1,094	43.9%	**9,324**	12,733	(3,409)	-26.8%
Income tax expense	**(234)**	(659)	425	-64.5%	**(2,472)**	(3,909)	1,437	-36.8%
Profit for the period from continuing operations	**3,352**	1,833	1,519	82.9%	**6,852**	8,824	(1,972)	-22.3%
Discontinued operations, net of income tax	**173**	(174)	347	-199.4%	**(97)**	(370)	273	-73.8%
Profit for the period	**3,525**	1,659	1,866	112.5%	**6,755**	8,454	(1,699)	-20.1%

1. Before its sale on 7 July 2020, the subsidiary Borgun hf. was classified as non-current assets and disposal groups held for sale, accordingly the comparative figures in this disclosure have been restated

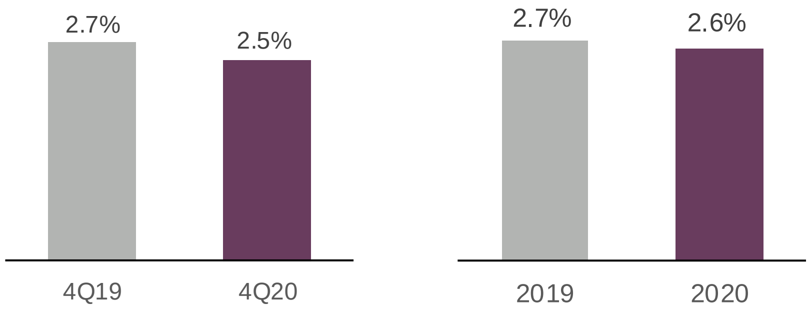
Net interest income rising despite lower rates environment

Rise due to increased lending – increase in lending margin compensates for drop in deposit margin

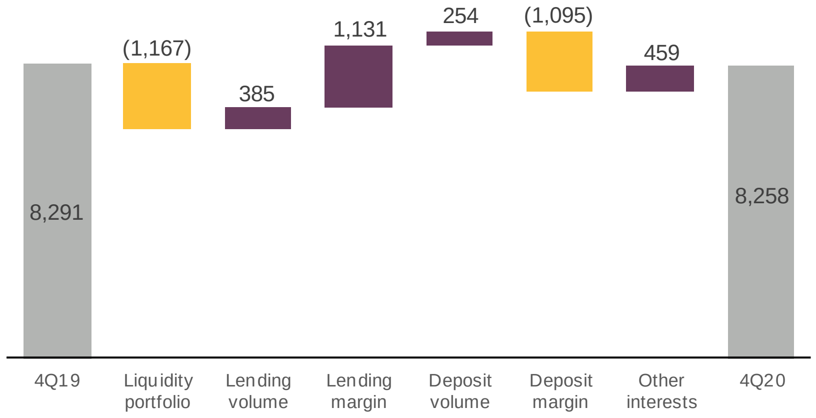
Net interest income
ISKm



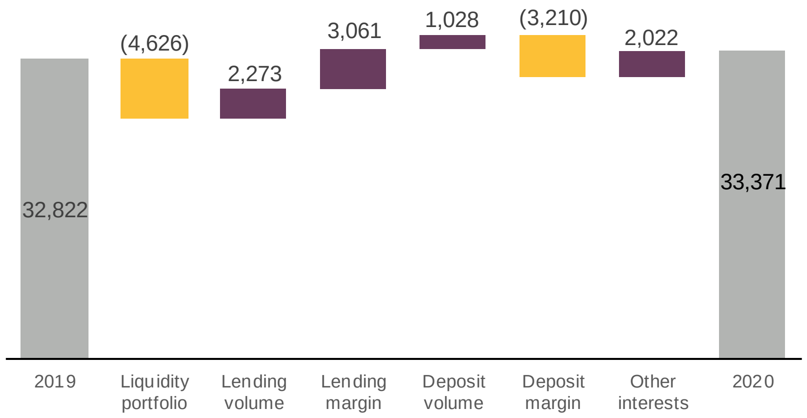
Net interest margin



NII – comparison 4Q YoY
ISKm



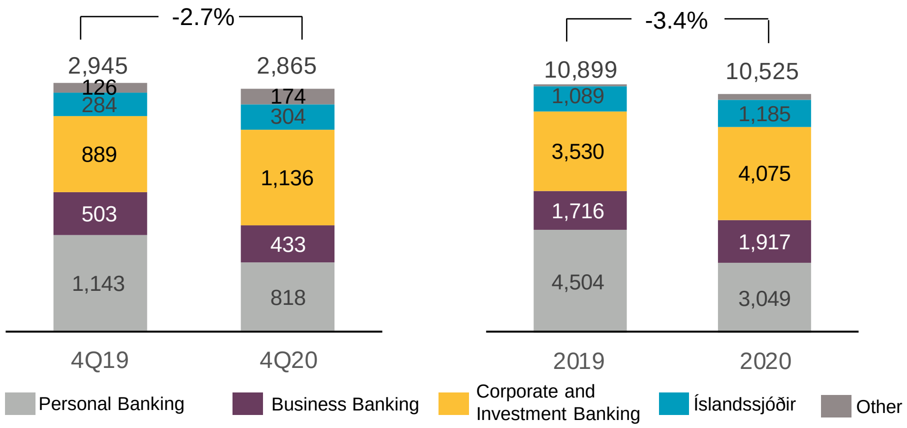
NII – comparison YoY
ISKm



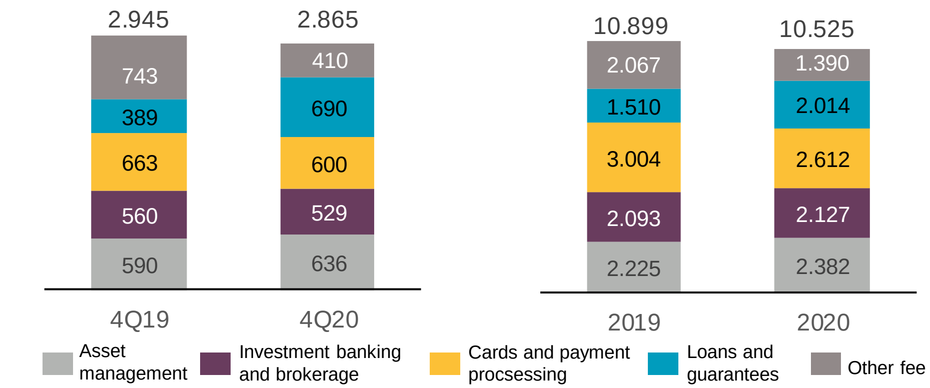
Robust net fee and commission income

Growth in fees from loans and guarantees result of increase in new lending and refinancing

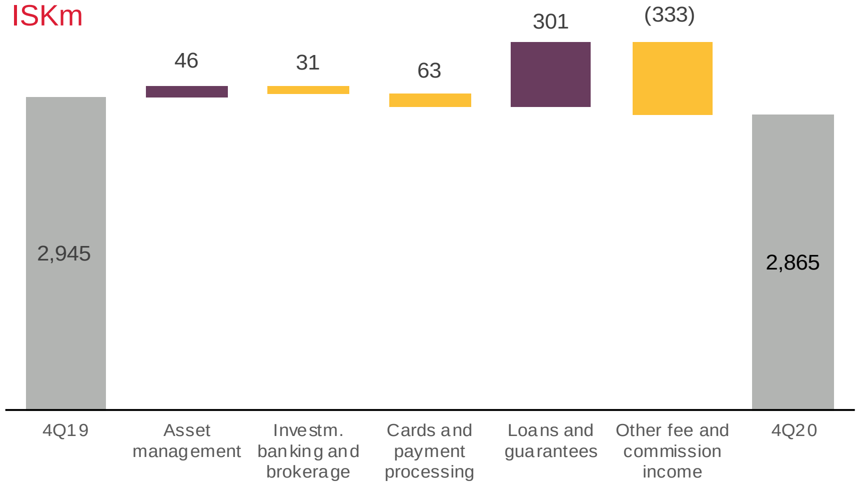
Net fee and commission income
ISKm



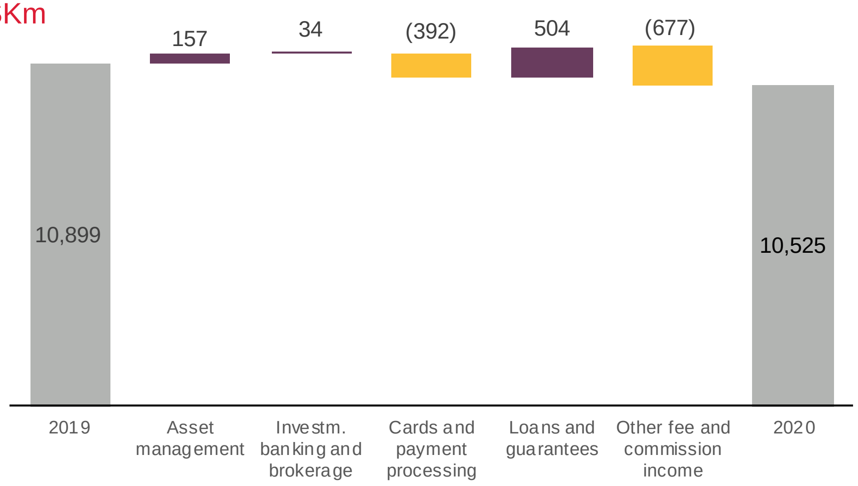
Net fee and commission income
ISKm, split by sector



NFCI - Comparison 4Q YoY
ISKm



NFCI – comparison YoY
ISKm



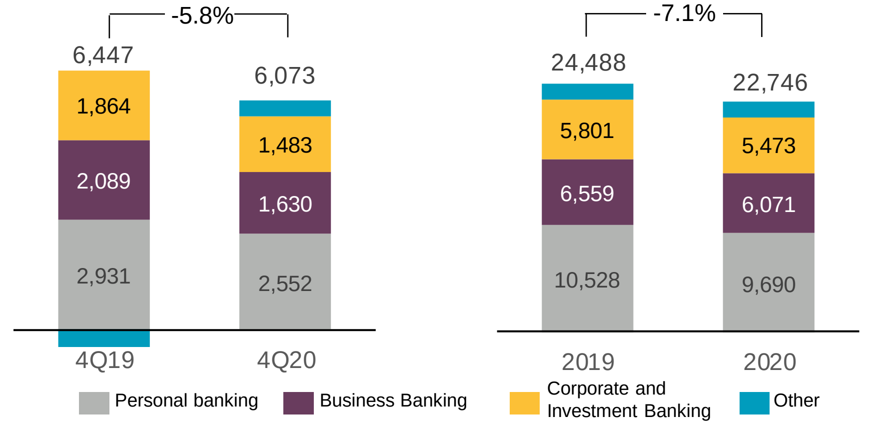
Substantial decrease in administrative expenses

Cost-to-income ratio for the year and quarter below the Bank´s 55% financial target

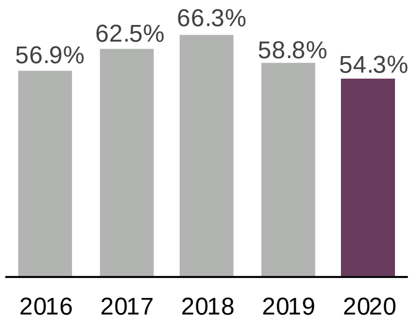
Comments

- The drop in administrative expenses is mainly explained by a decrease in salaries and related expenses, modest wage rises and an overall reduction in the Bank's cost base, partly due to COVID-19

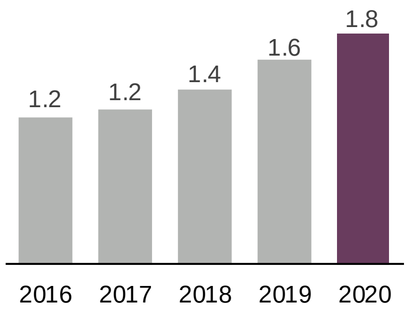
Administrative expenses[1]
ISKm



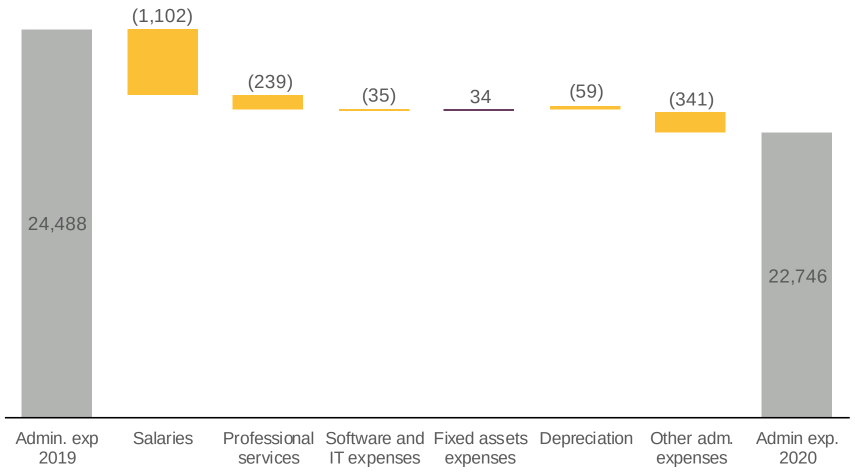
Cost to income ratio[2]



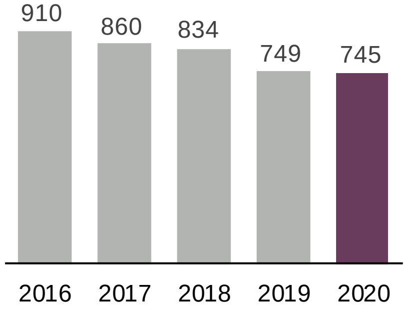
Total assets / FTE
ISKbn



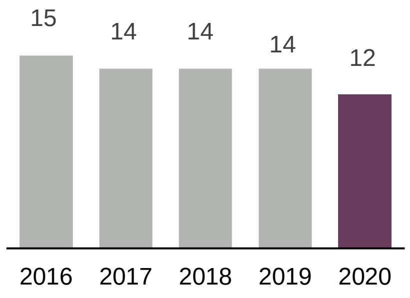
Administrative expenxes[3]
ISKm



Period end FTE numbers[4]
Parent company



Branch network



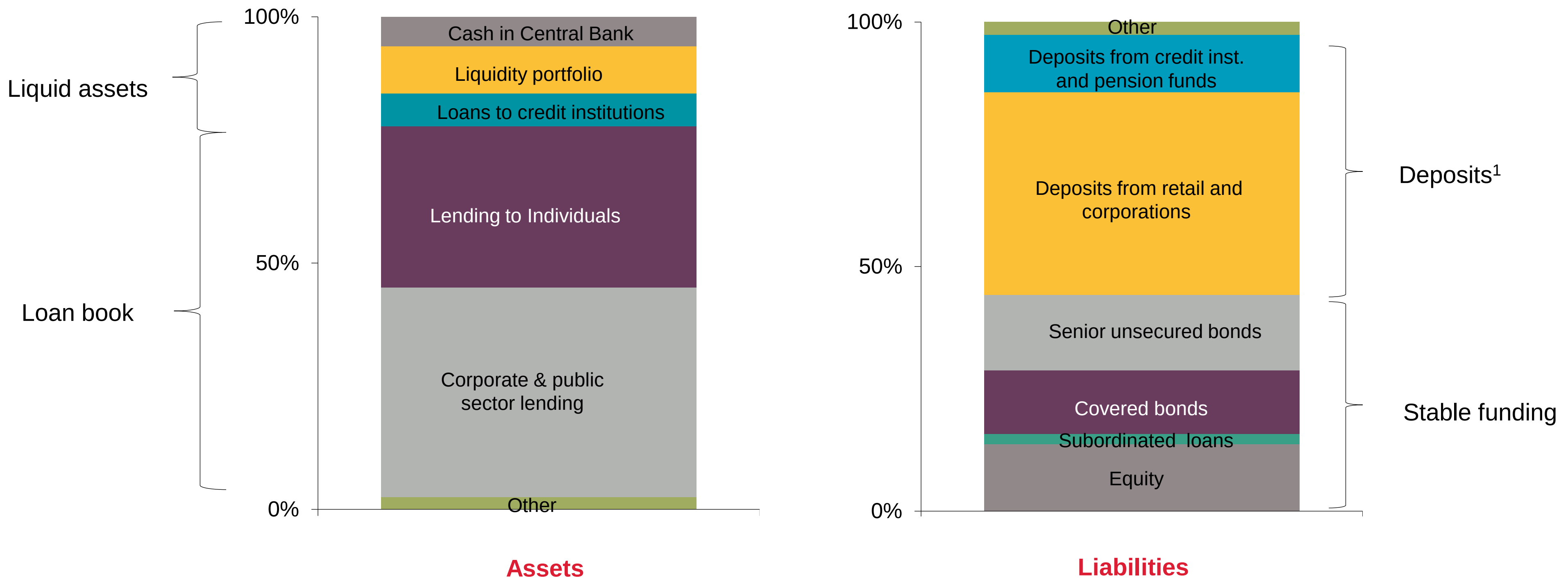
1. Negative cost in Other segment in 4Q19 due to changes in internal cost allocations
2. The cost-to-income ratio excludes bank tax and one-off items
3. See Notes 13 and 14 of Consolidated Financial Statements 2020 for further detail
4. FTE numbers exclude seasonal employees

