



Chairman's statement



Honoured guests

I would like to welcome you to Íslandsbanki's Annual General Meeting, held in the Bank's headquarters at Nordurtúrn in Kópavogur. This year's meeting is taking place under unusual circumstances, as a large number of guests are following events here via teleconferencing equipment, as a precautionary measure due to the COVID-19 pandemic. It is my last meeting as Chairman of the Board after a tenure of ten years, and it is safe to say that this meeting will be memorable for more than one reason.

Financial statements

Economic headwinds early in 2019, including the fallout from the collapse of WOW Air, created challenging conditions and a demanding operating environment for many of the Bank's customers. But the economy showed resilience, and statistics for the year turned out more positive than widely expected.

The Bank's operating performance in 2019 was good, with a consolidated profit of ISK 8.5 billion. This is equivalent to a return on equity of 4.8%, which is below our long-term target. The Bank's income rose by 7.8% during the year, and operating expenses declined, but as in 2018, some subsidiaries' operations had a negative impact on the consolidated results.

Growth in lending and deposits was strong during the year. Deposits were up by 6.8% and lending by

6.3%, and the year-end non-performing loan ratio was 2.4%, in line with the Bank's forecasts. Conditions in the capital markets, both in Iceland and abroad, were favourable for the Bank, and our funding remained diverse and successful. The Bank's liquidity and capital ratios were therefore strong, and well above both internal targets and regulatory requirements.

Economic contraction ahead but the Bank's

Íslandsbanki's strong position is even more important now, when the economy has been bludgeoned by the COVID-19 pandemic and the inevitable economic impact of official responses aimed at slowing the spread of the disease. For a small open economy with a large tourism sector, these are treacherous times – times that will severely test the economy. The risk is that many households and businesses will be hit hard, if only temporarily. Fortunately, the Icelandic authorities, financial sector, and private sector are generally well prepared for such a shock. The lessons we learned from the crash a decade ago are coming in quite handy now. The authorities have already taken important steps to mitigate the economic shock. Yesterday's decision by the financial stability committee to reduce the countercyclical capital buffer to zero for two years is an important contribution to strengthen the Icelandic commercial banks so that they can effectively react to challenges facing companies and households during

current situation caused by COVID-19. Additionally, the decision by the monetary committee to lower interest rates by 0.5% is a testament to the Central Bank's commitment to effectively use its tools to safeguard the economy. Other actions could include the further easing of liquidity requirements for the banks and thus providing them with more capacity to support the economy.

Icelandic banks are subject to much higher capital requirements than foreign banks are. In this context, it has been pointed out that the imposition of the so-called systemic risk buffer in Iceland was an onerous measure that is out of step with policy actions in other European countries. Without delving too deep into the technical aspects of the matter, it would be possible simply to lower the overall capital adequacy requirement for Iceland's banks by nearly two percentage points if the methods used abroad were applied here. This would free up ISK 15 billion for Íslandsbanki and dramatically increase the Bank's lending capacity. Clearly, such a move would strengthen the competitive position of Icelandic banks, thereby providing better support to the business community and the economy more generally during these difficult times.

More investment needed

We all hope the COVID-19 epidemic will pass in a few months. Once it has, the economy will rally once again, although it could take some time before things return to normal. When they do, we

must pick up where we left off. Iceland offers abundant opportunities at present. We can be proud of the value creation that has taken place here in the energy, tourism, fishing, and innovation sectors. But we cannot stop there. We must create conditions that foster the growth of a diverse economy based on innovation and Icelandic brain power. In order for this to happen, we must ensure that sufficient capital is available for profitable investments.

