



Chairman's statement

Honoured guests

I would like to welcome you here to Norðurturn for the second Annual General Meeting held in our new headquarters. The Bank's head offices have now been here for two successful years, and switching to an activity-based work environment has been a positive experience. The transition has exceeded expectations, and it has brought about considerably greater efficiency in use of facilities, as well as enhanced flexibility for employees and management. To be sure, moving from Kirkjusandur to Kópavogur was a big decision, but one motivated to a large degree by a drive for efficiency, both for the Bank and for its employees, who now travel about half as far to work, on average, as they did previously. The change was in line with current developments in financial companies' operations, where a bank's location is less important than before and where it is more important that customers be able to do their banking whenever and wherever they choose, via digital solutions. This has been the hallmark of the Bank's activities in the past year and will remain so in the years to come.

It is safe to say that 2018 was a year of major advancements for Íslandsbanki, as we launched investments in new technology and digital products and services. For example, the Bank passed an important milestone in autumn 2018 with the launch of a new core system, its biggest tech project to date. We focused on digital solutions during the year, developing a range of new business solutions in cooperation with customers and partner companies, with excellent results.

The annual accounts

The Bank had a good year in 2018, recording an after-tax profit of ISK10.6bn and an 8.0% annualised return on equity from regular operations, which is in line with its target. Íslandsbanki and IS Funds increased their income by 6% between years, although a loss recorded by one of the Bank's subsidiaries had a negative impact on total consolidated income. Lending to customers grew by 12% during the year and was distributed across all business units. The year-end expense ratio was 66.3% for the group and 60.4% for the parent company, whereas the Bank's long-term target is 55%. It is clear that our task for the next few years will be to cut costs while we invest in new technology and continue running conventional banking operations. Even so, we are optimistic about the future, thanks to new tech solutions that the Bank has developed – solutions that will help reduce costs while improving the service we provide to our customers.

Time to tidy up:

Iceland's GDP growth was robust in 2018, in spite of the slowdown in tourism after the sector's exponential growth. This year, GDP growth is expected to ease, owing to a contraction in business investment and moderate growth in private consumption. In addition, services exports are now growing more slowly than in the past few years. As a result, these drivers of GDP growth in the past few years can be expected to take a rest for the present, although growth is expected to pick up again in 2020. Iceland's largest economic sectors have seen



significant change recently, with increased concentration in both tourism and fishing. According to a report prepared for Íslandsbanki last year, small and medium-sized companies are the drivers of domestic GDP growth. They are better prepared for various types of shocks and have built up sound operations, which is extremely satisfying. As a result, this is an opportune time for Icelandic firms to use the new year to restructure, streamline their operations, and prepare themselves well before the next growth phase starts.

Board activities

The Board of Directors has met 23 times since the last AGM, and its subcommittees have met 24 times over the same period. In the past year, the Board has placed great emphasis on strengthening the Bank's risk culture, as identifying and assessing all types of risk is a fundamental element of its operations. The Board also plays an important role in preparing Íslandsbanki's five-year business plan, which is the basis for the ICAAP report on the Bank's capital requirement. This has been done in cooperation with the Bank's risk management team and the Financial Supervisory Authority (FME), and it represents a large part of the work done each year by the board of any financial company. In recent weeks, the Board has also been working with the Bank's Executive Committee on reviewing the Bank's strategy, in partnership with the Boston Consulting Group.

Competition

As most are aware, rapid technological advances are transforming the activities of conventional banks the world over. Companies in the financial technology, or fintech, sector increase competition. This is positive for consumers, and we welcome that competition. The Government's White Paper on

a Future Vision for the Financial System mentions the need for increased efficiency in the financial market, which will deliver better terms for consumers. This is certainly Íslandsbanki's goal, but it is also the responsibility of the Government to ensure that taxes and levies on financial institutions are not too onerous and do not undermine banks' competitive position vis-à-vis other financial institutions at home and abroad. Taxes on commercial banks are still many times higher in Iceland than in neighbouring countries. This is unfortunate in an environment where pension funds and fintech companies have joined the ranks of our competitors without having to pay levies to the State at a rate comparable to that paid by commercial banks. Competition is a good thing, but it is vital to maintain a level playing field, with the same ground rules for all. Furthermore, it has been pointed out time and again that these high taxes increase systemic risk in the financial system, as financial services are shifting to an increasing degree to entities not supervised by the FME.

Bank CEOs' salaries

In recent weeks, there has been much public discussion of the employment terms and pay rises granted to top management at companies that are majority-owned by the State. Naturally, the current wage negotiations have affected this discussion. I think it appropriate to take this opportunity to mention a few points that I consider important in this regard.