3. Balance sheet

Majority of lending funded with deposits

Strong funding structure mainly comprises long-term funding and stable deposits

Simplified balance sheet structure
31 December 2020, ISK 1,344bn



1.As defined by LCR categories

Growth in total assets

Loans to customers grew by 11.9% during the year, mainly from increase in mortgage lending

Comments

Liquid assets

— Three line-items – cash and balances with Central Bank, loans to credit institutions and bonds and debt instruments – amount to about ISK 297bn of which ISK 285bn are liquid assets

Bonds and debt instruments

— The Bank continued to shift liquidity to Treasury bills, short dated Treasury bonds and covered bonds, increasing Bonds and debt instruments during the year

Shares and equity instruments

— ISK 9.1bn used for economical hedging

Other assets

— Fall due to less volume of unsettled transactions at year-end

Assets, ISKm	31.12.20	30.09.20	Δ	Δ%	31.12.19	Δ	Δ%
Cash and balances with Central Bank	**78,948**	95,022	(16,074)	-16.9%	146,638	(67,690)	-46.2%
Loans to credit institutions	**89,920**	61,898	28,022	45.3%	54,376	35,544	65.4%
Bonds and debt instruments	**128,216**	149,426	(21,210)	-14.2%	52,870	75,346	142.5%
Derivatives	**6,647**	3,731	2,916	78.2%	5,621	1,026	18.3%
Loans to customers	**1,006,717**	970,309	36,408	3.8%	899,632	107,085	11.9%
Shares and equity instruments	**14,851**	14,657	194	1.3%	18,426	(3,575)	-19.4%
Investment in associates	**775**	750	25	3.3%	746	29	3.9%
Property and equipment	**7,341**	7,409	(68)	-0.9%	9,168	(1,827)	-19.9%
Intangible assets	**3,478**	3,554	(76)	-2.1%	4,330	(852)	-19.7%
Other assets	**4,125**	17,159	(13,034)	-76.0%	6,608	(2,483)	-37.6%
Non-current assets and disposal groups held for sale	**3,173**	4,809	(1,636)	-34.0%	1,075	2,098	195.2%
Total Assets	**1,344,191**	1,328,724	15,467	1.2%	1,199,490	144,701	12.1%

Loans to customers grew by 11.9% in 2020

New lending amounted to ISK 309bn in 2020 compared with ISK 226bn in 2019

Highlights

- New lending amounted to ISK 160bn for individuals and ISK 149bn for companies
- Outstanding loans that are refinanced within the Bank are shown both as an increase and a decrease in the net carrying amount
- Refinancing of outstanding loans amounted to ISK 63bn for individuals and ISK 34bn for companies
- The mortgage portfolio increased by 34% while the total loan portfolio of Personal Banking increased by 28% (ISK 91bn) which is the largest growth of the business units
- The loan portfolio of Business Banking rose by 1% (ISK 2bn) and Corporate & Inv. Banking by 6% (ISK 19bn)

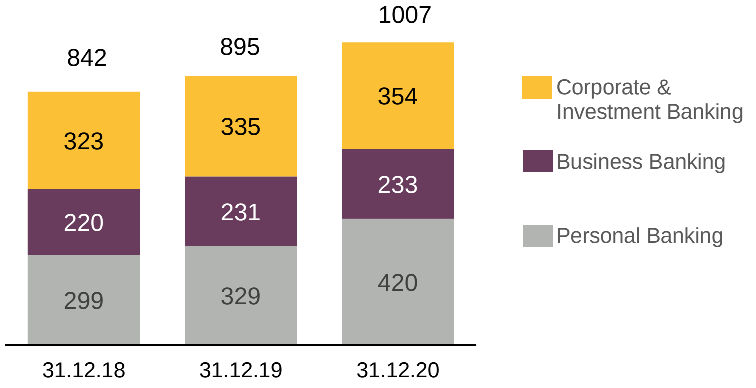
Main sources of changes in net carrying amount

ISKbn, consolidated

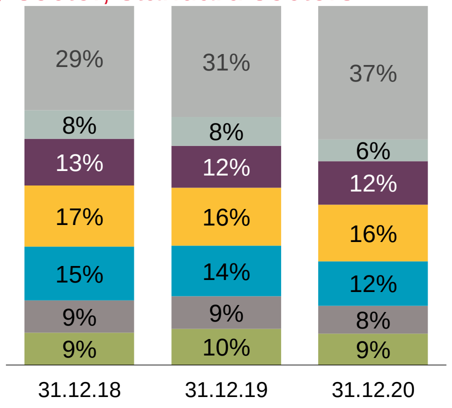
Diversified loan portfolio

Strong growth in mortgage lending, loans to individuals 43% of the Bank´s loan book

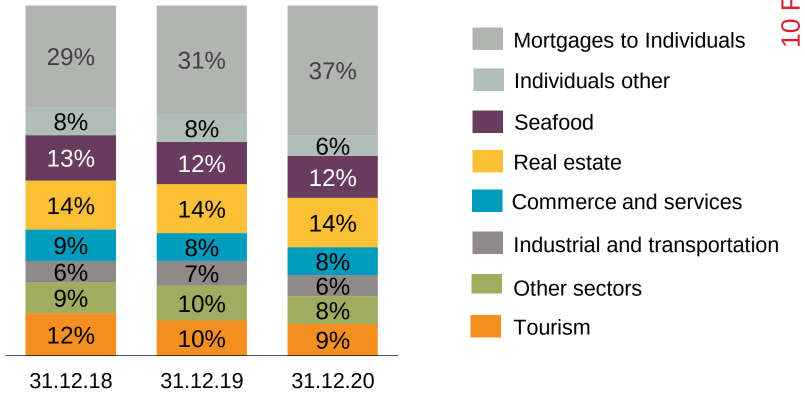
Loans to customers
By business divisions, ISKbn, parent



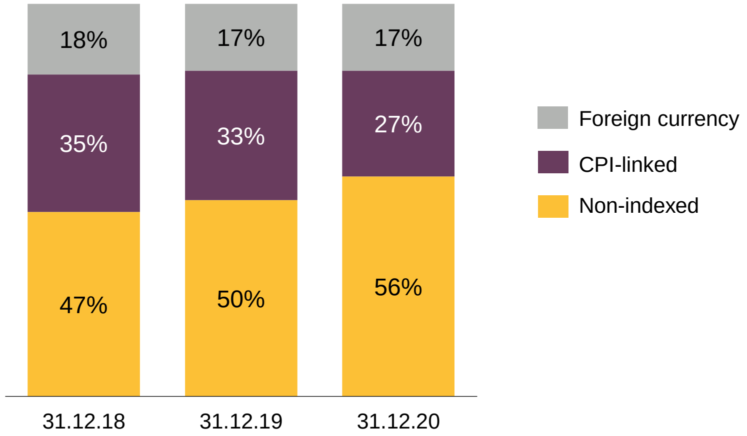
Loans to customers
By sector, standard sectors



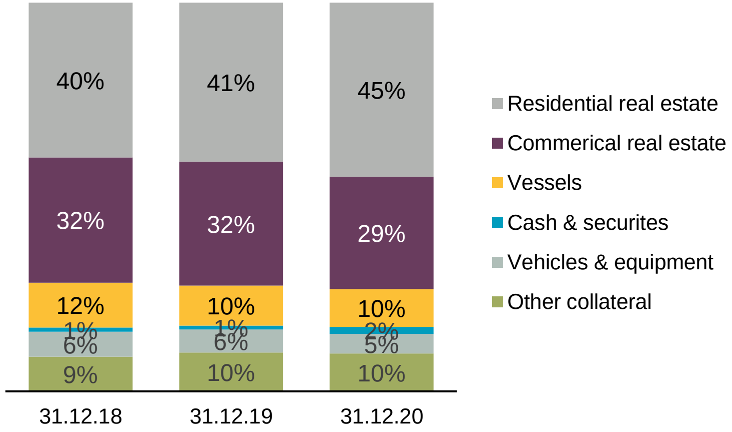
Loans to customers
By sector, carving out tourism



Loans to customers
By currency type



Credit exposure covered by collateral: ISK 930bn
By collateral type



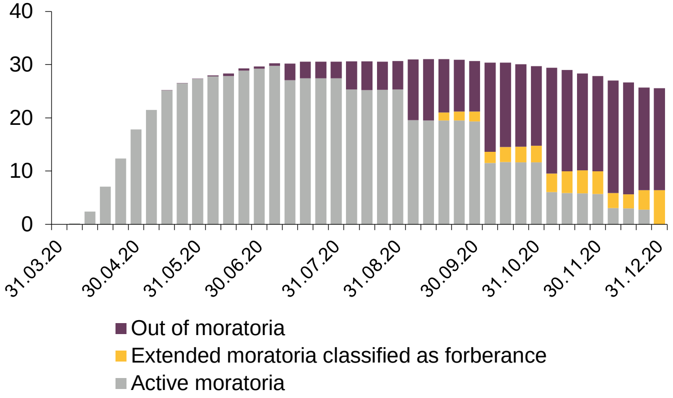
Comments

- Business divisions support customer centric structure
- The material increase in the mortgage portfolio is mostly due to refinancing from pension funds
- The shift from CPI-linked to non-indexed loans follow the Central Bank’s decrease in key rates from 3.0% to 0.75% in 2020
- Tourism has been the sector hardest hit by the COVID-19 pandemic and most of the tourism portfolio has been transferred to IFRS 9 stage 2

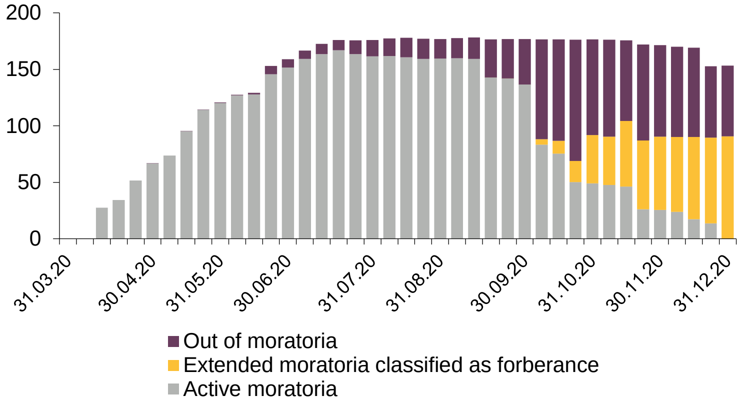
COVID-19 moratoria taper off, forbearance increases

Temporary moratorium uniformly executed and broadly applied during 2020

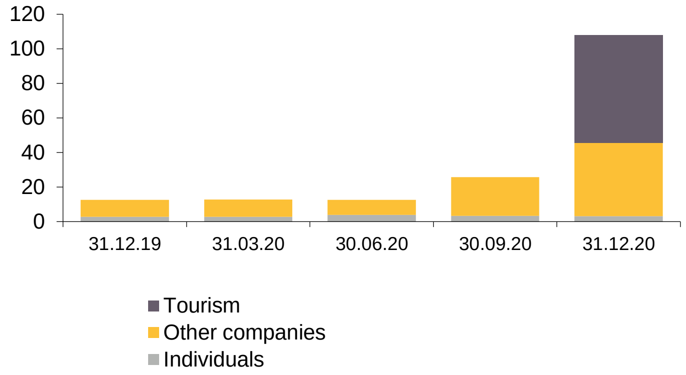
Loans to individuals granted COVID-19 moratorium
Gross carrying amount, ISKbn, weekly development



Loans to companies granted COVID-19 moratorium
Gross carrying amount, ISKbn, weekly development



Performing loans with forbearance
Gross carrying amount, ISKbn, by sector



COVID-19 moratorium important first support measure

- Íslandsbanki entered into an agreement with other lenders in Iceland to provide a moratorium for corporate and household customers, uniformly executed across institutions
- In accordance with guidelines from EBA and the Central Bank, moratoria of this kind do not trigger classification as forbearance
- Further extensions of moratoria may be granted on a case-by-case basis and will be classified as forbearance

Further extension of moratorium

- By end of year 11.1% of the gross performing loan book (not in Stage 3) was classified as forbearance, up from only 2.9% at end of Q3
- The increase is mostly due to extension of moratoria that were granted in Q4 to companies in the tourism sector (around 5% of the loan book)
- Loans that have been granted extended moratoria are primarily with collateral in residential or commercial real estate
- The extended moratoria usually last until mid-2021
- If the pandemic has not subsided by that time, further measures will be explored

Support loans as a part of government measures

- Support loans with government guarantees amounting to ISK 3.7bn were originated in 2H2020. Around 60% of the amount is with full government guarantee.
- The support loans and supplemental facilities are part of the support measures that the government has put in place following COVID-19 and Íslandsbanki facilitates the process

Loan portfolio with solid collateral coverage

Majority of collateral in residential and commercial real estate

Comments

— The average LTV for mortgages[1] was 64% at end of 2020, compared to 62% at year-end 2019. The increase is due to new lending.

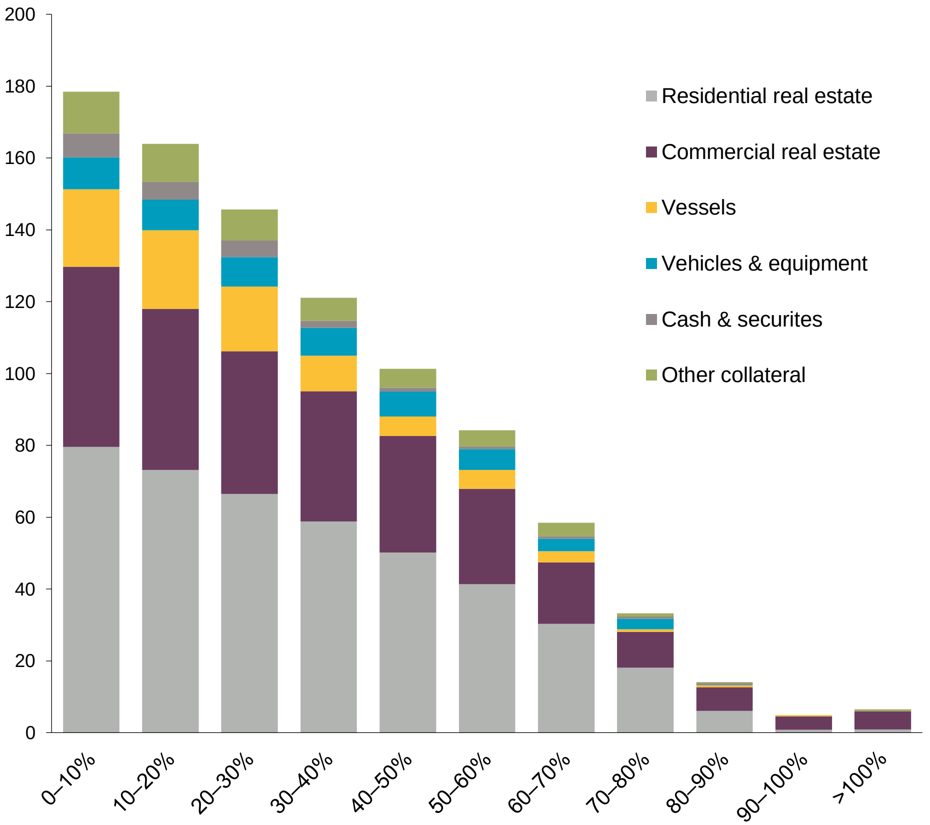
— The LTV distribution for commercial real estate is shown for the following industry sectors where this is the most important collateral type: Real estate, Commerce & services and Industrials & Transportation

— Following a sharp rise in recent years, the Central Bank's CRE price index has fallen in 2020

— Íslandsbanki's registered value of commercial real estate as collateral has risen at a much slower rate and lagged market prices in prior years. The Bank's CRE loan portfolio is therefore less vulnerable to market price changes.