In recent years, the pension funds have been virtually the only investors in the domestic market. The Government's White Paper on a Future Vision for the Financial System points out the necessity of bringing more players to the table in order to boost the effectiveness of our financial market. The White Paper advances a number of intriguing proposals on how to do this, including expanding individuals' freedom to invest their supplemental pension savings, as is done widely in other countries. It is important that the authorities and the business community follow up on the proposals in the White Paper in order to strengthen the Icelandic financial market. Investment is also needed to ensure further development of our social infrastructure. It is neither necessary nor advisable that the Government should stand alone in financing the many infrastructure projects that need to be undertaken. In this vein, it would be interesting to explore further opportunities for public-private partnerships, as we did for the construction and operation of the Hvalfjarðargöng tunnel. Such partnerships have been very successful in neighbouring countries.

High taxes, growing competition

In the decade since I took over as Chairman of the Board at Íslandsbanki, Iceland's financial system has changed radically.

First of all, the system is much smaller than it was before the financial crisis, as nearly all of Iceland's commercial banking operations focus on the domestic market. All of the risk within the banks is much better managed than before, and the banks' cooperation with the Financial Supervisory Authority and the Central Bank has been very fruitful. This cooperation has strengthened Íslandsbanki's risk framework and shored up its defences against money laundering, for instance. In addition, major investments have been made in digital technology during the post-crisis period. These investments have led to increased automation and simpler processes, thereby helping to improve operations and enhance security.

On the other hand, the competitive environment has changed dramatically with the arrival of fintech companies and other market participants. It is vital that the banks respond swiftly to these changed external conditions so as not to end up at the bottom of the heap competitively. And we must not forget that one of the foundations of successful operations is ensuring that customers and the general public have faith and confidence in the Bank. Indeed, fostering such confidence has been one of our primary objectives in recent years.

In a welcome move in 2019, Parliament approved a gradual reduction of the bank tax to 0.145% over a period of several years. But this is nowhere near enough: even with the reduction, taxes on Icelandic banks remain about five times higher than those

in neighbouring countries — as opposed to seven times higher before the tax cut was approved. This reduction should in my view be effective immediately due to the current situation. The aforementioned White Paper also notes that proposed statutory amendments and the establishment of a special resolution fund provide an opportunity for the authorities to conduct a comprehensive review of the special taxes and public levies in the financial market. It is important to look to the future and emphasise fair and appropriate taxation designed to build up funds so as to strengthen the foundations of the financial system and cushion against future shocks, as the Depositors' and Investors' Guarantee Fund and the resolution fund are designed to do. It would be inadvisable to increase the already high levies that have imposed on Icelandic banks in recent years.

At the same time as Iceland is imposing special taxes on its banks, global corporate giants such as Google, Facebook, Apple, and Amazon are expanding their operations, including into banking. These companies pay no taxes in Iceland and are siphoning off revenues from Icelandic companies without paying anything for the privilege.

Increased emphasis on sustainability: an investment for the future

The Board of Directors has met 22 times since the last AGM, and Board subcommittees have held 23 meetings over the same period. Most of the Board's work has been "business as usual", but a few points merit particular mention.

Following the strategy-setting work done last year with Boston Consulting Group, strategy implementation and the launch of key digital development projects and sustainability initiatives have been at the forefront of the Bank's work.

At the end of 2019, the Board of Íslandsbanki approved a new sustainability policy for the Bank. It was an important step forward. The policy emphasises integrating the Bank's commitment to sustainability into its operations and overall strategy, alongside its profit objectives and other financial targets. The sustainability policy, which has been introduced in response to stakeholders' demands for action in the area of sustainability, is consistent with the Government's ownership policy and the UN Global Sustainable Development Goals. With this step, the Bank aims to be a leader in the field of sustainable development and a force for good in the community.

Furthermore, the Board has been working on improvements to Íslandsbanki's risk culture, as reviewing and assessing all types of risk is a fundamental aspect of the Bank's operations. The Board also plays a major role in preparing the Bank's five-year business plan, which forms the basis for the ICAAP report on the Bank's capital requirement. The business plan, which was prepared in cooperation with the Bank's risk management team and the Financial Supervisory Authority, constitutes a large part of the work done by financial institutions' boards of directors.

