3Q2020 Financial Results

islandsbanki.is

Table of Contents

1. 3Q2020 highlights

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
744
Parent company end of September 2020

12 Branches

Market share[1]

30%	Retail customers
35%	SMEs
34%	Large companies

Sustainability

Environment	**1.62** CO_2tn	Carbon emission per employee
Social	**1.14%**	Gender pay gap
Governance	**67%**	of women chairing committees at board level

Key Figures 3Q2020

ROE	7.4%	LCR Group, all currencies	136%
Cost to income ratio	46.7%	NSFR Group, all currencies	113%
Total capital ratio	22.2%	Leverage Ratio	13.4%
Tier 1 capital ratio	19.4%	Total assets	ISK 1,329bn

Ratings and certifications

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

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones in 3Q2020

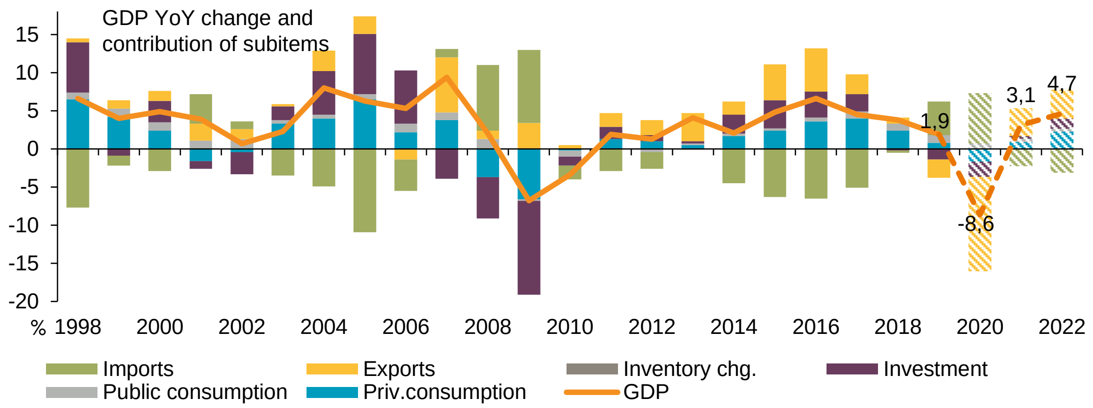
- Íslandsbanki app available for companies
- Chatbot Fróði serves 40% of all contact center chats and finishes 85% end-to-end
- Increased use of digital solutions in COVID-19 period
- Automated COVID-19 support loans process

1. Based on Gallup surveys regarding primary bank

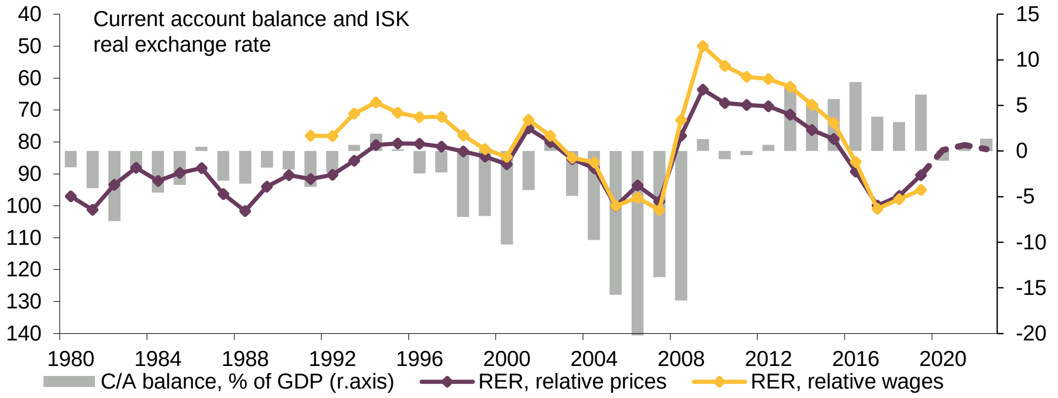
Pandemic-induced recession deep but hopefully temporary

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

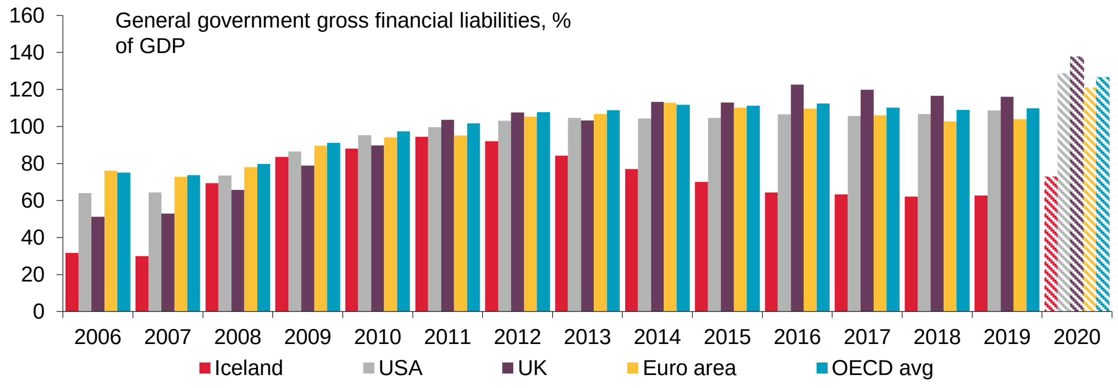
The economic impact of COVID-19 will be deep in 2020...



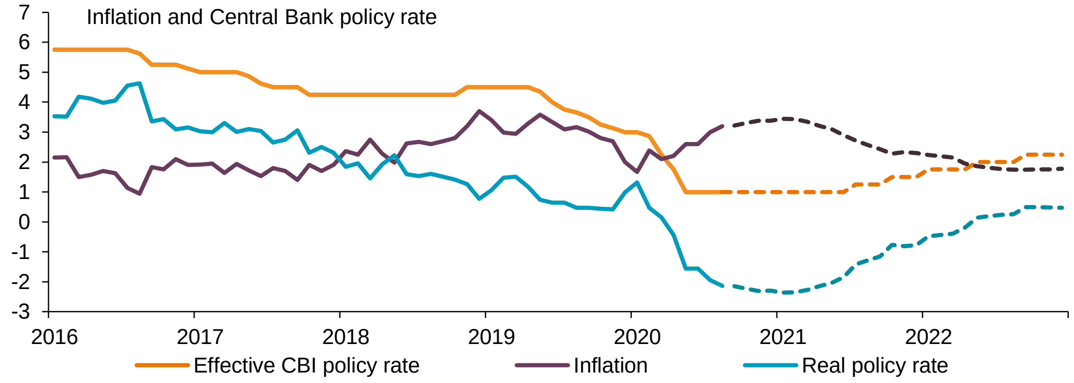
...although a lower real exchange rate will aid export sector recovery



Moderate public debt increases scope for countercyclical measures...