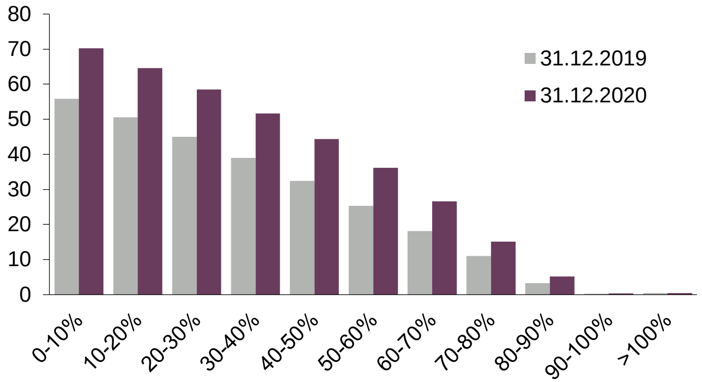
LTV distribution by underlying asset class

ISKbn, by type of underlying asset, as of 31.12.2020



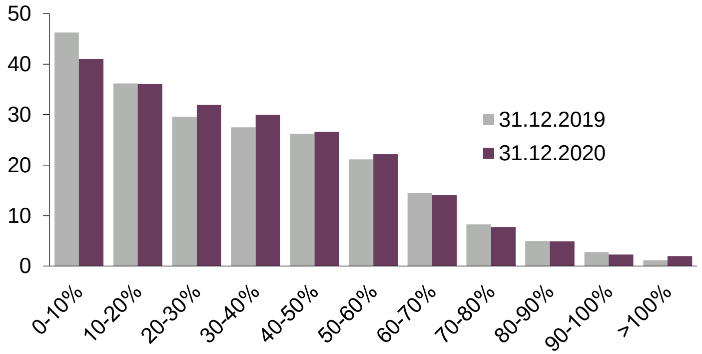
LTV distribution of mortgages to individuals

ISKbn



LTV distribution of loans secured by commercial real estate

ISKbn

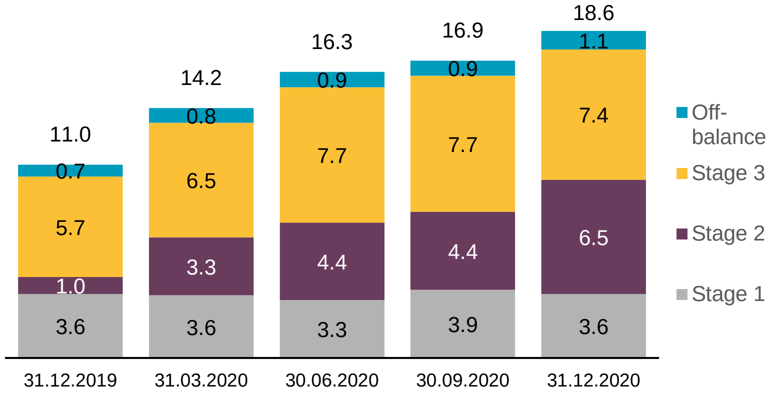


1. The average LTV can be calculated in many different ways and therefore the definition is important for comparison to other banks. The weight is Íslandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Íslandsbanki's loans of the property.

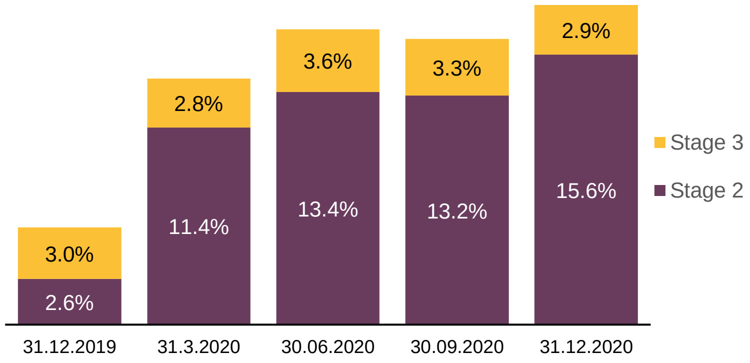
Loans to the tourism sector moved to Stage 2 in 2020

Exposure in Stage 2 increases due to the COVID-19 pandemic, but Stage 3 has not yet increased

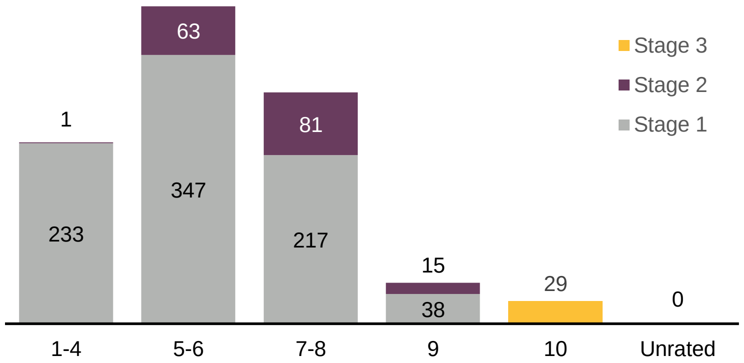
Loans to customers & off-balance sheet items
Impairment allowance account, ISKbn



Loans to customers: Stage 2 and 3
Development of gross carrying amount as ratio



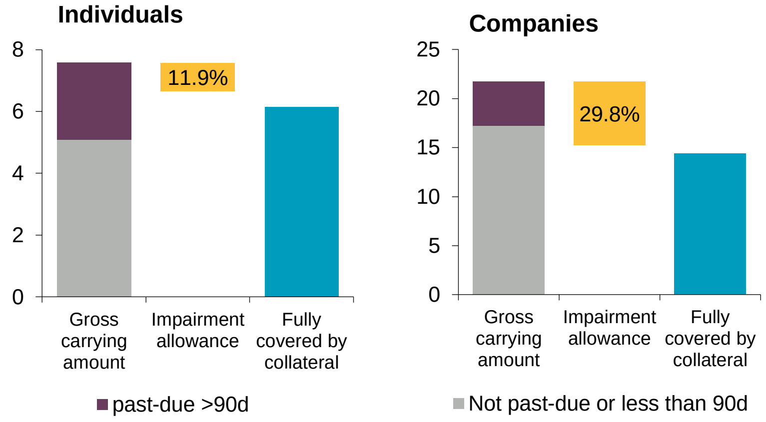
Loans to customers: gross carrying amount
31.12.2020, risk class and impairment stage, ISKbn



Loans to customers: credit quality
31.12.2020, Break-down of loans to customers

	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISK bn)	% of total	(ISK bn)	RCR	(ISK bn)	% of total
Stage 1	835	81.6%	3.6	0.4%	832	82.6%
Stage 2	160	15.6%	6.5	4.1%	153	15.2%
Stage 3	29	2.9%	7.4	25.3%	22	2.2%
Total	1,024	100.0%	17.5	1.7%	1,007	100.0%

Loans to customers in Stage 3, impairment & collateral
31.12.2020, by customer type and days past-due, ISKbn



Comments

- Net impairment charges amount to ISK 8.8bn in 2020. Thereof ISK 6.1bn from loans to the tourist sector that were transferred to Stage 2 with an increased impairment allowance (see next page)
- There has not yet been a significant change in exposures in Stage 3
- The reserve coverage ratio (RCR) in Stage 3 might appear low, 11.9% for individuals and 29.8% for companies, but is explained by good collateral coverage and high cure rate
- The collateral coverage in Stage 3 is 70% (ISK 21bn)
- In January 2021 one material exposure in Stage 3 was fully repaid as expected, bringing the NPL ratio down to 2.7% and the RCR in Stage 3 up to 27.7%. The RCR for companies goes up to 35.7%.

Additional impairment allowance due to COVID-19 in 2020

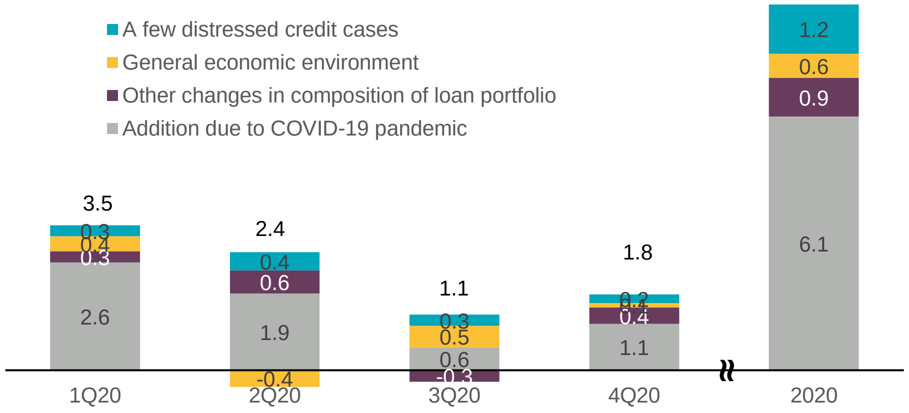
Tourism sector hardest hit and fully in Stage 2, overlay factors to account for uncertainty

Comments

- The impairment model of IFRS 9 is forward-looking and reflects a probability weighted average of possible outcomes
- In addition to the base forecast, scaling factors are produced for a good and a bad case
- The probability weights of the scenarios were set to 15% (good) 55% (base) 30% (bad) at year-end
- A shift of 5% weight from the baseline to the pessimistic scenario would increase the impairment allowance by ISK 0.5bn while a 5% shift from the baseline to the optimistic scenario would reduce the allowance by ISK 0.25bn
- The net impairment charge over loans to customers was 0.18% in Q4 and 0.91% in FY2020

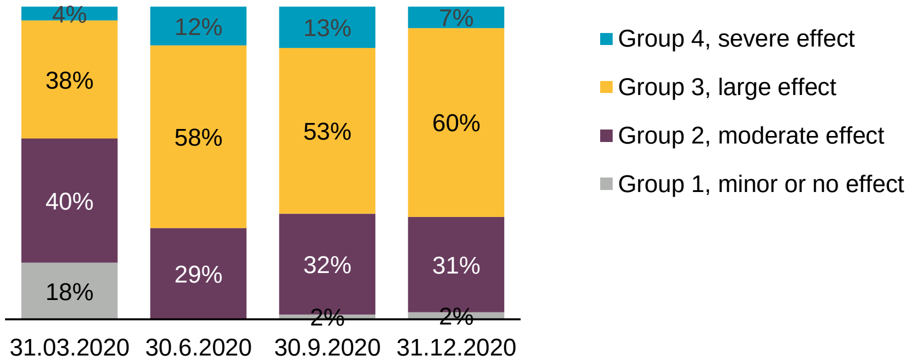
Net impairment on financial assets

ISKbn, by period



Exposure to tourism by effect of COVID-19 crisis

Net carrying amount, a proportion of approximately ISK 100bn



Macroeconomic scenario applied to IFRS 9 model

Base case, uncertainty is high

Change in economic indicators (%)	2019	2020	2021	2022	2023
Economic growth	1.9	(8.6)	3.1	4.7	2.5
Housing prices in Iceland	3.4	2.6	1.5	3.0	4.0
Purchasing power	1.8	3.0	1.1	2.1	2.1
ISK exchange rate index	8.5	11.2	3.1	(1.8)	(2.8)
Policy rate, Central Bank of Iceland	3.9	1.5	1.2	2.0	3.0
Inflation	3.0	2.7	2.7	1.9	1.9
Capital formation	(6.6)	(10.2)	1.5	6.7	1.2
thereof capital formation in industry	(18.1)	(16.9)	(0.2)	8.7	3.5

Temporary changes to the impairment model due to COVID-19

- To account for the uncertainty in the operating environment of companies in the tourism industry, not reflected in their current risk class, they are classified into four groups based on an assessment of vulnerability to when the pandemic subsides
- Groups 2-4 were transferred to Stage 2 and carry a life-time expected credit loss
- An overlay factor was applied to the expected credit loss, comparable to an increase in up to three risk classes
- A higher haircut was applied to value of collateral for the higher impact groups in the more severe scenarios

Total liabilities are 13.6% up from year-end 2019

Deposits from customers increased by 9.9% in 2020, mainly from retail customers and corporations

Liabilities & Equity, ISKm	**31.12.20**	30.09.20	Δ	Δ%	31.12.19	Δ	Δ%
Deposits from Central Bank and credit institutions	**39,758**	36,438	3,320	9.1%	30,925	8,833	28.6%
Deposits from customers	**679,455**	698,610	(19,155)	-2.7%	618,313	61,142	9.9%
Derivative instruments and short positions	**6,936**	8,406	(1,470)	-17.5%	6,219	717	11.5%
Debt issued and other borrowed funds	**387,274**	324,752	62,522	19.3%	306,381	80,893	26.4%
Subordinated loans	**27,194**	26,798	396	1.5%	22,674	4,520	19.9%
Tax liabilities	**5,450**	7,137	(1,687)	-23.6%	7,853	(2,403)	-30.6%
Other liabilities	**11,920**	44,074	(32,154)	-73.0%	27,063	(15,143)	-56.0%
Total Liabilities	**1,157,987**	1,146,215	11,772	1.0%	1,019,428	138,559	13.6%
Total Equity	**186,204**	182,509	3,695	2.0%	180,062	6,142	3.4%
Total Liabilities and Equity	**1,344,191**	1,328,724	15,467	1.2%	1,199,490	144,701	12.1%

Stable deposits remain the main source of funding

Long term funding sources increased steadily during the year

Comments

Stable core deposit base

— At year-end 2020, 76% of deposits were in non-indexed ISK, 13% CPI-linked and 11% in foreign currencies

Deposit concentration stable

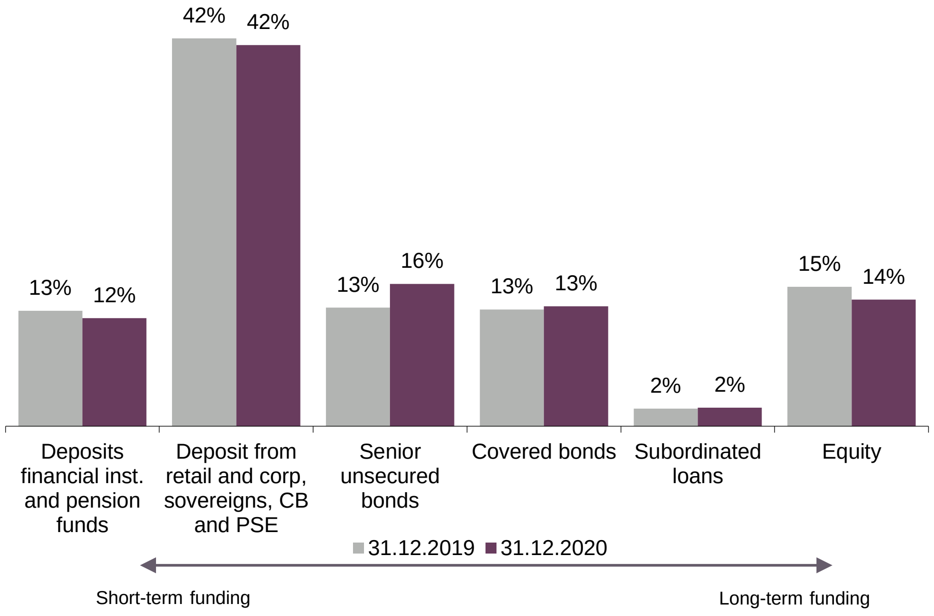
— 16% of the Bank's deposits belonged to the 10 largest depositors and 31% to the 100 largest depositors at year-end 2020, compared to 17% and 32% respectively at year-end 2019

Deposit development

— Total increase in deposits amounted to ISK 70bn since year-end 2019, thereof ISK 8bn from depreciation of ISK

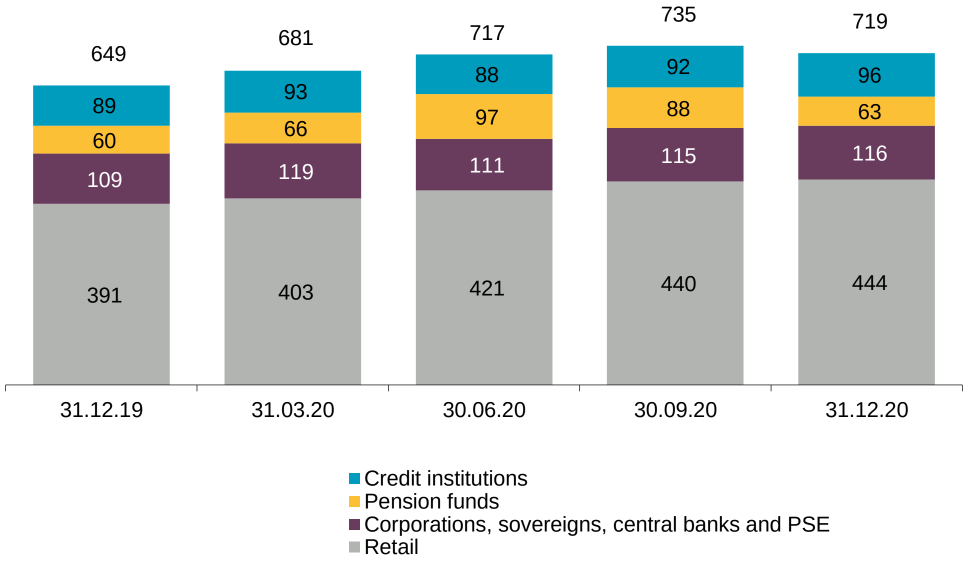
Funding sources

By type, % of total liabilities and equity



Deposit from customers and credit institutions by LCR category

Development, ISKbn



Successful funding operations and good market access

The Bank´s sustainable and green funding journey started on a positive note in 2020