The Board also emphasised the development of a recovery plan for the Bank, where shock scenarios are presented alongside possible responses designed to mitigate the impact of the shocks. These scenarios have proven very useful as we assess the impact of measures to address

the economic repercussions of the COVID-19 pandemic.

Proposals for the Annual General Meeting

In accordance with the Act on Public Limited Companies and the Act on Financial Undertakings, proposals have been presented for consideration by this meeting.

First, the Board recommends that no dividend be paid to shareholders for 2019, in view of the unprecedented conditions prevailing in the financial markets. This is done in spite of the Bank's long-term policy of paying dividends of 40–50%. The Board also requests the AGM's authorisation to call an extraordinary shareholders' meeting later in the year, as it is possible that a proposal for payment of dividends on previous operating years' profits will be presented.

Second, Icelandic State Financial Investments, which administers the Icelandic Government's holding in the Bank, proposes that the following individuals be elected to the Board until the next AGM:

Principal members:

Hallgrímur Snorrason
Heiðrún Jónsdóttir
Anna Þórðardóttir
Árni Stefánsson
Flóki Halldórsson
Frosti Ólafsson

Guðrún Þorgeirsdóttir

Alternates:

Herdís Gunnarsdóttir
Óskar Jósefsson

It is also proposed that Hallgrímur Snorrason be elected Chairman of the Board.

Third, it is proposed that the AGM approve Ernst & Young as the Bank's external auditors.

Fourth, it is proposed that the Íslandsbanki AGM approve the following remuneration to Board members: for Board members, ISK 420,000 per month; for the Chairman of the Board, ISK 735,000 per month, and for the Vice-Chairman, ISK 525,000 per month. In addition, Board members shall be paid ISK 210,000 per month for participation in Board sub-committees, and sub-committee chairmen shall receive ISK 30,000 per month. Remuneration to alternate Board members shall be ISK 210,000 for each Board meeting attended or each meeting with the Financial Supervisory Authority concerning eligibility, but never more than the remuneration of a Board member in any given month. Payments to each alternate Board member shall be subject to a minimum of ISK 420,000 per year.

All of these amounts are unchanged from last year.

Finally, it is proposed that the AGM approve the Bank's Employment Terms Policy, in accordance with the proposal submitted herewith. The Employment Terms Policy is issued publicly and is available at the meeting. In substance, it is unchanged from last year.

Thanks and good wishes

At this AGM, three Board members are stepping down. In addition to myself, those resigning are Auður Finnbogadóttir, who has served on the Board for the past four years, and Tómas Már

Sigurðsson, who has been an alternate for the past year. On behalf of the three of us, I would like to thank our fellow Board members for a satisfying cooperative relationship. Furthermore, on behalf of the outgoing Board, I would like to thank all those with whom the Bank collaborated during the year. Particular thanks go to Icelandic State Financial Investments, which administers the State's holding. In addition, I would like to thank the staff of the Financial Supervisory Authority, the Central Bank, and Ernst & Young, the Bank's external auditors. I would also like to thank Íslandsbanki's customers for their confidence and loyalty. And on behalf of the outgoing Board, I want to extend my warmest thanks to the Bank's management and staff for their ambitious and successful work during the year. Special thanks go to CEO Birna Einarisdóttir for an outstanding collaborative relationship; her strong and tireless leadership as she directs the Bank's day-to-day activities is an example to us all. And I personally would like to thank Birna for the highly fruitful and rewarding decade we have spent working together.

I am grateful for the time I have spent serving the Bank as Chairman of its Board of Directors. I have met many outstanding people both in the Bank and on the Board. Exciting yet demanding times lie ahead. I am certain that the Bank's strong executive leadership and its talented and competent staff will protect its interests in the years to come, and I am equally certain that the Bank will benefit from its investments in new technology, responsible strategies, and outstanding service to customers.

I wish the new Board and Chairman all the best in their work, and I look forward to watching Íslandsbanki grow in the years to come.