...and monetary conditions have been eased considerably to aid economy



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

Operational highlights in 3Q2020

Increased digital focus in wake of COVID-19

- Íslandsbanki received the Icelandic knowledge award for the year 2020, awarded by the Association of Business and Economist graduates in Iceland (FVH). The Bank is said to be exemplary among Icelandic businesses by international comparison in terms of standards in environmental, social and governance practices
- Íslandsbanki was awarded as exemplary in good governance for the seventh year consecutively
- Íslandsbanki jointly managed the issuance of new shares in the local airline Icelandair. Strong demand with 85% oversubscription, both from institutional and retail investors. As a result, underwriting of ISK 14bn jointly committed by Íslandsbanki and Landsbankinn was not utilised
- Due to limited face-to-face services during the COVID-19 pandemic increased focus has been placed on digital and phone services
- Fróði, a new virtual advisor, was introduced as a quick and easy way of interacting with the Bank. More detailed inquiries are referred to the contact centre. This reduces waiting time and increases service
- A new and comprehensive corporate banking app facilitates daily banking for business owners and managers
- The total number of active users in the Íslandsbanki app has increased by 446% since YE19 and close to 50% of all refinancing requests of mortgages are now processed automatically via digital channels
- A new marketing campaign was launched, addressing the Bank‘s role as a responsible and positive force in society

Íslandsbanki becomes the first Icelandic bank to publish a Sustainable Financing Framework[1]

Project categories mapped against the Bank's loan portfolio, paving way for new sustainable loans and sustainable bond issuances

The Bank's most important sustainability undertaking to date and follows from its 2019 Sustainability Policy[2]

- Built on Green, Social and Sustainable Bond Principles issued by ICMA[3]
- Supports UN SDGs, Iceland Climate Action Plan and follows declaration of intent for investing for a sustainable development[4]
- Examples of projects include smaller hydropower plants, geothermal power plants, wind and solar power plants, environmentally certified products (also related to fisheries), environmentally friendly and certified buildings, loans to schools for promoting job creation for women and disadvantaged groups

The Green Bond Principles

The Social Bond Principles

Cooperation with:

CIRCULAR

Second Party Opinion by:

SUSTAINALYTICS
a Morningstar company

Green project categories

1. Clean Transportation
2. Eco-efficient and circular economy adapted products, production technologies and processes
3. Energy efficiency
4. Pollution prevention and control
5. Renewable energy
6. Green buildings
7. Environmentally sustainable management of living natural resources and land use, and terrestrial biodiversity conservation
8. Sustainable waste management
9. Information & communications technology

Blue project categories

1. Eco-efficient and circular economy adapted products, production technologies and processes
2. Pollution prevention and control
3. Clean Transportation

Social project categories

1. Government defined company support
2. Affordable housing
3. Education and vocational training
4. Financial support for MSMEs
5. Equality, diversity and empowerment
6. Affordable basic infrastructure

1.See further information regarding Framework here
2. See further here
3. International Capital Market Association
4. See declaration here

Seven sustainability goals for 2025 approved

Measurable and timed targets will be set on an annual basis for each goal

Íslandsbanki‘s goals for 2025	Relation to SDGs
1. Become carbon neutral in our operations	13 Climate Action
2. Offer our customers green and sustainable products	4 Quality Education; 5 Gender Equality; 9 Industry, Innovation and Infrastructure; 13 Climate Action
3. Balance gender ratios through all of the Bank‘s operations	5 Gender Equality
4. Create a work culture that celebrates diversity and inclusion	4 Quality Education; 5 Gender Equality
5. Work with suppliers and partners that champion sustainability	4 Quality Education; 5 Gender Equality; 9 Industry, Innovation and Infrastructure; 13 Climate Action
6. Assess and publish sustainability risk and define internal decision making	4 Quality Education; 5 Gender Equality; 9 Industry, Innovation and Infrastructure; 13 Climate Action
7. Place special emphasis on four of the UN SDGs	4 Quality Education; 5 Gender Equality; 9 Industry, Innovation and Infrastructure; 13 Climate Action

Overview

Key figures & ratios

		3Q20	3Q19	9M20	9M19	2019
PROFITABILITY	After tax profit, ISKm	**3,361**	2,086	**3,230**	6,795	8,454
	Return on equity (after tax)	**7.4%**	4.7%	**2.4%**	5.1%	4.8%
	Net interest margin (of total assets)	**2.5%**	2.7%	**2.6%**	2.7%	2.8%
	Cost to income ratio[1]	**46.7%**	56.3%	**55.3%**	57.5%	62.4%
		30.09.2020	30.06.2020	31.03.2020	31.12.2019	30.09.2019
BALANCE SHEET	Loans to customers, ISKm	**970,309**	933,320	923,850	899,632	909,175
	Total assets, ISKm	**1,328,724**	1,303,256	1,255,691	1,199,490	1,233,855
	Risk exposure amount, ISKm	**942,339**	923,133	911,375	884,550	912,843
	Deposits from customers, ISKm	**698,610**	681,223	647,795	618,313	610,281
	Customer loans to customer deposits ratio	**138.9%**	137.0%	142.6%	145.5%	149.0%
	NPL ratio[2]	**3.3%**	3.6%	2.8%	3.0%	2.8%
LIQUIDITY	Liquidity coverage ratio (LCR), for all currencies	**136%**	179%	177%	155%	174%
	Net stable funding ratio (NSFR), for all currencies	**113%**	117%	120%	119%	117%
CAPITAL	Total equity, ISKm	**182,509**	179,722	179,542	180,062	177,984
	Tier 1 capital ratio	**19.4%**	19.4%	19.2%	19.9%	19.0%
	Total capital ratio	**22.2%**	22.2%	21.9%	22.4%	21.4%
	Leverage ratio	**13.4%**	13.4%	13.5%	14.2%	13.6%

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

2. Income statement

Strong third quarter but profitability below target for 9M20[1]

Impairment charge related to COVID-19 affects profit

Comments

- Total operating income increased during 3Q20 but fell in 9M20 as a result of loss in net financial income and less card related income
- Net financial loss due to loss in trading and banking books for equity and equity like instruments in 1Q20, CPI hedges in 2Q20 and fair value changes in 3Q20
- The bank tax has been reduced to 14.5 basis points from 31.8 basis points
- Income tax expense as a ratio of profit before tax increased in 9M20 due to non-deductible financial losses and fluctuation in combination of income
- The cost of risk for loans to customers was 0.11% in the quarter (0.44% annualised) and 0.74% in 9M20 0.98% annualised)