Comments

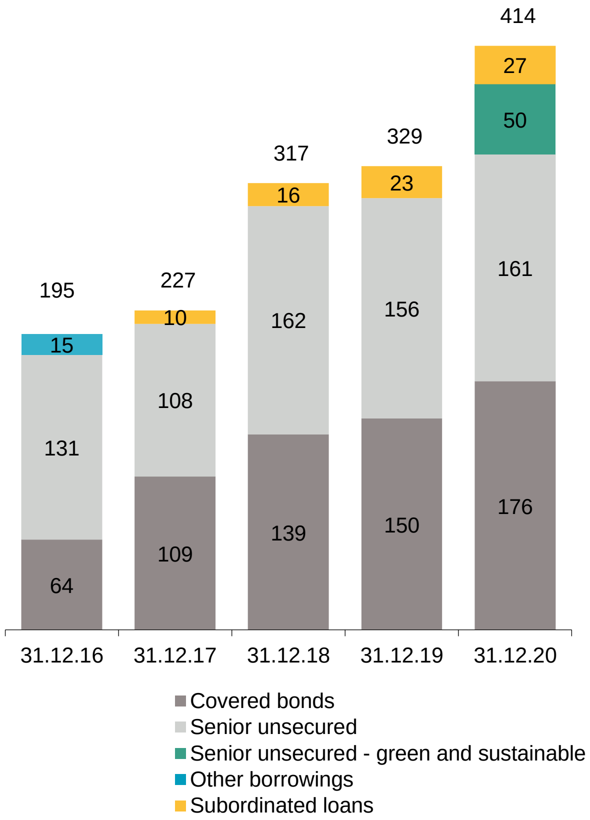
- The Bank´s funding model is straightforward designed to:
  - Limit refinancing and liquidity risks
  - Optimise cost of funding and use of proceeds
- Funding sources is raised to match the lending programme of the Bank using three main funding sources:
  - Stable deposits
  - Covered bonds
  - Senior unsecured bonds

Sustainable and green bond issuance milestones

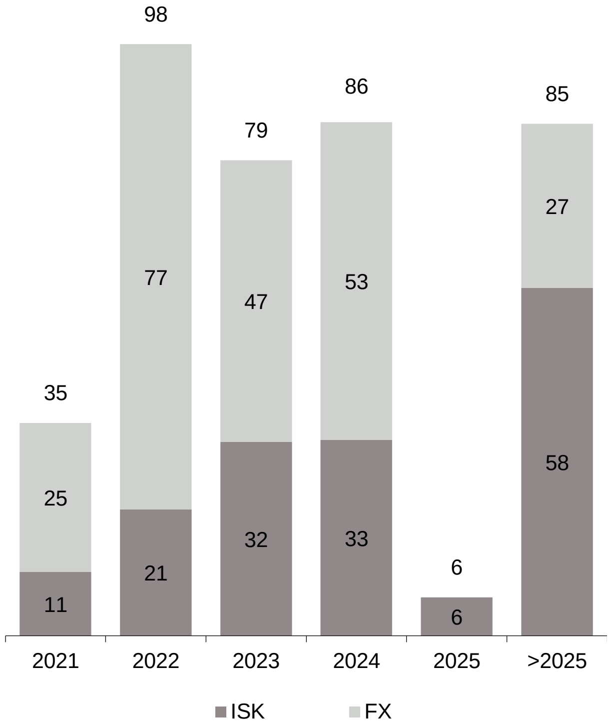
In November, the Bank was the first domestic issuer to issue sustainable and green bonds

- 3-year, €300 million benchmark sustainable bond
- ISK 2.7bn senior 5-year green bond

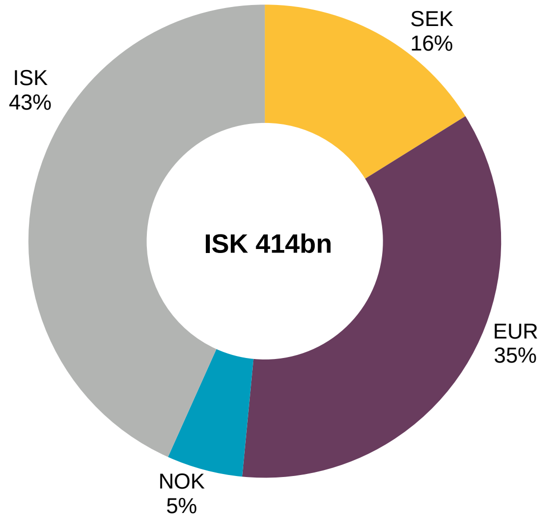
Sources of market borrowings
Book value, ISKbn



Maturity profile of long-term debt
31.12.2020, Nominal value, ISKbn



Currency split of market borrowing sources
31.12.2020, Nominal value, ISKbn



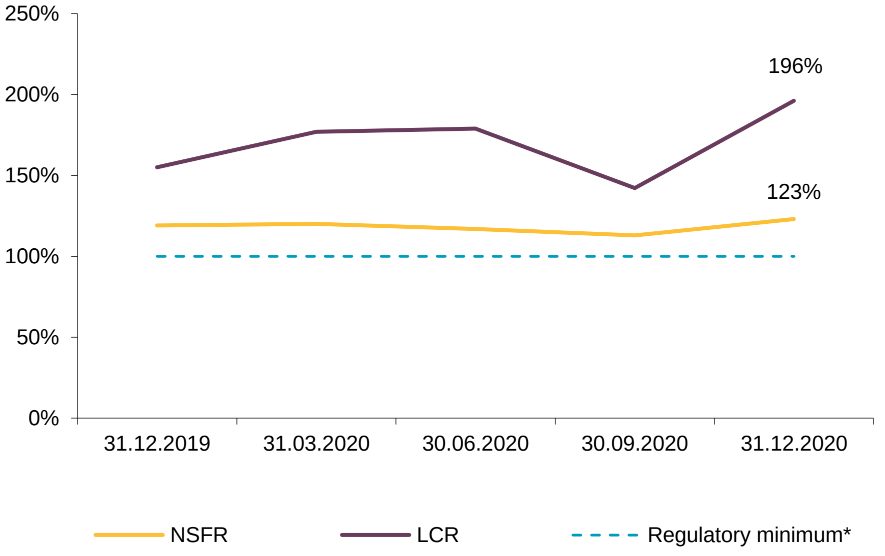
Sound management of liquidity – all ratios above requirements

Liquid assets of ISK 285bn are prudently managed, 21% of total assets

Comments

- The Icelandic Central Bank postponed a planned increase in the minimum requirements for LCR in ISK. The minimum requirements will therefore continue to be 30% for the year 2021 but increase to 40% in 2022
- After the Central Bank decided to stop offering one-month term deposits the Bank shifted ISK liquidity to Treasury bills, short dated Treasury bonds and covered bonds to earn higher yield

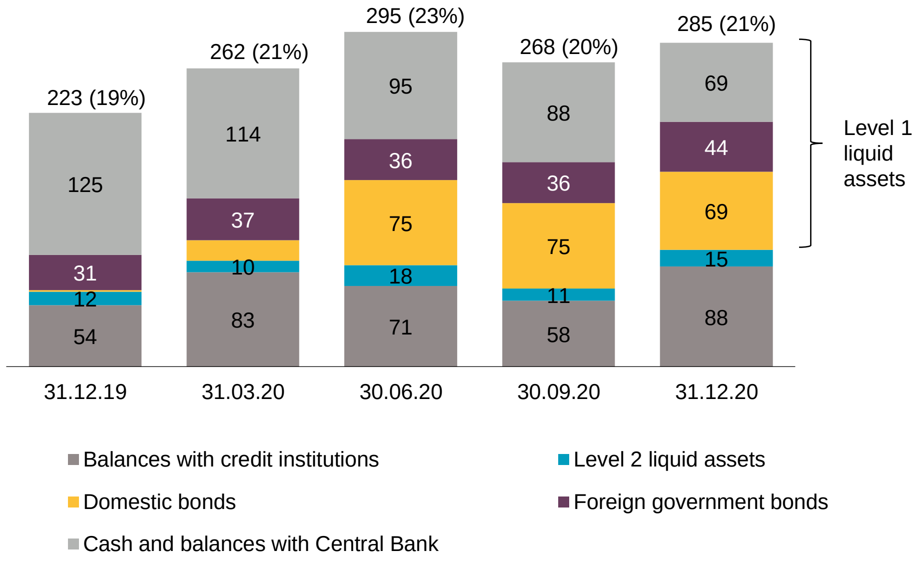
Total liquidity coverage ratio[1] (LCR) and total net stable funding ratio[2] (NSFR)



*Total NSFR minimum requirements taking effect 1 June 2021

Liquid assets

ISKbn, % of total assets



1. LCR in ISK was 95% at YE20 compared to 110% at YE19. LCR in foreign currencies increased to 463% at YE20 from 325% YE19
2. NSFR in foreign currencies was 179% at YE20 compared to 156% at YE19.

Market risk well within appetite

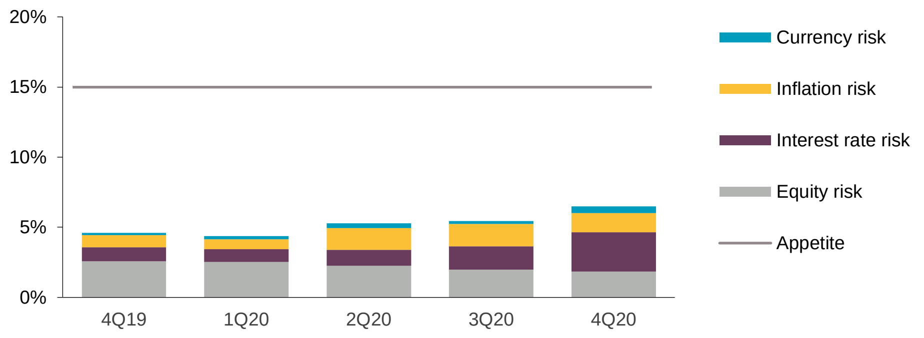
The Bank has a modest market risk profile, despite an increase in interest rate risk

Comments

- Interest rate risk in the banking book rose in Q4 due to increased fixed rate mortgage lending, primarily in non-indexed ISK
- The interest rate risk is well within appetite

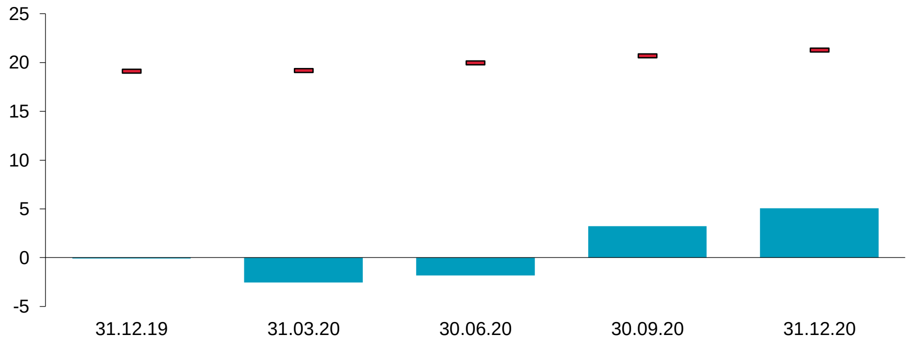
Market risk exposure and market risk appetite

Average positions per quarter (% of total capital base)



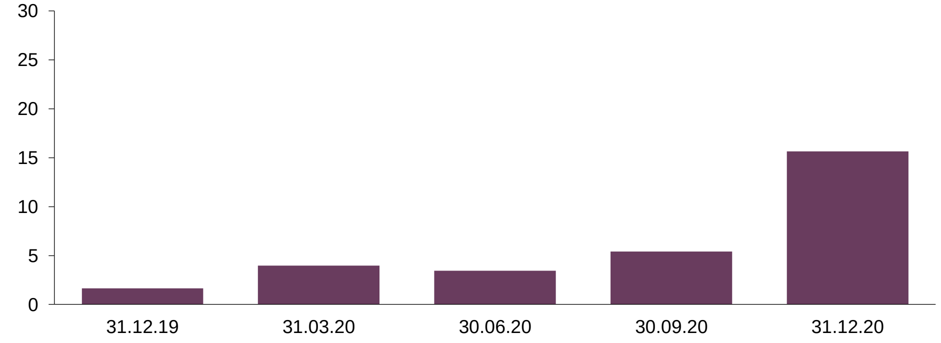
Currency imbalance, compared with regulatory limit

ISKbn, end of quarter



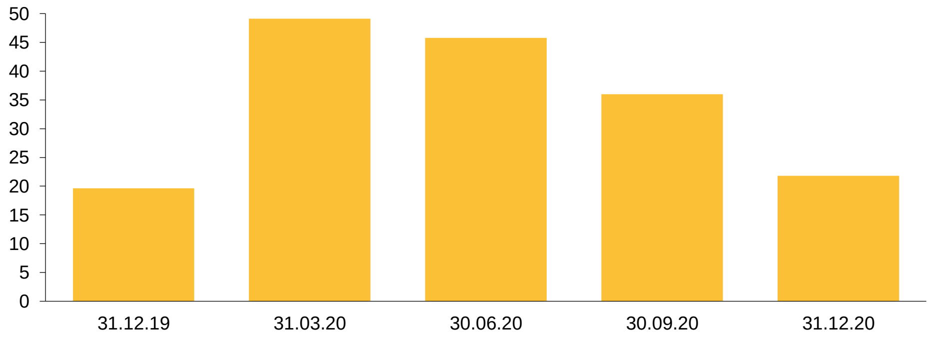
Interest rate risk in the banking book

Weighted average BPV, end of quarter, ISKm



Banking book inflation imbalance

ISKbn, end of quarter



Sound capital position to navigate uncertain environment

High REA density and low leverage in international comparison

Comments

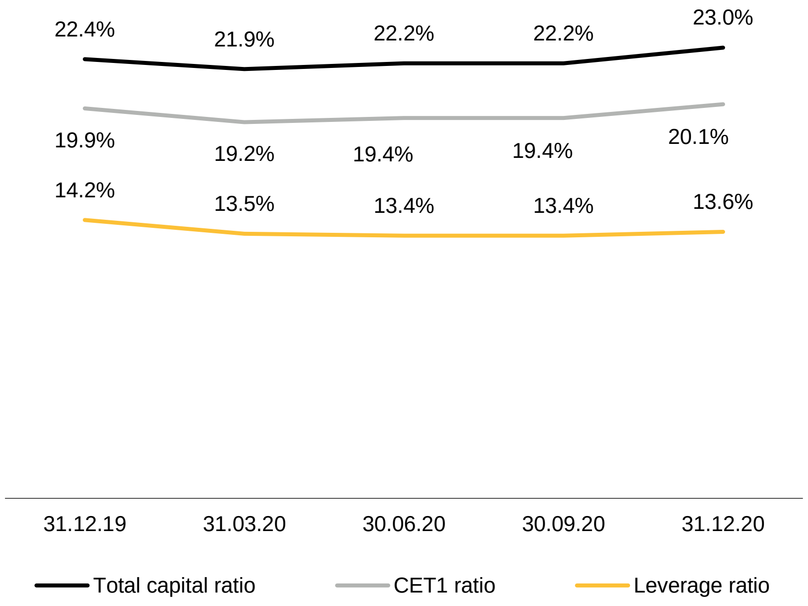
Capital ratios

- The CET1 capital was ISK 188bn at year-end 2020 compared to 176bn at year-end 2019
- The capital base was ISK 215bn compared to ISK 198bn a year before
- Implementation of IFRS 9 transitional rules in Iceland in June 2020, where IFRS 9 impairment is partially included as CET1, increase the CET1 capital by ISK 5bn
- The depreciation of the ISK increased the value of the subordinated loan, increasing the capital base
- The Annual General Meeting approved that a dividend to shareholders for the operating year 2019 should not be paid in light of uncertainties due to COVID-19

Risk exposure amount (REA)

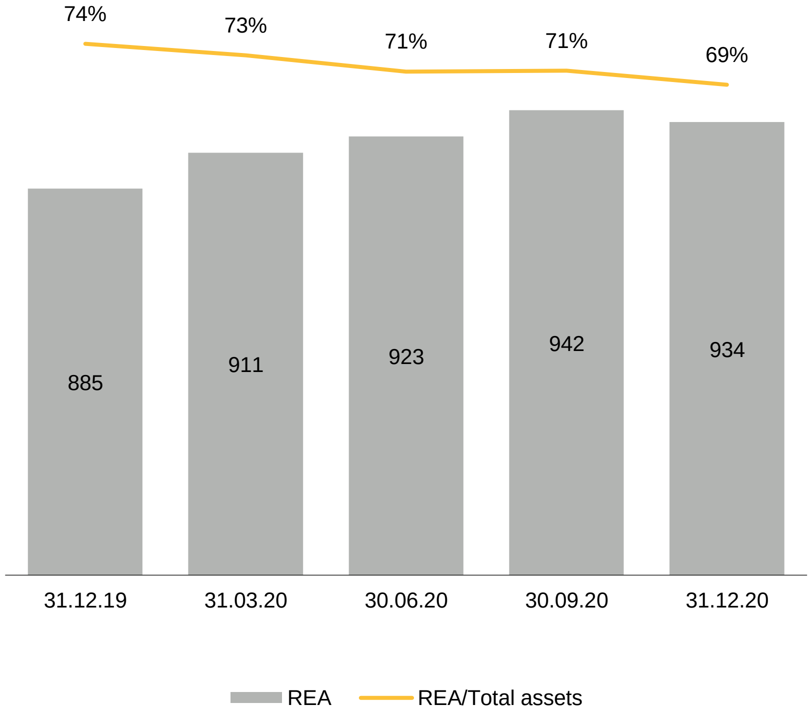
- The REA increased during the year mainly due to new lending
- REA as a proportion of total assets decreases as the biggest part of the loan growth came from mortgages with low risk weighted