The remuneration paid to the Bank's CEO and Executive Committee is always specified in the annual accounts, as can be seen on page 31 of this year's Annual Report, in Note 15. The Board of Íslandsbanki has always complied with the Bank's employment terms policy as approved at the AGM.

It is clear that after the most recent changes, the monthly salary of Íslandsbanki's CEO is lower in ISK terms than it was in 2016, when the State acquired the Bank. The wage index has risen by more than 23% over that same period. These changes have been made by the Board and the CEO, Birna Einarsdóttir, in a cooperative effort and, to a degree, at Birna's behest.

The sale of the Bank

Ownership of commercial banks has been a frequent topic of discussion in recent years, as the Icelandic Government's holdings in commercial banks are many times larger than in most other parts of Europe. The aforementioned White Paper discusses the advantages of selling Íslandsbanki, preferably to a foreign buyer. It is clear that Íslandsbanki is ready to be sold after streamlining and investing in core infrastructure in recent years. Based on the figures that have been floated, the sale could generate the equivalent of at least four new teaching hospitals. It is therefore of vital interest to Icelandic taxpayers that the sale of Íslandsbanki be undertaken successfully. Foreign ownership or listing on foreign and domestic equity markets would be desirable. Of course, it is the owner – the Icelandic Government – that will decide the matter, but it is exceedingly important that the sale process be fair, trustworthy, and transparent.

A responsible Bank

It is vital that companies like Íslandsbanki should be responsible members of their community and have a positive impact on it. This has been our guiding principle in matters such as gender equality, the environment, and humanitarian issues. We want to build up confidence in the Bank and to be transparent in all that we do, as our operations are an impor-

tant part of creating a strong, diverse community. Íslandsbanki has focused on managing its activities in line with best practice in corporate governance, on ensuring that its governance practices and internal organisation foster efficient and prudent management of the Bank, and on preventing conflicts of interests. Its staff and Board of Directors are determined to adhere to the Bank's core values.

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 of all, the Board of Directors proposes that a dividend of ISK 5.3bn on 2018 profits be paid to shareholders. The dividend equals about 50% of the profit for the year and is therefore in line with the Bank's long-term policy of paying dividends in the 40-50% range.

Second, Icelandic State Financial Investments, which administers the State's holding in the Bank, proposes that the following be elected to the Board of the Bank.

Friðrik Sophusson, Chairman of the Board

Other board members:

Anna Þórðardóttir

Auður Finnbogadóttir

Árni Stefánsson

Hallgrímur Snorrason

Heiðrún Emelía Jónsdóttir, and

Tómas Már Sigurðsson

The following are proposed as alternates:
Herdís Gunnarsdóttir and Pálmi Kristinsson

Third, it is proposed that Ernst & Young be kept on as auditors of the Bank's accounts.

Fourth, it is proposed Board members' remuneration remain unchanged.

Fifth, a proposal for an employment terms policy has been presented. The proposal was sent by the Board of Icelandic State Financial Investments to the Board of the Bank, which presents it here. The proposal states unequivocally that terms of employment should be moderate as well as competitive, and that they should not lead the market. Several references are presented in this context. It is also stipulated that the CEO should prepare proposals for subsidiaries' employment terms policies and their remuneration to Board members, and present these proposals to the Board of the Bank. It is stipulated as well that the Board should publish information on the CEO's terms of employment in the Annual Report, as has been done heretofore, and those of each member of the Executive Committee. Finally, it is proposed that Article 8 of the Bank's Articles of Association be amended to accord with the obligations on State-owned companies as laid down in the Act on Public Limited Companies.

Thanks to employees and others

Helga Valfells, Deputy Chairman of the Board, does not seek re-election. Helga has extensive experience in banking in Iceland and abroad, and in recent years she has chaired the Board Risk Management Committee. On behalf of the Board, I would like to thank her for a highly fruitful collaborative relationship. We wish her all the best in her future endeavours. I would also like to thank all of those who have collaborated with Íslandsbanki this year. In particular, I wish to thank the Board and staff of Icelandic State Financial Investments, which administers the State's holding in the Bank. Furthermore, I would like to thank the employees of the Finan-

cial Supervisory Authority and the Central Bank, as well as the employees of our auditing firm, Ernst & Young. I would also like to thank Íslandsbanki's customers for their confidence and loyalty. And on behalf of the Board, I want to extend my warmest thanks to the Bank's management and staff for their ambitious and successful efforts during the year. Special thanks go to CEO Birna Einarsdóttir for an outstanding collaborative relationship and for her strong and tireless leadership as she directs the Bank's day-to-day activities.

The future is bright for Íslandsbanki, thanks to our vibrant team of employees who are determined to see the Bank play a leading role in the continuing development of our community.