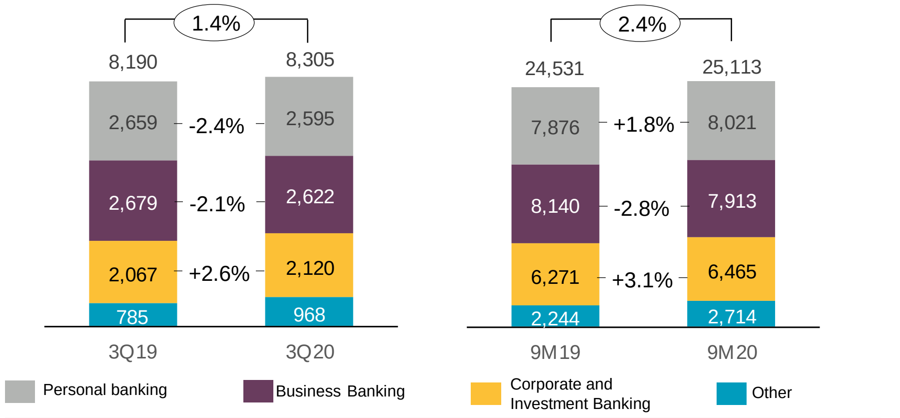
ISKm	**3Q20**	3Q19	Δ	Δ%	**9M20**	9M19	Δ	Δ%
Net interest income	**8,305**	8,190	115	1.4%	**25,113**	24,531	582	2.4%
Net fee and commission income	**2,862**	2,549	313	12.3%	**7,660**	7,954	(294)	-3.7%
Net financial income (expense)	**(255)**	(602)	347	-57.6%	**(2,174)**	20	(2,194)	-10970.0%
Net foreign exchange gain	**101**	159	(58)	-36.5%	**364**	23	341	1482.6%
Other operating income	**44**	37	7	18.9%	**134**	1,205	(1,071)	-88.9%
Total operating income	**11,057**	10,333	724	7.0%	**31,097**	33,733	(2,636)	-7.8%
Salaries and related expenses	**(2,842)**	(3,242)	400	-12.3%	**(9,536)**	(10,395)	859	-8.3%
Other operating expenses	**(2,268)**	(2,366)	98	-4.1%	**(7,137)**	(7,646)	509	-6.7%
Administrative expenses	**(5,110)**	(5,608)	498	-8.9%	**(16,673)**	(18,041)	1,368	-7.6%
Contribution to the Depositor's and Investors' Guarantee Fund	**(50)**	(210)	160	-76.2%	**(525)**	(720)	195	-27.1%
Bank tax	**(416)**	(900)	484	-53.8%	**(1,174)**	(2,714)	1,540	-56.7%
Total operating expenses	**(5,576)**	(6,718)	1,142	-17.0%	**(18,372)**	(21,475)	3,103	-14.4%
Profit before net impairment on financial assets	**5,481**	3,615	1,866	51.6%	**12,725**	12,258	467	3.8%
Net impairment on financial assets	**(1,058)**	(208)	(850)	408.7%	**(6,987)**	(2,017)	(4,970)	246.4%
Profit before tax	**4,423**	3,407	1,016	29.8%	**5,738**	10,241	(4,503)	-44.0%
Income tax expense	**(1,350)**	(1,328)	(22)	1.7%	**(2,238)**	(3,250)	1,012	-31.1%
Profit for the period from continuing operations	**3,073**	2,079	994	47.8%	**3,500**	6,991	(3,491)	-49.9%
Discontinued operations, net of income tax	**288**	7	281	4014.3%	**(270)**	(196)	(74)	37.8%
Profit for the period	**3,361**	2,086	1,275	61.1%	**3,230**	6,795	(3,565)	-52.5%

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

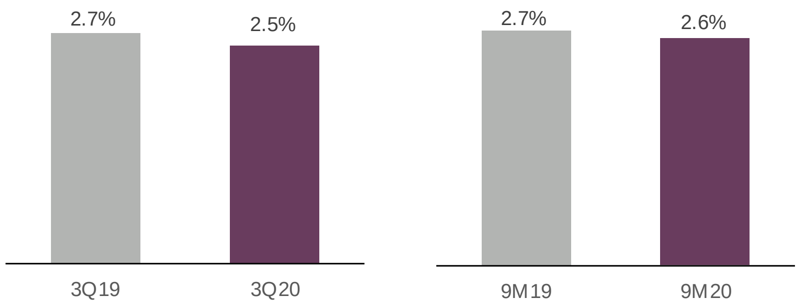
Net interest income rising

As a result of higher interest-bearing assets

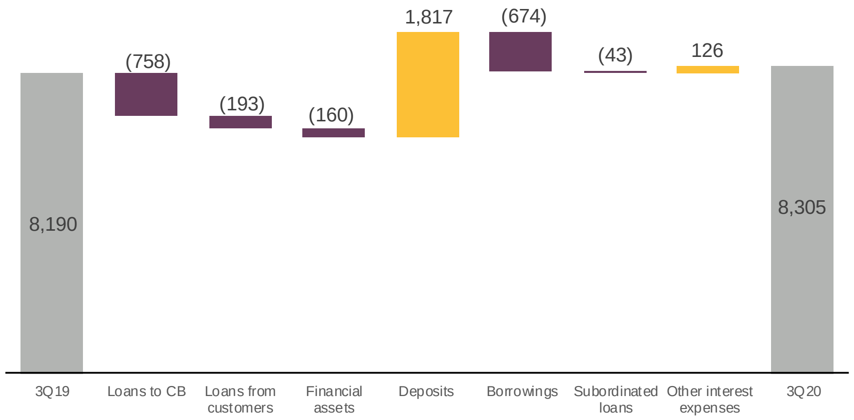
Net interest income
ISKm



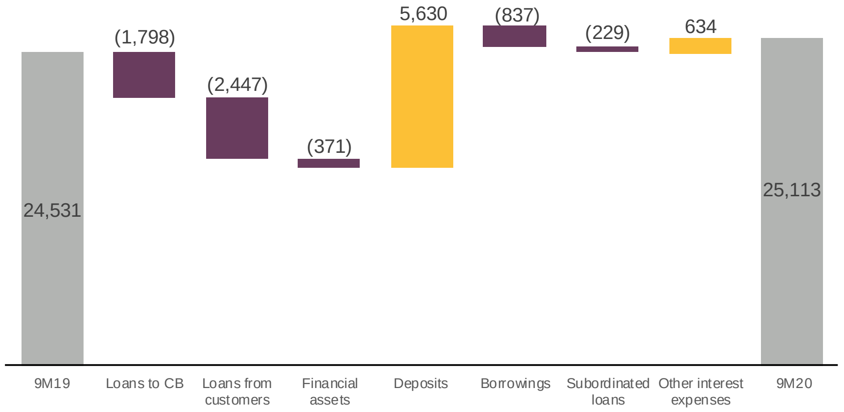
Net interest margin



NII – comparison 3Q YoY
ISKm



NII – comparison 9M YoY
ISKm



1.See Note 7 of Condensed Consolidated Interim Financial Statements 3Q20 for further detail