Capital and leverage ratios



Risk exposure amount (REA)

ISKbn



Íslandsbanki's capital ratios well above target

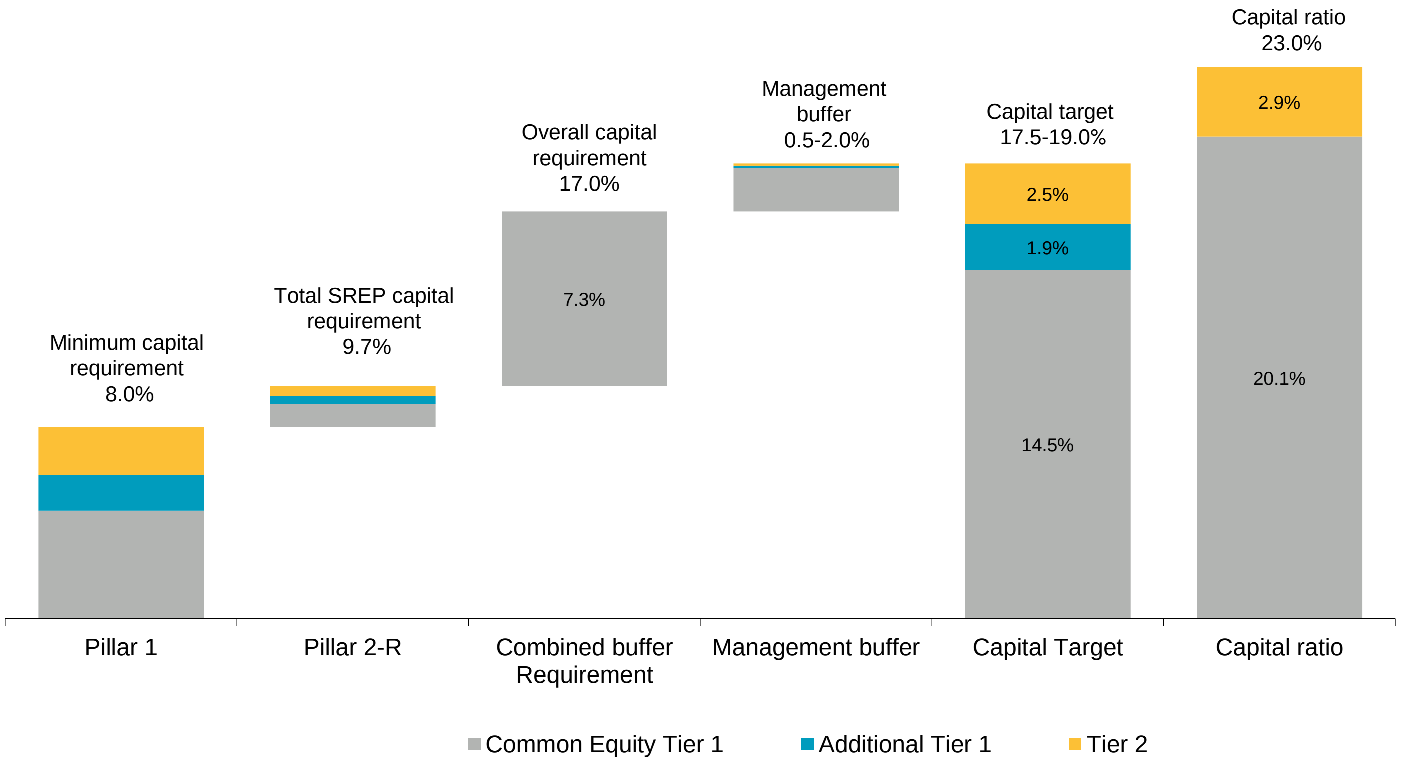
Countercyclical buffer reduced to 0% as a result of COVID-19

Comments

- The countercyclical capital buffer was lowered from 2% to 0% in March 2020 as a response to COVID-19
- The Financial Supervision Committee decided that the 2019 SREP assessment concerning additional capital requirements (Pillar 2-R) shall remain unchanged at 1.7% of REA
- The overall capital requirement is therefore unchanged at 17% of REA
- Íslandsbanki's total capital target ratio is based on the overall regulatory requirement in addition to a 50-200bp management buffer
- Due to the uncertainty in relation to the effects of COVID-19 on the capital base, the Bank aims to have an ample buffer in excess of the current target until there is further clarity regarding international travel and other sources of uncertainty
- Íslandsbanki's profit and a new statement from the Central Bank allows for a dividend payment to shareholders according to dividend policy, which amounts to 40-50% of 2020 profits

Current regulatory requirements and minimum capital target

31.12.2020, by capital composition



4. Annex - Financial overview and about Íslandsbanki

Financial overview
Key figures & ratios

		4Q20	4Q19	2020	2019	2018
PROFITABILITY	After tax profit, ISKm	**3,525**	1,659	**6,755**	8,454	10,645
	Return on equity (after tax)	**7.6%**	3.7%	**3.7%**	4.8%	6.1%
	ROE margin	**7.1%**	0.9%	**2.6%**	1.2%	2.1%
	Net interest margin (of total assets)	**2.5%**	2.7%	**2.6%**	2.7%	2.9%
	Cost to income ratio[1]	**51.7%**	62.9%	**54.3%**	58.8%	66.3%

		31.12.2020	30.9.2020	30.6.2020	31.12.2019	31.12.2018
BALANCE SHEET	Loans to customers, ISKm	**1,006,717**	970,309	933,320	899,632	846,599
	Total assets, ISKm	**1,344,191**	1,328,724	1,303,256	1,199,490	1,130,403
	Risk exposure amount, ISKm	**933,521**	942,339	923,133	884,550	845,949
	Deposits from customers, ISKm	**679,455**	698,610	681,223	618,313	578,959
	Customer loans to customer deposits ratio	**148.2%**	138.9%	137.0%	145.5%	146.2%
	NPL ratio[2]	**2.9%**	3.3%	3.6%	3.0%	2.0%
LIQUIDITY	Liquidity coverage ratio (LCR), for all currencies	**196%**	136%	179%	155%	172%
	Net stable funding ratio (NSFR), for all currencies	**123%**	113%	117%	119%	114%
CAPITAL	Total equity, ISKm	**186,204**	182,509	179,722	180,062	176,313
	Total capital ratio	**23.0%**	22.2%	22.2%	22.4%	22.2%
	Tier 1 capital ratio	**20.1%**	19.4%	19.4%	19.9%	20.3%
	Leverage ratio	**13.6%**	13.4%	13.4%	14.2%	14.6%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items).
2. Stage 3, loans to customers, gross carrying amount

This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

Vision and Values

Vision to be
#1 for service

Passion
Professionalism
Collaboration

The Bank

FTEs
745
number of FTEs at Íslandsbanki at year-end

12 branches

Market share[1]

32% retail customers

35% SMEs

35% large companies

Sustainability 4Q20

First Icelandic bank to develop Sustainable Financing Framework

First sustainable bond by an Icelandic bank

Member of a global Partnership for Carbon Accounting Financials (PCAF)

Key Figures 4Q20

ROE	7.6%	LCR Group, all currencies	196%
Cost to income ratio	51.7%	NSFR Group, all currencies	123%
Total capital ratio	23.0%	Leverage Ratio	13.6%
Tier 1 capital ratio	20.1%	Total assets	ISK 1,344bn

Ratings and certifications

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

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 4Q20

Increased app usage across all customer segments

The first open banking feature added to the app

Continuous growth in new and refinanced mortgages through automated digital channels

1. Based on Gallup surveys regarding primary bank

5. Annex – Icelandic economy update

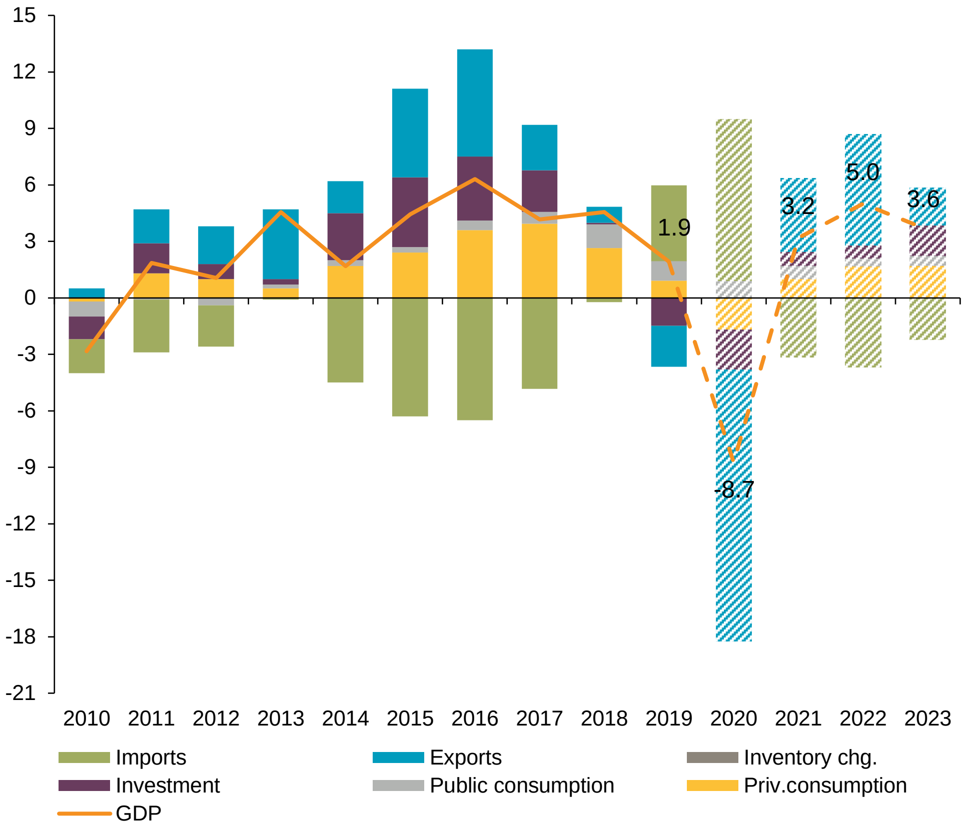
Economy likely to gain a foothold this year after COVID-19

GDP growth to gain pace in H2/2021; robust growth expected in 2022

Highlights

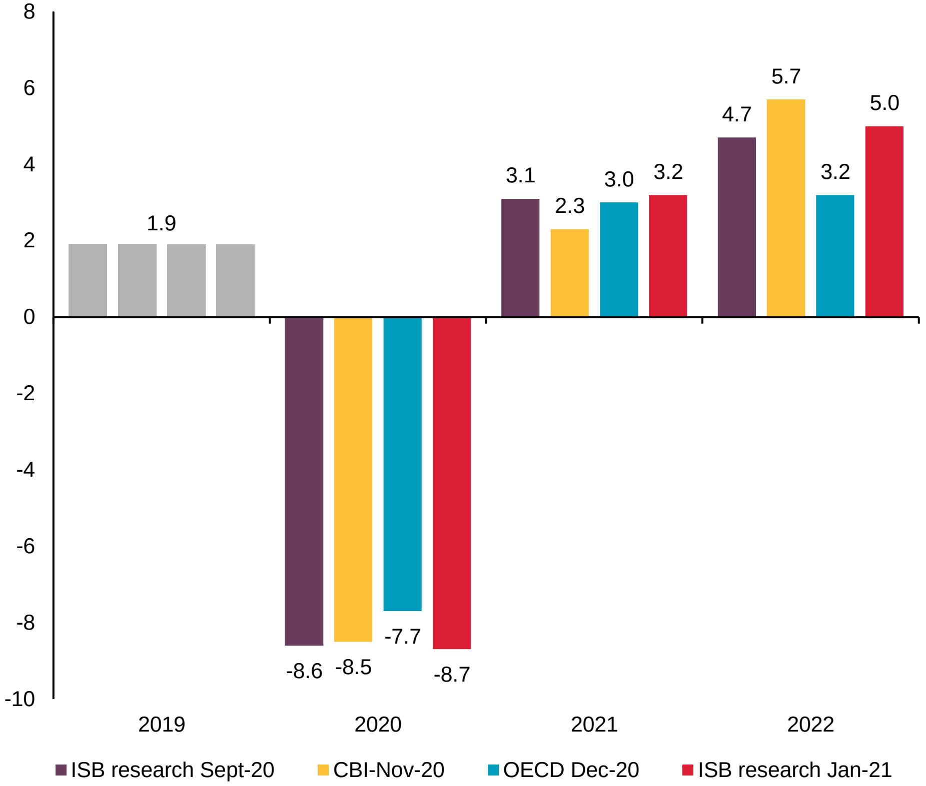
- The COVID-19 pandemic has changed the near-term outlook for the Icelandic economy drastically
- ISB Research estimates that GDP contracted by 8.7% in 2020
- A sharp decline in exports and a contraction in private domestic demand contributed to the fall in GDP while decreasing imports and increased public consumption softened the impact
- ISB research forecasts GDP growth at 3.2% in 2021, driven mainly by the recovery of exports and moderate growth in consumption and investment
- In 2022 the outlook is for 5% growth, with exports and domestic demand set to regain an even more secure footing during the year
- In 2023 we project growth at just under 3.6%, driven by exports, investment, and consumption in roughly equal measure. If the forecast materialises, real GDP will finally rise above the pre-pandemic level in the last year of the horizon

GDP and the contribution of major subitems [1]
YoY change (%)



1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Statistic Iceland, ISB Research, the Central Bank of Iceland, OECD

GDP forecast comparison
YoY change (%)



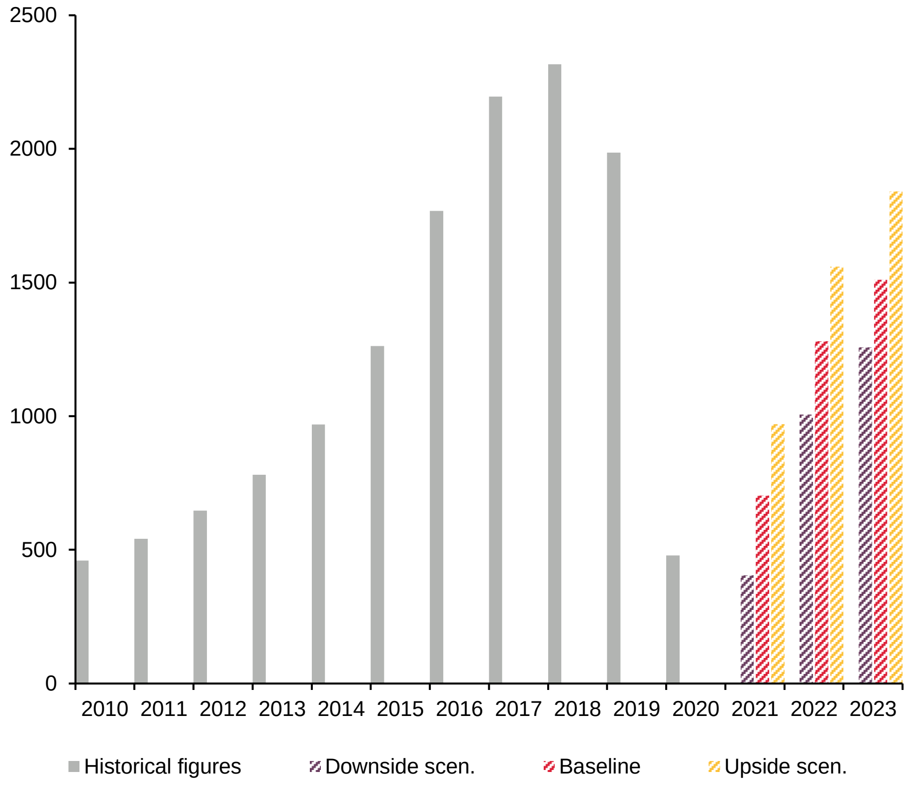
Tourism sector hit hard by COVID pandemic