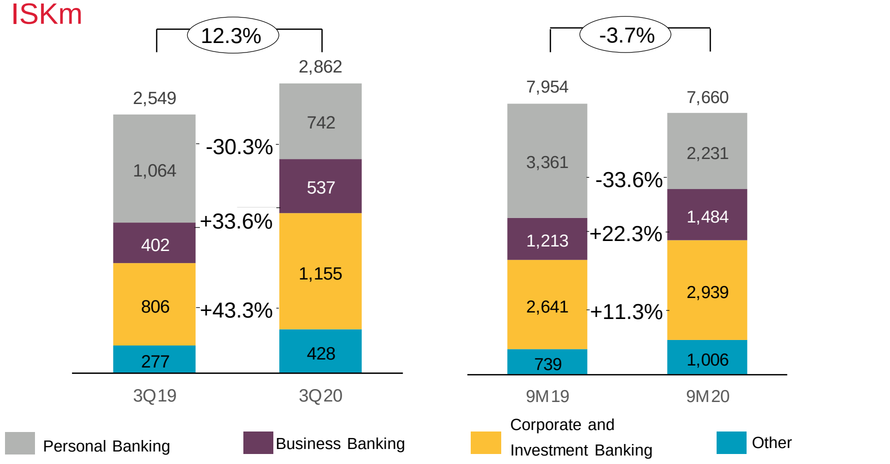
Net fee and commission income rising

Increase from asset management, investment banking and brokerage

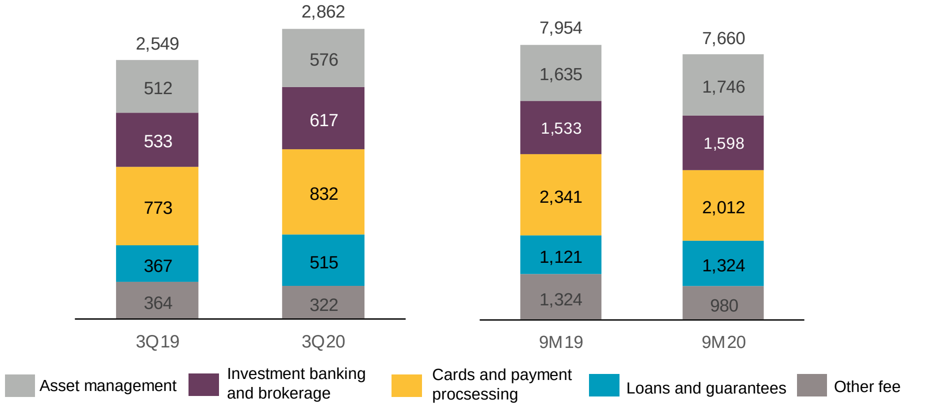
Comments

- Following the sale of Borgun hf., eliminations from the first half are reversed following the sale of the subsidiary. This further contributes to increased NFCI in 3Q20
- In 9M20 NFCI decreased due to reduced payment card and currency exchange activity in the wake of COVID-19

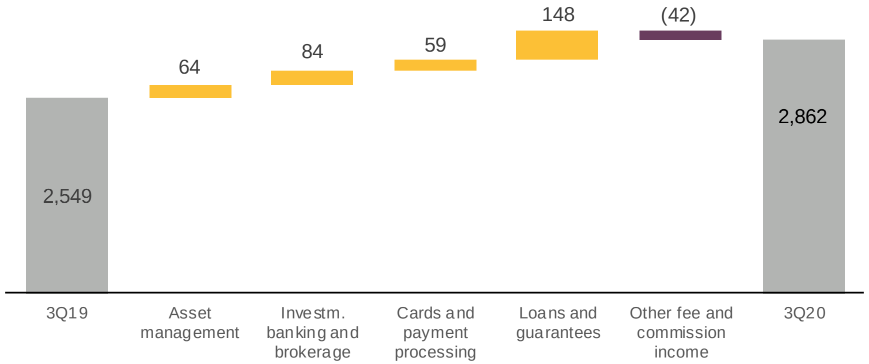
Net fee and commission income
ISKm



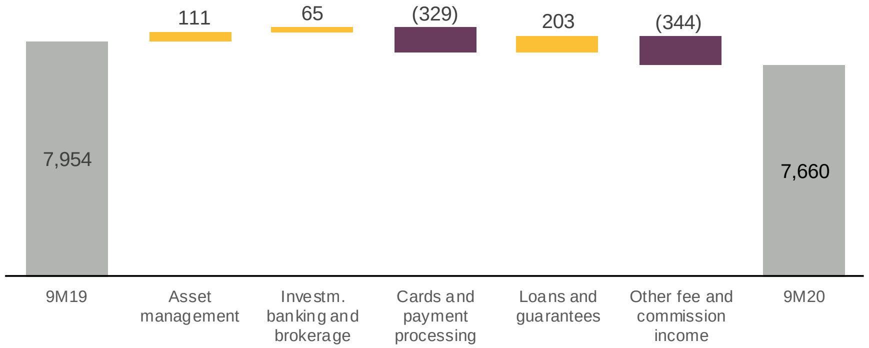
Net fee and commission income
ISKm, split by sector



NFCI - Comparison 3Q YoY



NFCI – comparison 9M YoY



1.See Note 8 of Condensed Consolidated Interim Financial Statements 3Q20 for further detail

Administrative expenses decrease

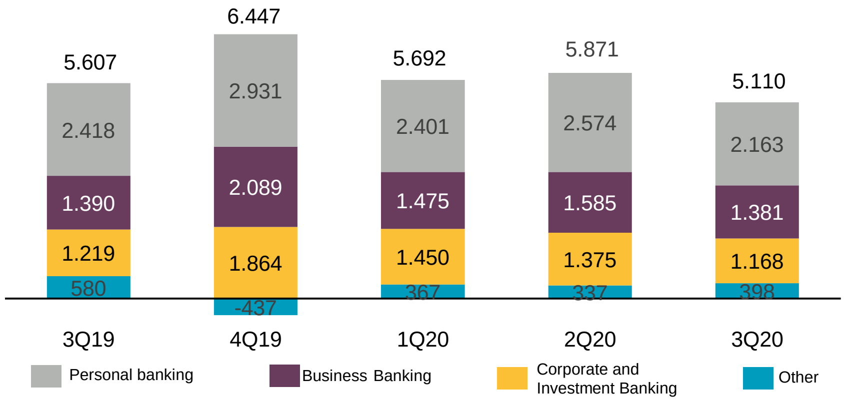
Fall in administrative expenses by 8.9% in 3Q20 YoY is driven by lower salary cost and operating expenses

Comments

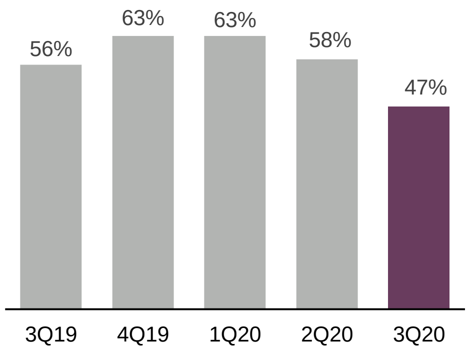
- The drop in administrative expenses in the period is mainly explained by a decrease in salaries and related expenses, modest wage rises and an overall reduction in the Bank´s cost base, partly due to COVID-19
- C/I ratio at 46.7% in 3Q20, under the Bank´s target of less than 55%. For 9M20 the C/I ratio was 55.3% compared to 57.5% in 9M19

Administrative expenses[1]

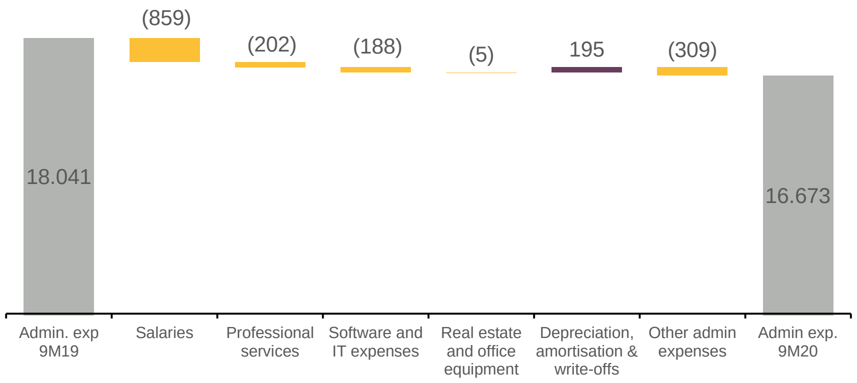
ISKm



Efficiency – Cost to income ratio[2]

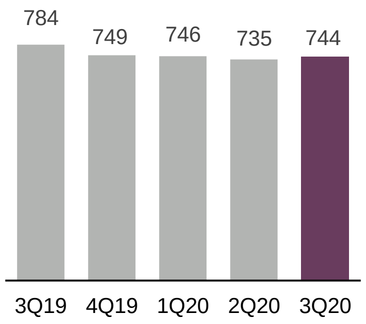


Administrative expenxes[3]

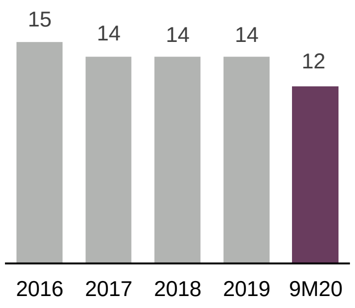


Period end FTE numbers[4]

Parent company



Branch network



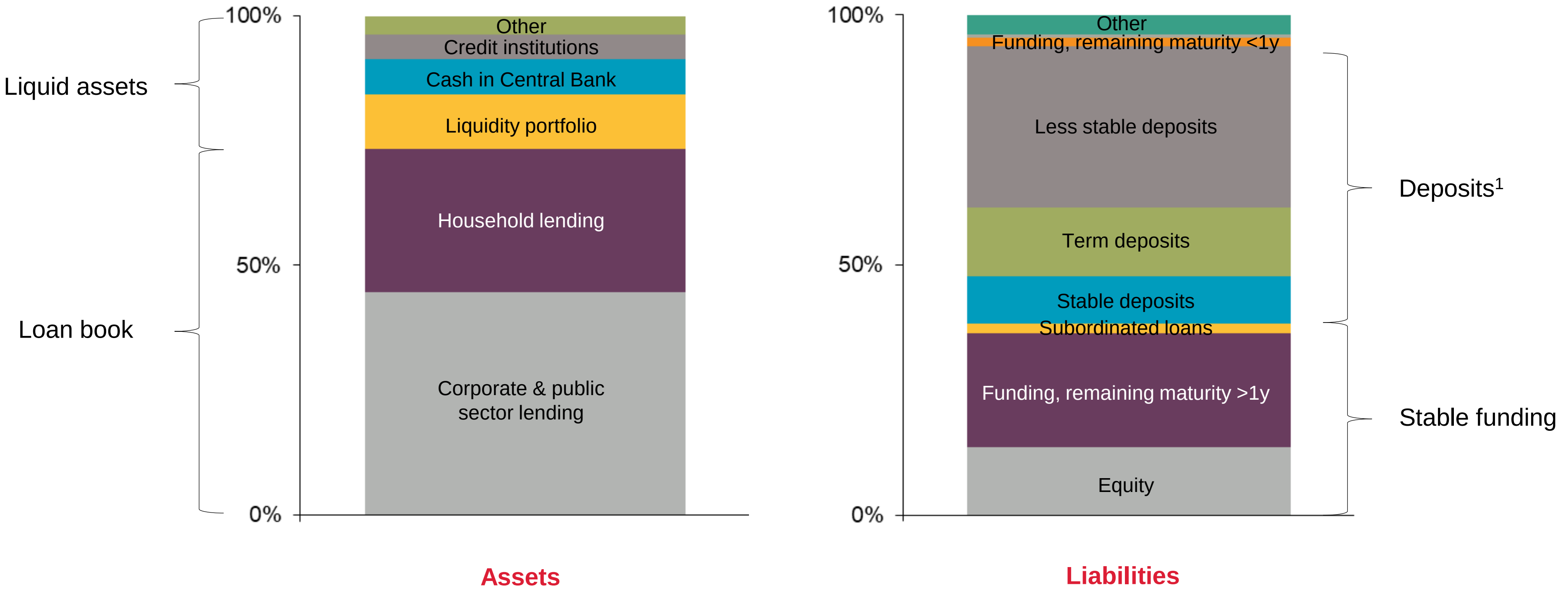
1. Negative cost in Other segment in 4Q19 due to changes in internal cost allocations
2. The cost-to-income ratio excludes bank tax and one-off items
3. See Notes 12 and 13 of Condensed Consolidated Interim Financial Statements 3Q20 for further detail
4. FTE numbers exclude seasonal employees

3. **Balance sheet**

Balance sheet overview

Strong balance sheet structure with deposits as primary source of funding

Simplified balance sheet structure
30 September 2020, ISK 1,329bn



1.As defined by LCR categories

Total assets are 10.8% up from year-end 2019

Loans to customers grew by 7.9% from YE19, 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 306bn of which ISK 267bn are liquid assets

Loans to customers

— Net increase in loan portfolio is mostly due to increase in mortgage lending and the depreciation of the Icelandic króna

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

Shares and equity instruments

— ISK 8.8bn used for economical hedging

Other assets

— Increased due to unsettled transactions in 3Q20

Non-current asset

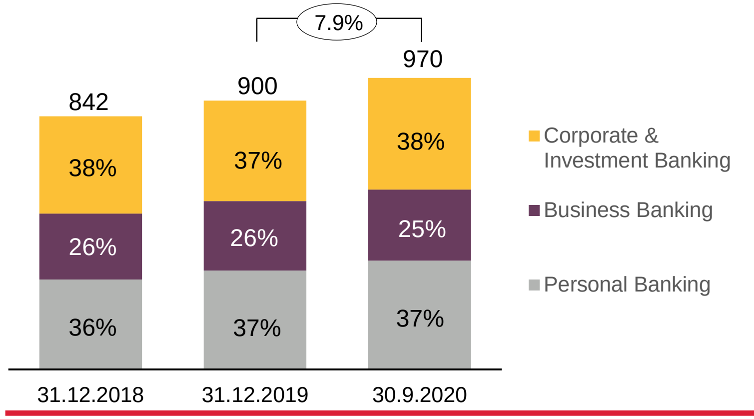
— Reduction from 2Q20 due to the sale of Borgun hf.