Number of tourists visiting Iceland shrinks by 75% in 2020

Highlights

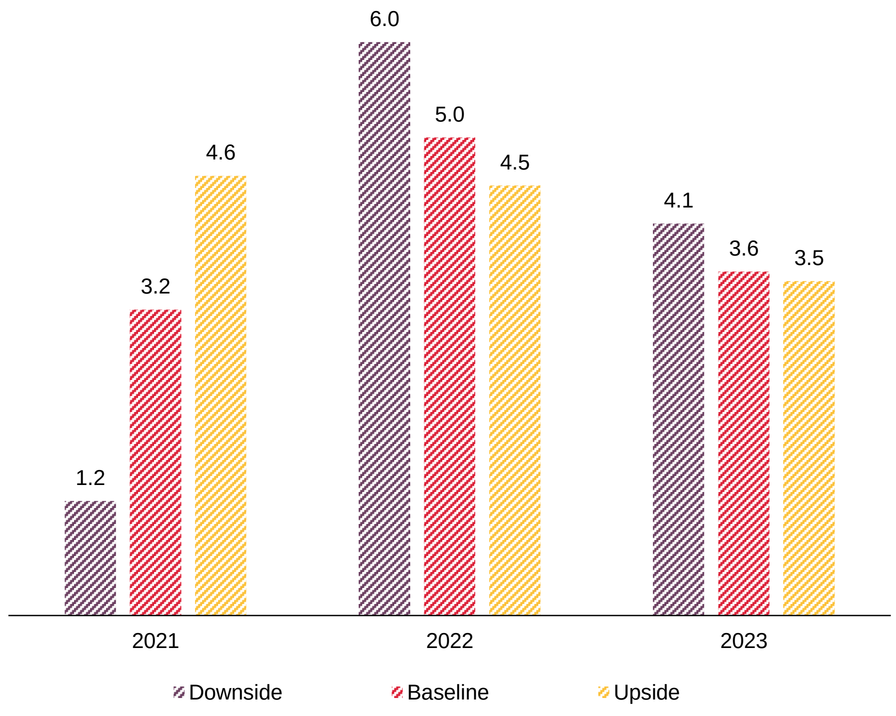
- As the recovery of the tourist sector is the most significant short-term risk factor, ISB Research has prepared an upside and downside scenario along with the baseline forecast
- The baseline assumes that 700,000 tourists will visit Iceland in 2021, the vast majority of them in H2, followed by 1.3 million arrivals in 2022 and 1.5 million in 2023
- The upside scenario assumes nearly 1.0 million tourists will visit in 2021, followed by 1.5 million in 2022 and 1.8 million in 2023
- The downside scenario assumes tourist arrivals will total only 400,000 this year, followed by 1.0 million in 2022 and 1.3 million in 2023
- Growth could rise to nearly 5% in 2021 in the upside scenario while the downside scenario results in just over 1% growth in 2021
- The number of tourist arrivals will be positively correlated with GDP growth and ISK exchange rate and inversely correlated with decline in inflation and unemployment

Foreign visitors
Departures through KEF airport, thousand



1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Statistics Iceland, Iceland Tourist Board, ISB Research, the Central Bank of Iceland

GDP growth assuming different scenarios for tourism
%



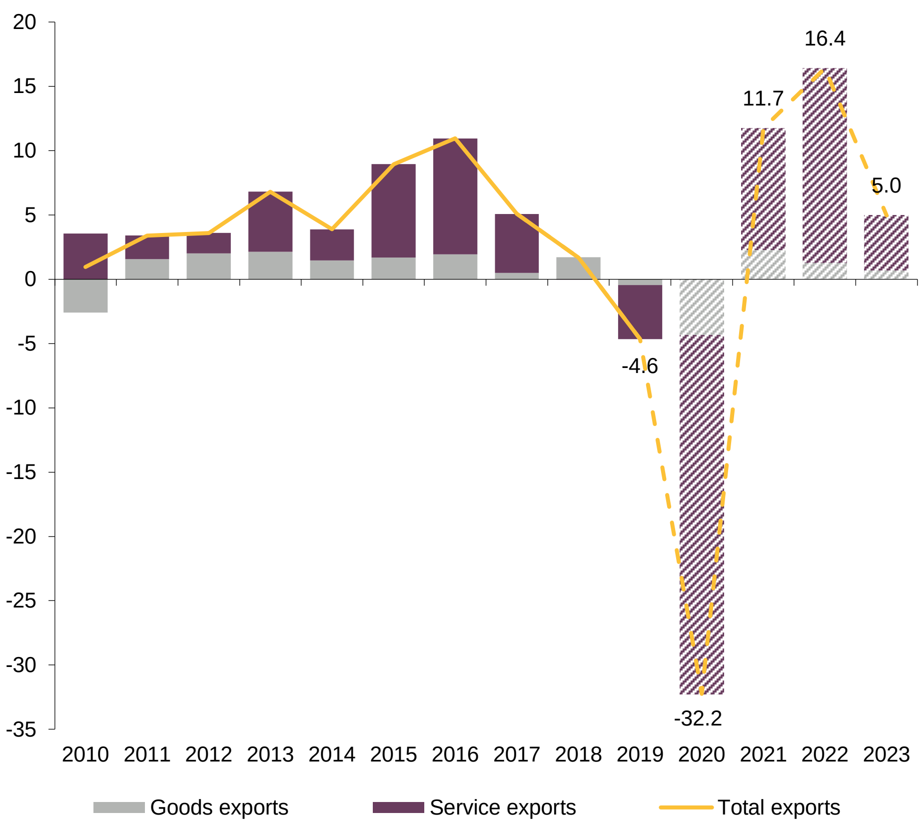
Current account resilient to export shock

Dramatic fall in exports causes a temporary deficit but medium-term outlook benign

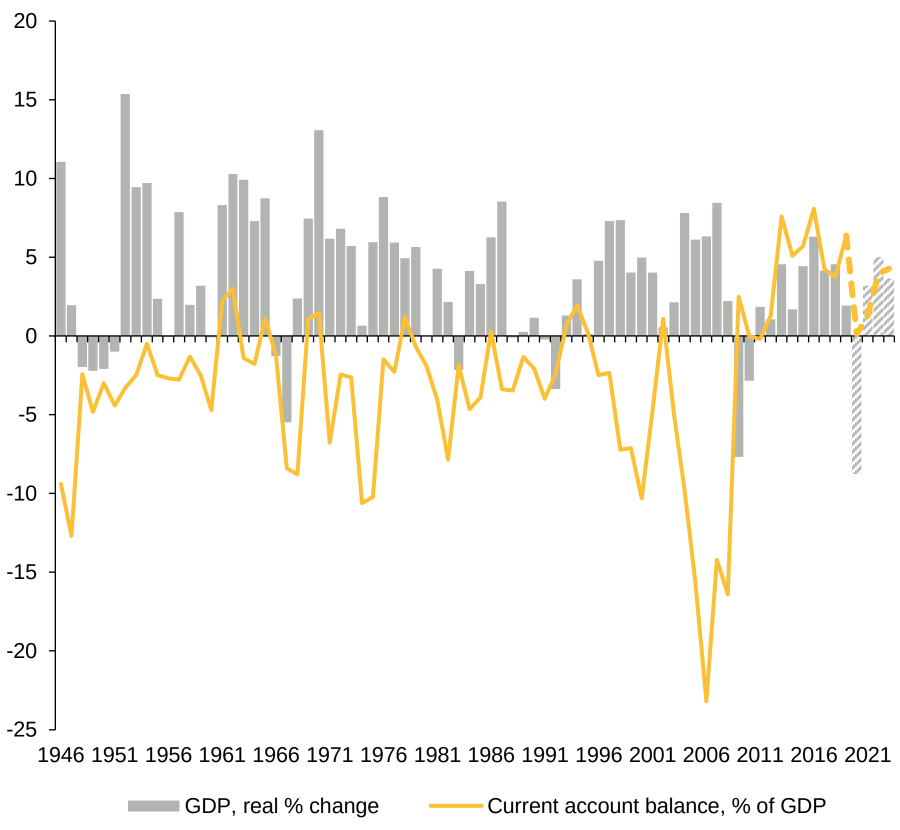
Highlights

- In the baseline forecast, this year's number of tourists would be about one-third of the 2019 figure. Revenue growth in the tourism sector would nevertheless be over 40% YoY
- This is supplemented by growth in goods exports, chief among them farmed fish, aluminium, and other industrial goods. Overall, the outlook is for nearly 12% export growth in 2021
- For 2022, tourism will deliver the lion's share of the year's 16% export growth. In 2023, we expect moderate export growth of 5%
- Imports will broadly follow the export trend at a more moderate pace
- Despite the 1/3 drop in exports, the current account was broadly balanced in 2020, with the contraction in imports and a handsome income account surplus compensating for the plunge in exports
- The CA surplus is expected to measure 1.3% of GDP, or ISK 40bn, this year. In 2022 and 2023, it will measure 4% or more of GDP, according to our forecast

Export volume
YoY change



Current account balance *
% of GDP

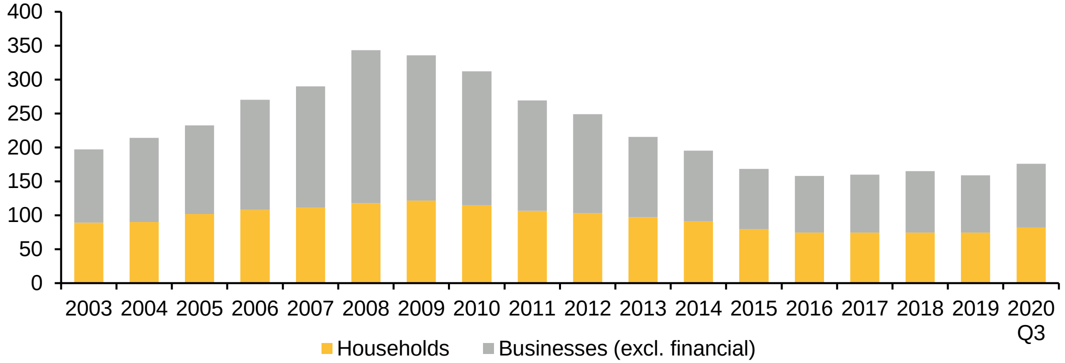


1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Central bank of Iceland, Statistics Iceland and ISB Research

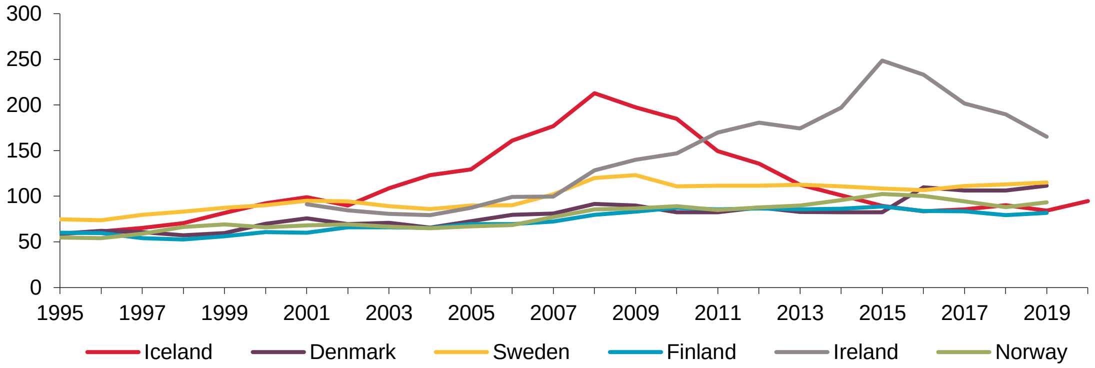
Domestic balance sheets healthy before COVID

Economy-wide leverage moderate in comparison with peers and historical levels

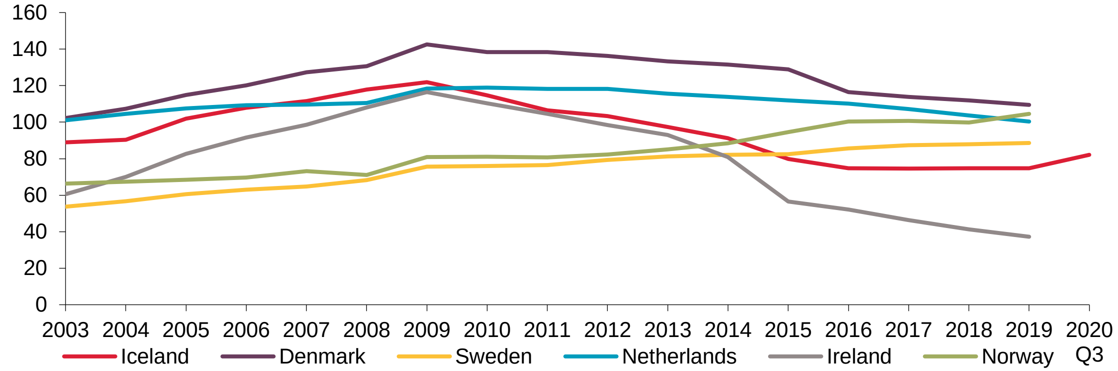
Private sector debt
% of GDP



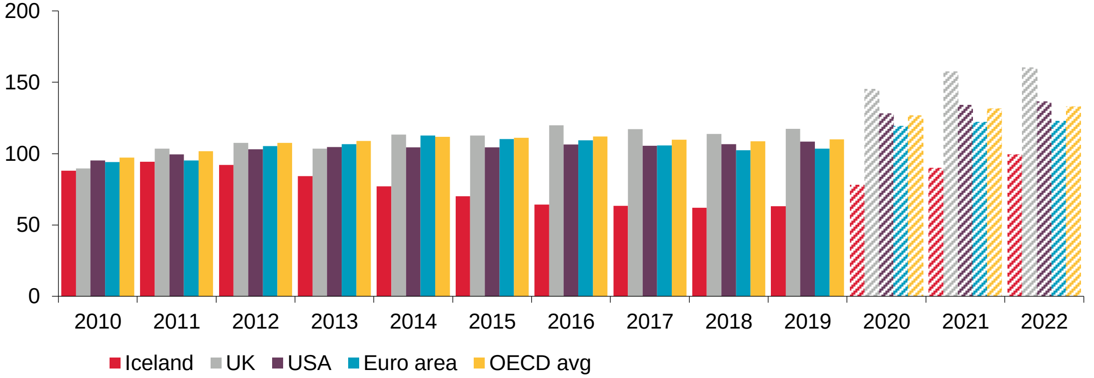
Corporate debt
% of GDP



Household debt
% of GDP



General government gross financial liabilities
% of GDP



1. Shaded areas and dotted lines indicate forecasts
Source: Central bank of Iceland, Statistics Iceland, OECD and ISB Research

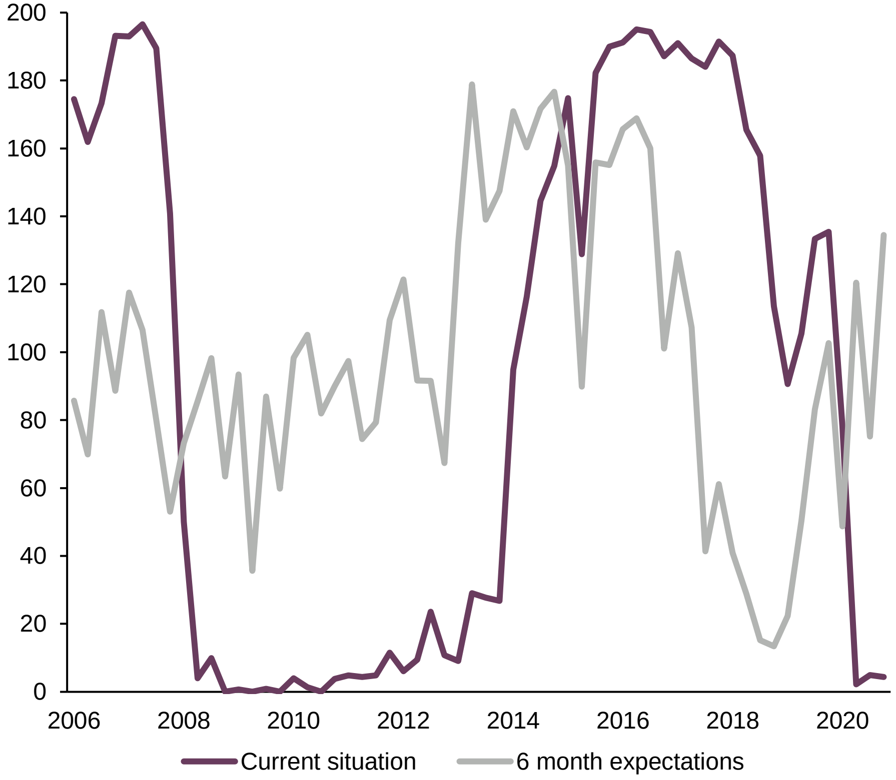
Businesses braving headwinds

Business investment has contracted and lending growth to businesses is minimal

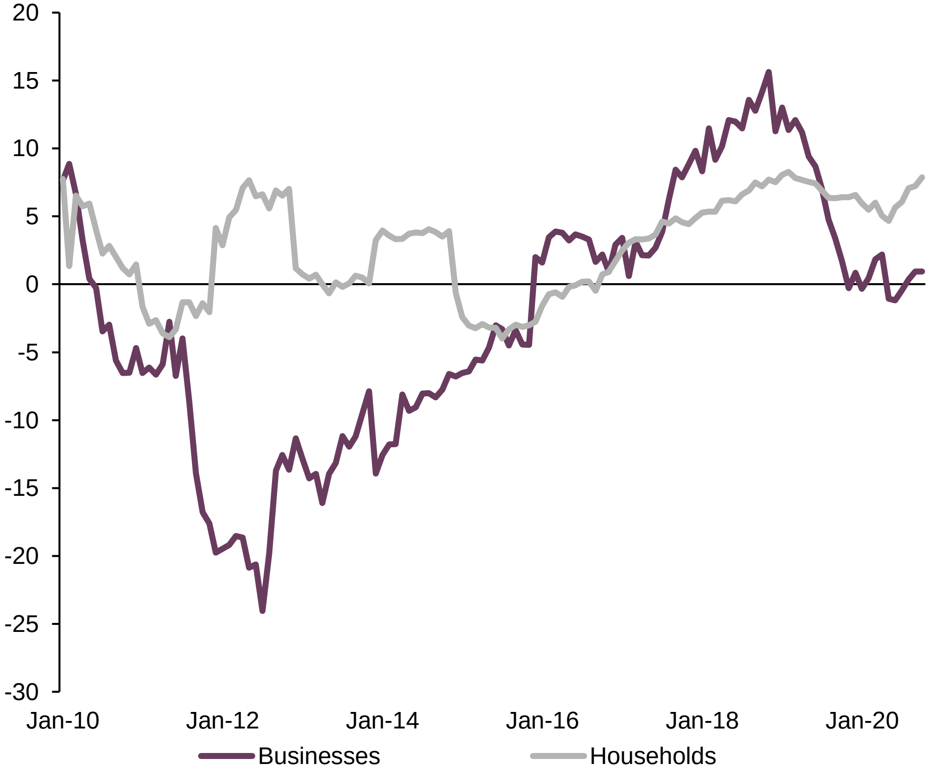
Highlights

- Gross capital formation sagged in 2019 despite robust residential investment. Total investment declined by 6.9% YoY in 2019
- In 2020, the contraction was steeper, as all main components of investment turned downwards. We estimate the contraction in 2020 at 10.5%
- The investment-to-GDP ratio has not suffered much, however, unlike the post-financial crisis situation
- The outlook is for investment to gather pace gradually, but without sudden surges, in the next few years. Public sector investment will lead growth in 2021 with the private sector taking the reins in 2022-2023
- Business sentiment has seesawed recently. After a sharp drop in sentiment as the pandemic hit, business executives generally seem increasingly optimistic that the headwinds will prove temporary
- Lending growth to businesses has slowed markedly after peaking in H2 2018. Corporate lending was almost unchanged over the year 2019 and growth has been negligible in 2020