Assets, ISKm	30.09.2020	30.06.2020	Δ	Δ%	31.12.2019	Δ	Δ%
Cash and balances with Central Bank	**95,022**	103,569	(8,547)	-8.3%	146,638	(51,616)	-35.2%
Loans to credit institutions	**61,898**	70,307	(8,409)	-12.0%	54,376	7,522	13.8%
Bonds and debt instruments	**149,426**	140,422	9,004	6.4%	52,870	96,556	182.6%
Derivatives	**3,731**	6,366	(2,635)	-41.4%	5,621	(1,890)	-33.6%
Loans to customers	**970,309**	933,320	36,989	4.0%	899,632	70,677	7.9%
Shares and equity instruments	**14,657**	10,943	3,714	33.9%	18,426	(3,769)	-20.5%
Investment in associates	**750**	750	-	0.0%	746	4	0.5%
Property and equipment	**7,409**	7,549	(140)	-1.9%	9,168	(1,759)	-19.2%
Intangible assets	**3,554**	3,667	(113)	-3.1%	4,330	(776)	-17.9%
Other assets	**17,159**	6,370	10,789	169.4%	6,608	10,551	159.7%
Non-current assets and disposal groups held for sale	**4,809**	19,993	(15,184)	-75.9%	1,075	3,734	347.3%
Total Assets	**1,328,724**	1,303,256	25,468	2.0%	1,199,490	129,234	10.8%

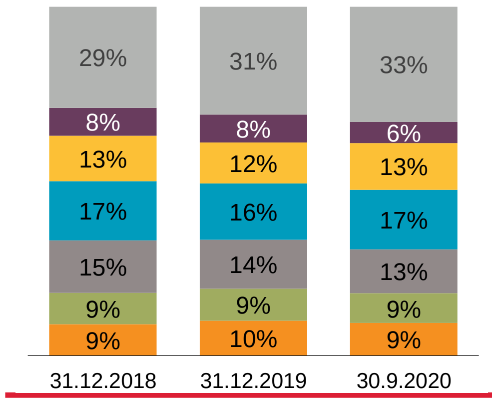
Diversified loan portfolio in terms of sectors and collateral

Exposure to tourism is 10% of loans to customers

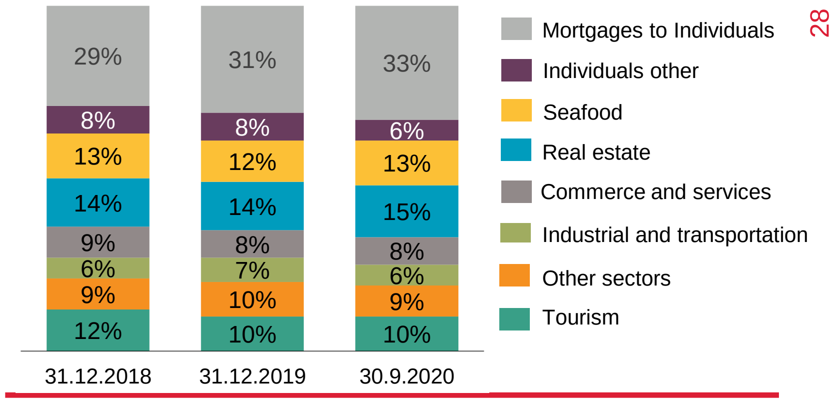
Loans to customers
By business divisions, ISKbn, consolidated



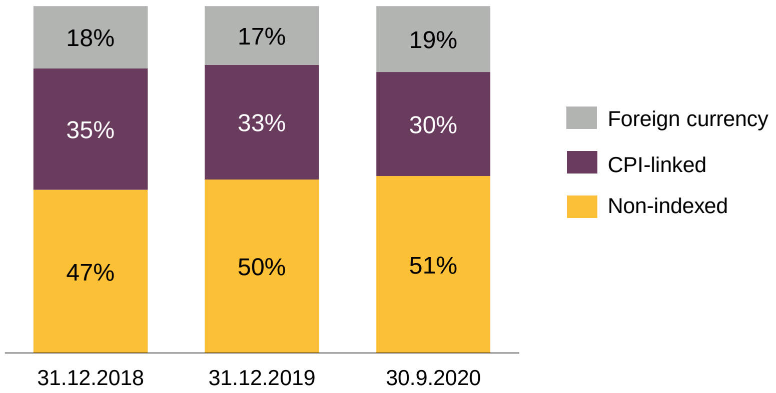
Loans to customers
By sector, consolidated, standard sectors



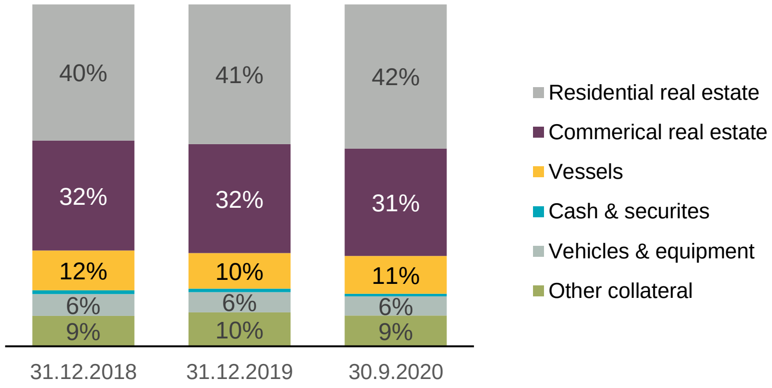
Loans to customers
By sector, consolidated, carving out tourism



Loans to customers
By currency type, consolidated



Credit exposure covered by collateral: ISK 936bn
By collateral type



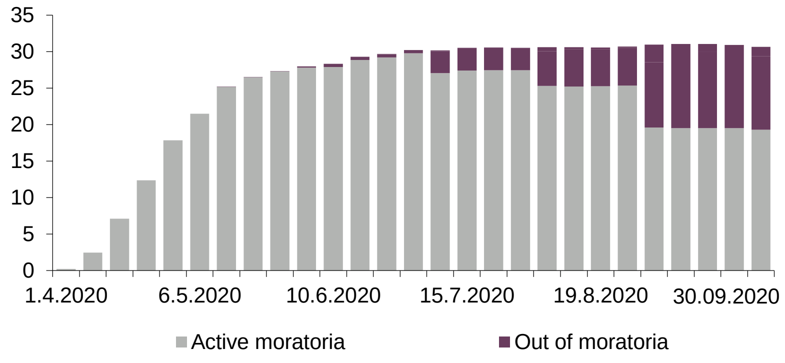
Comments

- Business divisions support customer centric structure
- The Bank had one large exposure at the end of September
- Growth in foreign currency loan book due to depreciation of the ISK

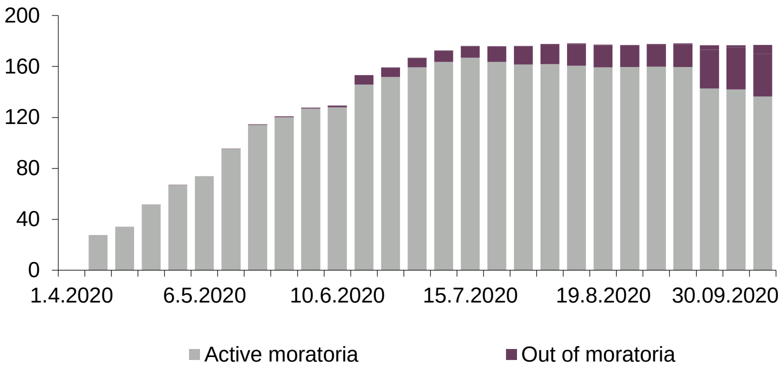
COVID-19 moratorium tapers off

Temporary moratorium uniformly executed and broadly applied, support loans part of Government measures