Business sentiment, 400 largest companies
Index



Credit system net lending
YoY % change



Source: Statistic Iceland, the Central Bank of Iceland and Gallup

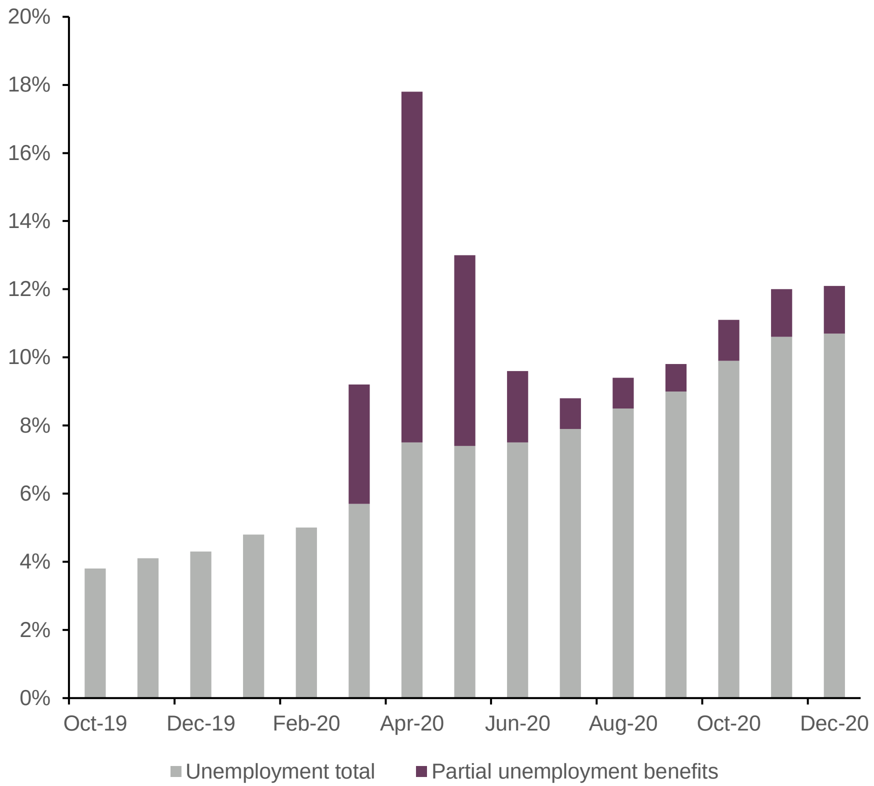
Protracted unemployment wave in the offing?

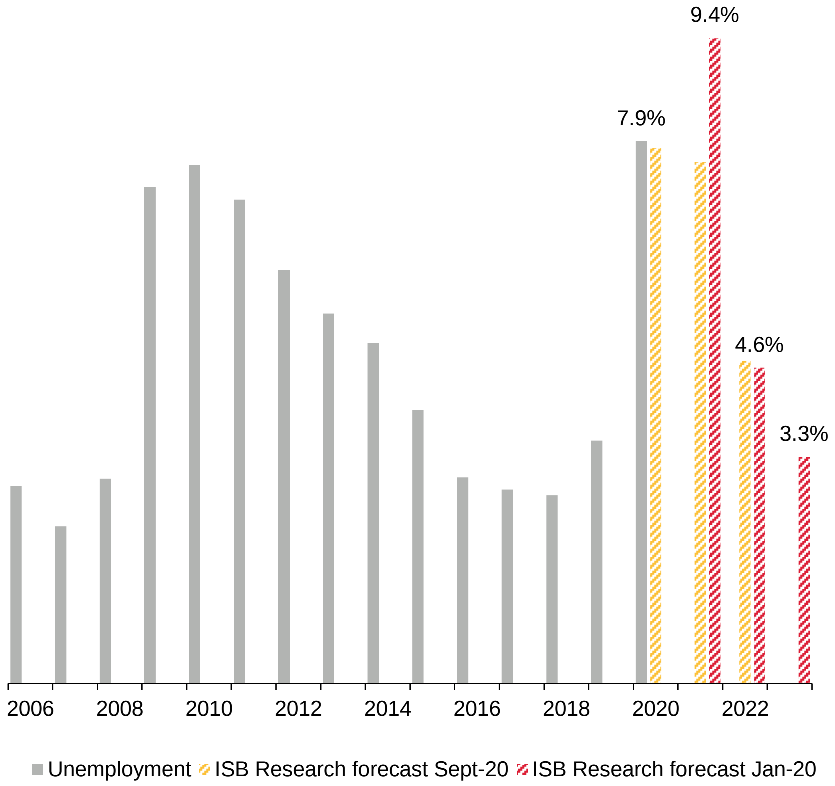
The recovery of tourism plays a key role in determining how fast unemployment subsides

Highlights

- The Corona crisis has laid bare Iceland's vulnerability to shocks in labour-intensive industries such as tourism, other services sectors, and construction
- Unemployment has skyrocketed in the recent past, and over 10% of the labour force is now without work despite the mitigating measures taken by the government
- Due to a more protracted period of low tourism, unemployment also looks set to be more persistent than previously projected
- The labour market likely to start gradually improving by Q3 and slack to remain throughout most of the forecast horizon
- Unemployment is expected to average 9.4% in 2021, 4.7% in 2022, and 3.3% in 2023
- If economic developments follow the path set out in the downside scenario, unemployment will be even more persistent, remaining above 10% for most of this year and above 5% until 2023

Unemployment
% of workforce





Source: Statistics Iceland, the Directorate of Labour and ISB Research

Private consumption a countercyclical force

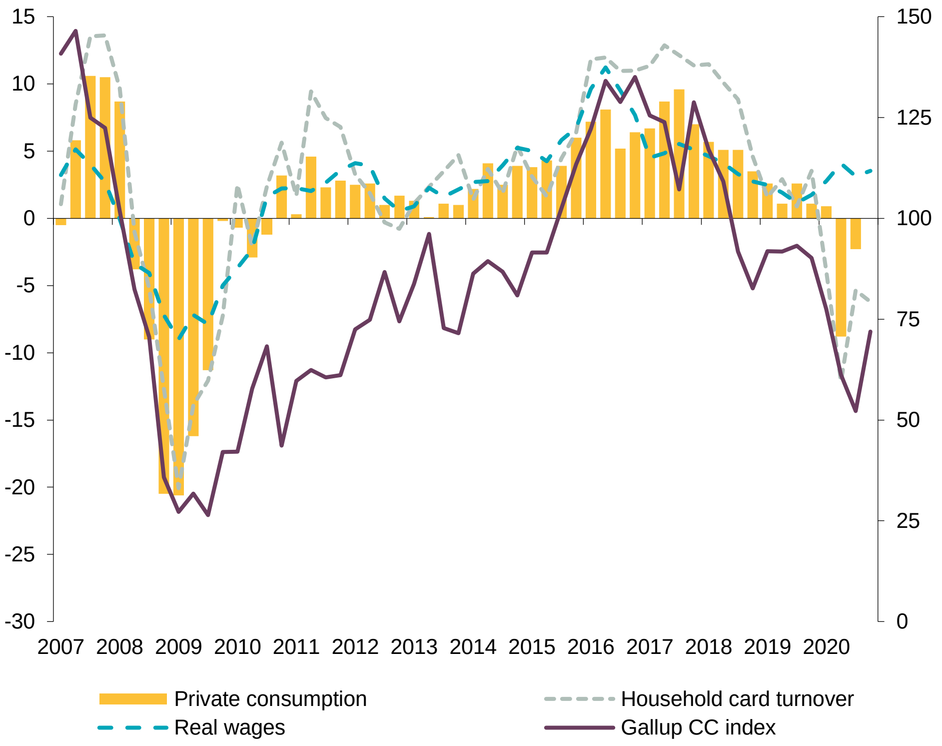
High unemployment will make its mark on private consumption, but the financial strength of most households will help

Highlights

- Although private consumption contracted by around 3.4% in 2020, the contraction was concentrated in consumption abroad while consumption within Iceland more or less held its own
- Households' strong asset position, higher real wages among those still employed, and the effects of interest rate cuts have boosted consumers' appetite for spending and will continue to do so
- On the other hand, high unemployment has a strongly negative impact. Furthermore, the effects of public health measures and uncertainty about consumers' spending appetite and capacity will persist in coming months, albeit to a diminishing degree over the course of the year
- ISB Research forecasts that private consumption will grow by nearly 2% in 2021 and just over 3% per year in 2022 and 2023
- Households' consumption will therefore act as a countercyclical force throughout the business cycle this time, in a departure from the pattern seen in recent decades in Iceland

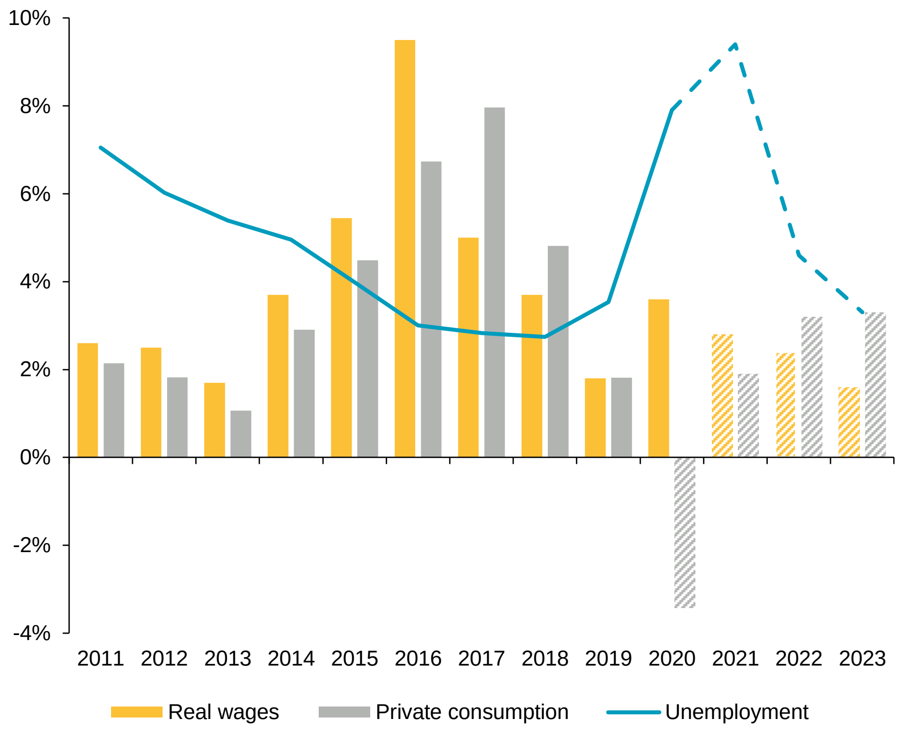
Private consumption and related indicators

YoY real % change (l.axis) and index (r.axis)



Private consumption, unemployment and real wages

YoY % change (consumption, real wages) and % (unemployment)



Source: Statistics Iceland, Gallup and the Central Bank of Iceland

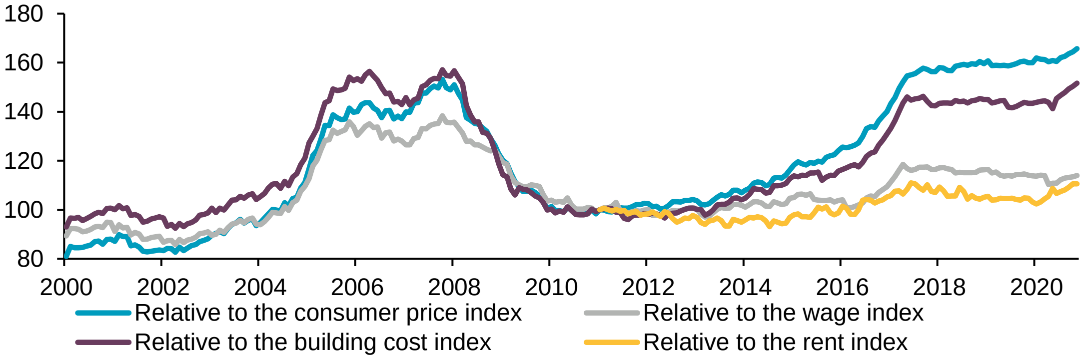
Real estate market resilient despite recession

Residential housing market turnover has been brisk and prices have risen steadily

Commercial property prices closer to historical trend after price decline in H1 of 2020

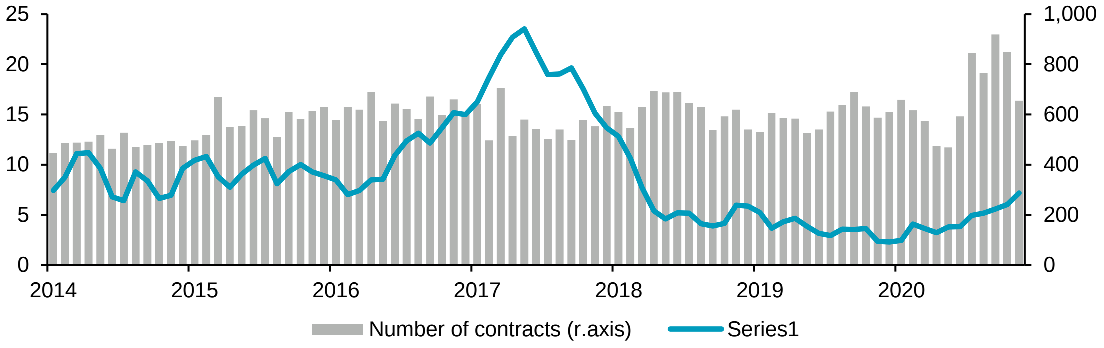
Capital area house prices relative to macroeconomic fundamentals

Index, January 2011=100



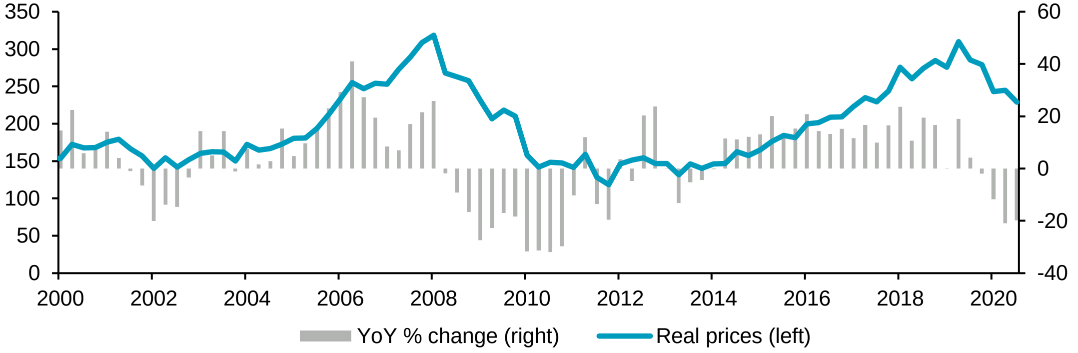
Residential house prices and turnover in greater Reykjavik