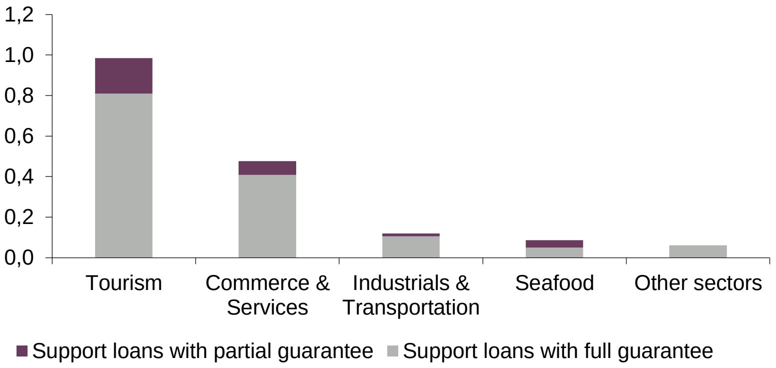
Loans to individuals granted COVID-19 moratorium
Gross carrying amount, ISKbn, weekly development



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



COVID-19 support loans with Government guarantees
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
- This general measure closed for new applications on 30 September 2020. Further extensions of moratoria may be granted on a case-by-case basis and will be classified as forbearance

Further extension of moratorium expected for tourism

- By end of 3Q20, 14% of the total loan book was in moratorium, or 20% of the corporate loan book and 5% loans to individuals
- Almost 80% of loans in the tourism industry have been granted moratorium and that portfolio amounts to half of all loans to corporates in moratoria
- Although this does not classify as forbearance, the tourist loan portfolio has been moved to Stage 2, see next page
- Loans that have been granted moratoria are mostly with residential or commercial real estate

The first support loans have been granted as a part of Government measures

- Support loans with Government guarantees amounting to ISK 1.7bn were originated in Q3 2020. Around 85% of the amount is with full Government guarantee
- The support loans are part of the support measures that the Government has put in place following COVID-19 and Íslandsbanki facilitates the process
- Further lending of this type is expected in Q4

Additional impairment charge due to COVID-19

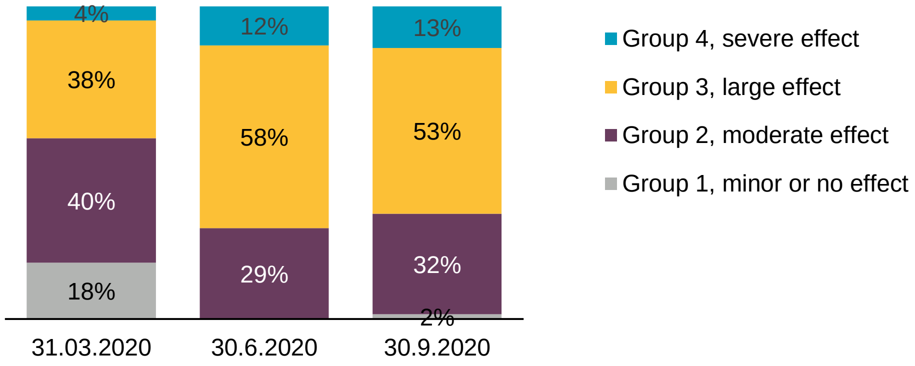
Tourism sector hardest hit by COVID-19 and fully in Stage 2

Temporary changes to the impairment model due to COVID-19

- To account for the material change in the operating environment of companies in the tourism industry, not reflected in their current risk class, they are further classified into four groups based on an assessment of additional increase in credit risk due to COVID-19
- For groups 2-4, the exposure was transferred to Stage 2 in Q1, thus carrying a life-time expected credit loss instead of 12m
- In addition, an overlay factor was applied to the expected credit loss, comparable to an increase by one risk class for group 2 and two risk classes for groups 3 and 4
- As the situation progressed, the classification was updated based on judgement from credit officers and results from stress test
- In Q3, additional overlay factor was applied to loans to individuals to account for the unusual unemployment
- 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 at end of Q3 set to 15% (good) 55% (base) 30% (bad)

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

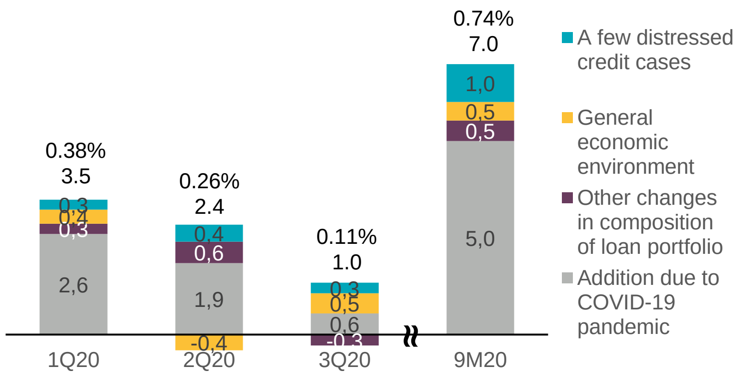
Change in economic indicators (%)	2019	2020	2021	2022	2023
Economic growth	1.9	(8.6)	3.1	4.7	2.5
Housing prices in Iceland	3.4	2.6	1.5	3.0	4.0
Purchasing power	1.8	3.0	1.1	2.1	2.1
ISK exchange rate index	8.5	11.2	3.1	(1.8)	(2.8)
Policy rate, Central Bank of Iceland	3.9	1.5	1.2	2.0	3.0
Inflation	3.0	2.7	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

Increase in credit risk to the tourism sector

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

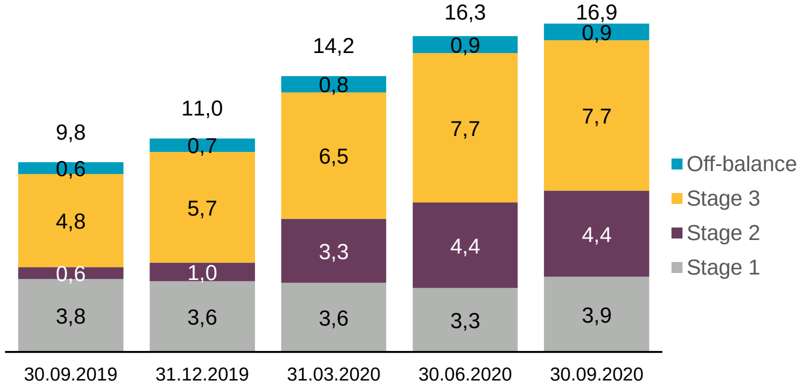
Net impairment on financial assets

ISK bn and % of gross loans to customers, by period[1]



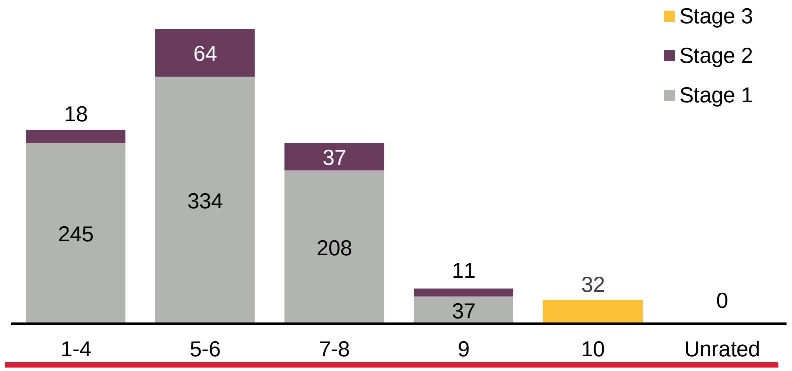
Loans to customers & off-balance sheet items: impairment allowance account