% change (left) and number (right)



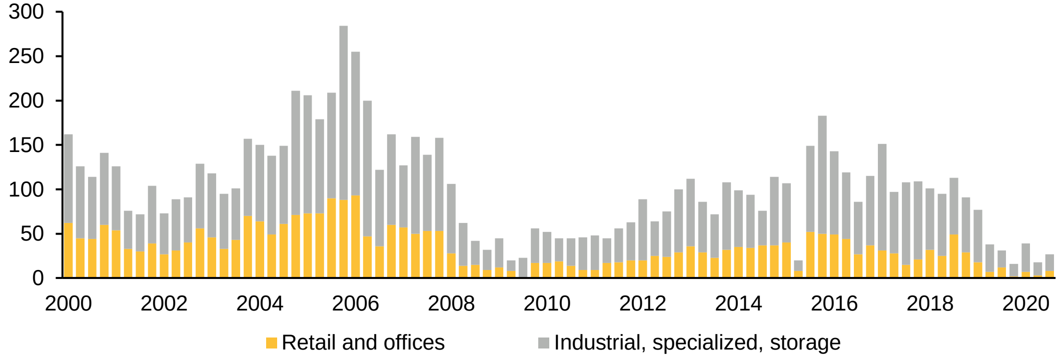
Commercial property real prices in greater Reykjavik

Index, 1995=100



Commercial real estate market activity

No. of registered purchase agreements



Source: The Central Bank of Iceland

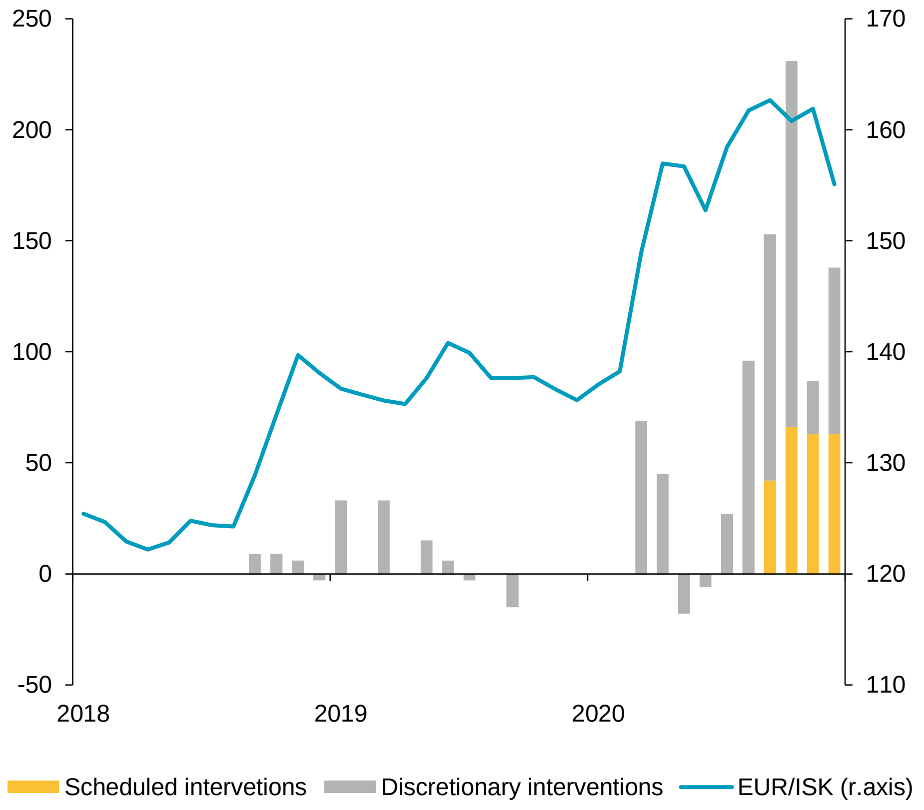
ISK likely to strengthen with rising tourist numbers

The CBI has significantly mitigated exchange rate volatility but could pull back this year

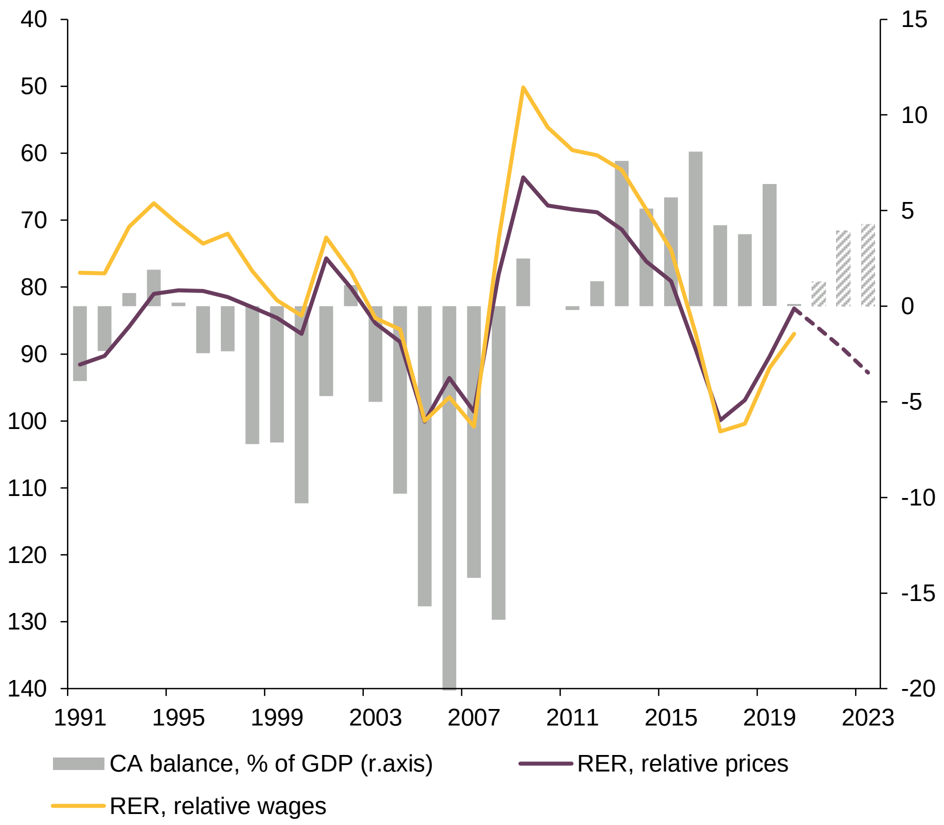
Highlights

- The ISK depreciated by nearly 10% against major currencies over the course of 2020
- The depreciation came mainly in two waves: In March and April, after the pandemic first started raging worldwide, and again in the autumn, due to renewed rise in the pandemic and significant financial outflows
- The CBI sold a total of EUR 820m from its FX reserves in 2020 with the aim of mitigating ISK volatility
- Presumably, the ISK will be under pressure until the tourism industry bounces back, but by the same token, we expect the CBI to continue mitigating excess volatility
- Once the trade balance moves back into surplus, the ISK is expected to appreciate once again as fundamentals remain sound and short-term FX obligations are at a low
- ISB Research's forecast assumes that the ISK exchange rate will be 8-9% above its 2020 average by the end of the forecast horizon

ISK exchange rate and Central Bank FX interventions



Real exchange rate indices and current account balance



1. Dotted lines indicate ISB Research forecasts

Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research

Inflation spike to retreat quickly in coming quarters

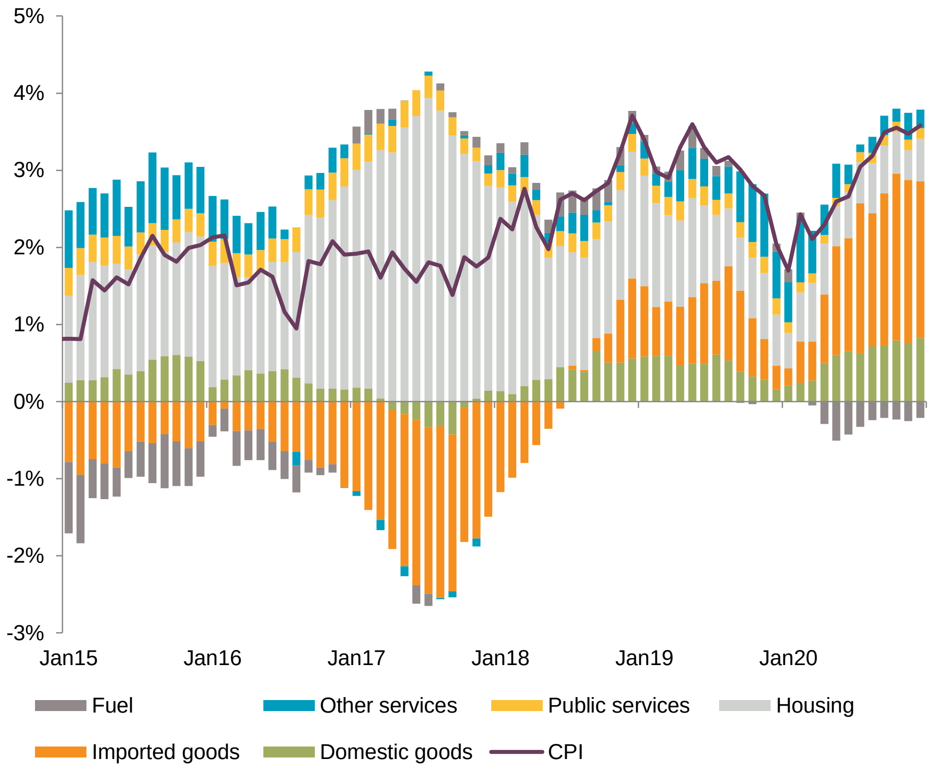
Policy rate to remain low into 2022

Highlights

- Inflation rose steadily in 2020, from 2.0% at the beginning of the year to 3.6% by December and 4.3% in January 2021
- ISK depreciation in 2020 is the largest cause of rising inflation, although there have been domestic inflationary pressures as well and house prices have not had a downward impact as expected
- The outlook is for a relatively swift disinflation episode as the slack in the economy takes hold and the ISK eventually appreciates
- Inflation could reach the CBI's 2.5% target by year-end and stay close to the target in 2022-2023
- Following cuts totalling 2.25% in 2020, the policy rate is likely to stay at 0.75% until the economy is on solid footing again
- Rate hikes unlikely until 2022 and expected to be gradual thereafter
- Long-term rates to rise modestly in 2022-2023 but stay below historical averages

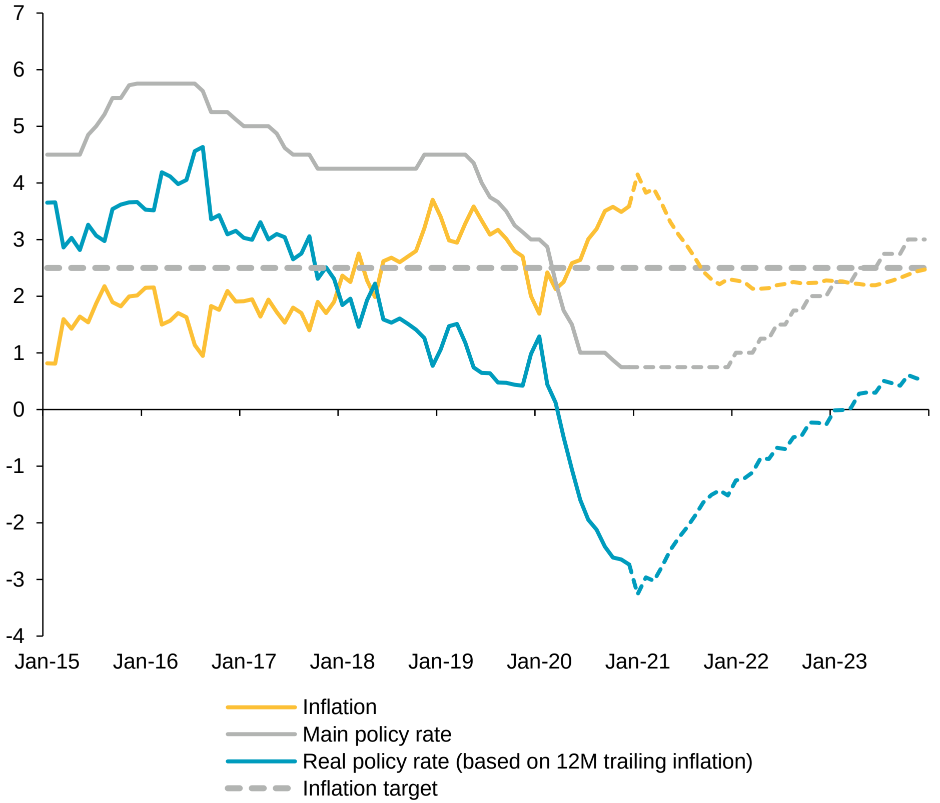
Inflation and contribution of main subitems

%



Inflation, policy rate and real policy rate

%

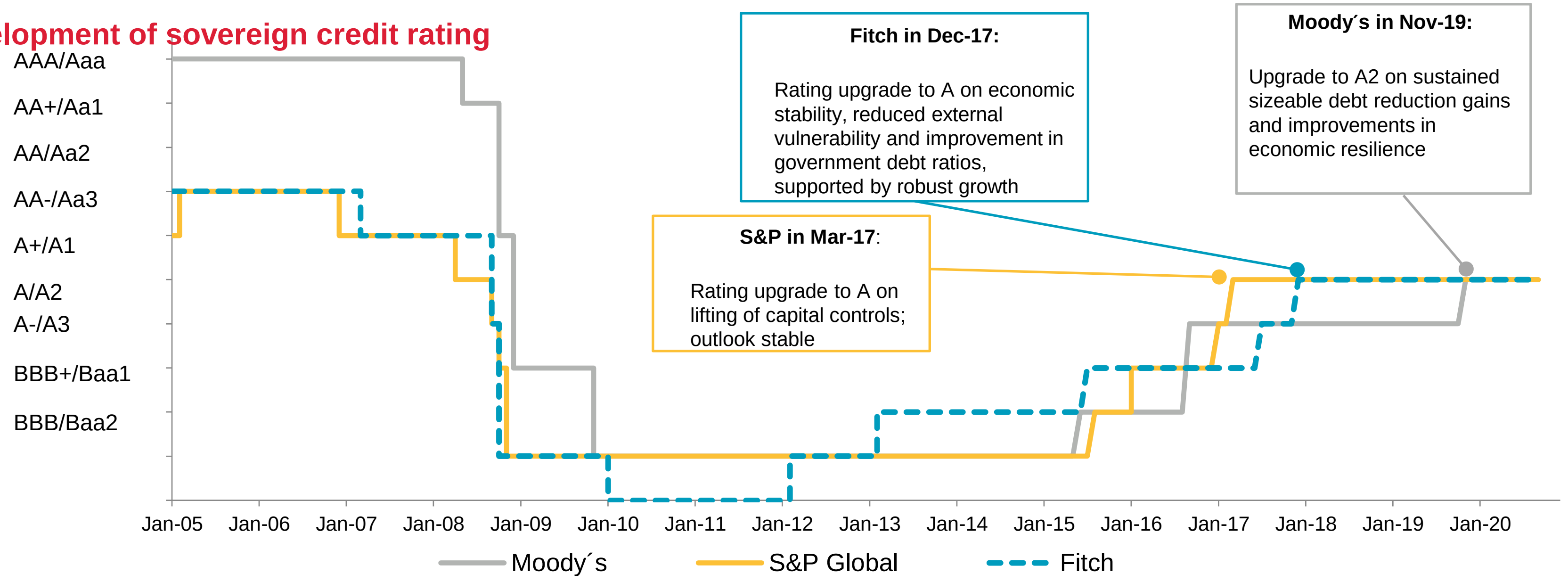


1. Dotted lines indicate ISB Research forecasts
Source: Statistics Iceland, the Central Bank of Iceland and ISB Research

Iceland’s credit rating has remained at A

Setbacks in the tourist sector has not affected the sovereign ratings

Development of sovereign credit rating



MOODY’S IN OCTOBER 2020

- The stable outlook reflects our view that downside risks stemming from the economy's small size and high concentration are mitigated by Iceland's relative macroeconomic and financial robustness, based on reduced indebtedness and improved external balance

FITCH IN OCTOBER 2020

- Rating affirmed at A with a negative outlook
- The 'A' rating is driven by Iceland's very high income per capita, very strong performance on governance, human development and doing business indicators that are more consistent with that of 'AAA' and 'AA' rated countries
- The negative outlook reflects rising government debt/GDP and downside risks of a prolonged and intensified pandemic leading to macroeconomic and financial spill-overs

S&P IN NOVEMBER 2020

- The stable outlook reflects our expectation that Icelandic authorities will be able to gradually stabilize the damage done to public finances by the global pandemic through 2023
- Moreover, despite the significant hit to the tourism sector, we also expect that Iceland will be able to maintain its current account balance in surplus over the next few years

Source: Moody´s, S&P, Fitch Ratings and Central Bank of Iceland

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