Development of allowance account, ISKbn



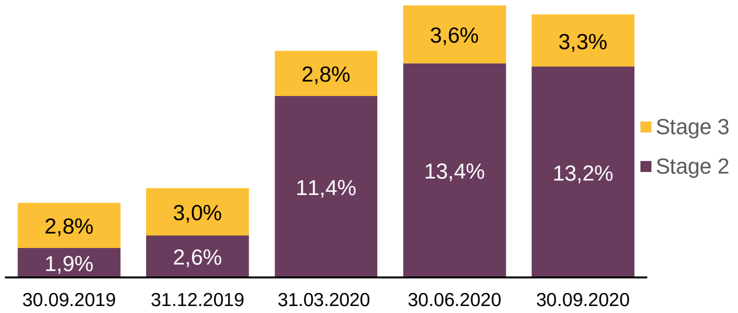
Loans to customers: gross carrying amount

30.09.2020, risk class and impairment stage, ISKbn



Loans to customers: Stage 2 and 3

Development of gross carrying amount as ratio



Loans to customers: credit quality

30.09.2020, 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	824	83.5%	3.9	0.5%	820	84.5%
Stage 2	130	13.2%	4.4	3.4%	126	13.0%
Stage 3	32	3.3%	7.7	23.9%	25	2.5%
Total	986	100%	16.0	1.6%	970	100%

Comments

- Net impairment charges amount to almost ISK 7bn in 9M20. Thereof, ISK 5bn comes from loans to the tourist sector that were transferred to stage 2 with an increased impairment allowance
- There has not yet been a significant change in exposures in stage 3
- The reserve coverage ratio (RCR) in stage 3 might appear low, but is explained by good collateral coverage
- The collateral coverage in Stage 3 was 72% (ISK 23bn) by end of September

1.The net impairment charge over loans to customers is shown as a percentage for each period. The annualised number for 3Q20 is 0.44% and for 9M20 it is 0.98%.

Loan portfolio with solid collateral coverage

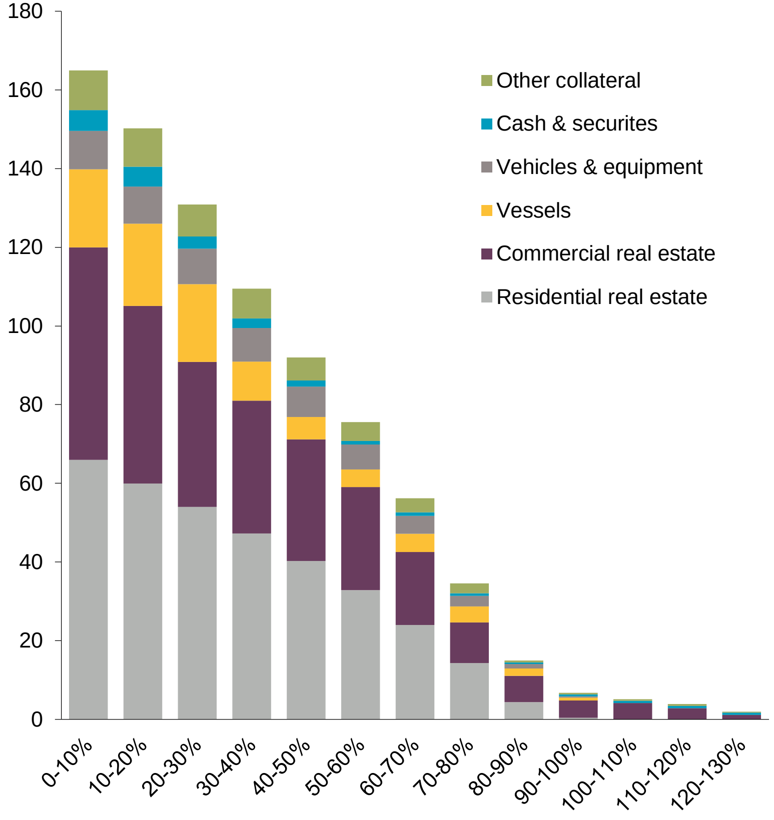
Majority of collateral in residential and commercial real estate

Comments

- Most of the Bank's collateral is in the form of residential and commercial real estate
- The second most important collateral type is vessels, mostly fishing vessels
- For seasoned mortgages, the LTV distribution is calculated from tax value of properties, which is published annually in June, but for newly granted mortgages the purchase price of the property is used as a valuation while it is considered more accurate
- The average LTV for mortgages[1] was 64% at end of September, compared to 62% at year-end 2019
- 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

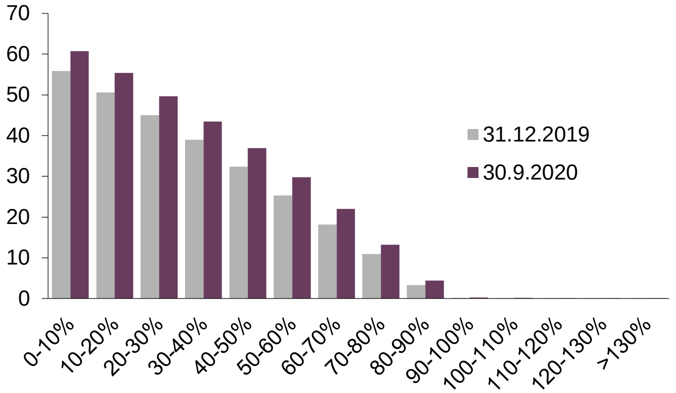
LTV distribution by underlying asset class

ISK bn, by type of underlying asset, as of 30.09.2020



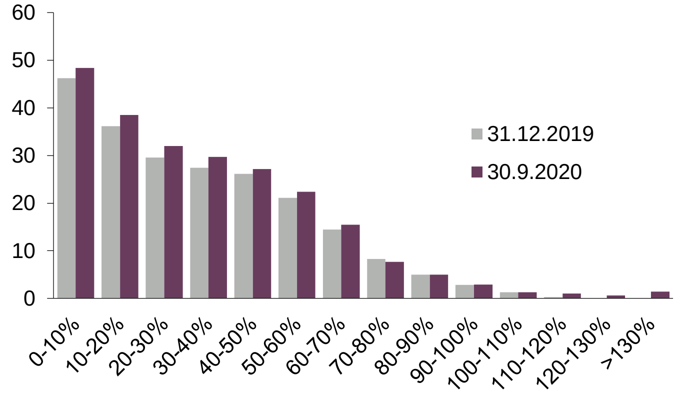
LTV distribution of mortgages to individuals

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.

Total liabilities are 12.4% up from year-end 2019

Deposits from customers increased by 13.0% from YE19, mainly from retail customers and pension funds

Comments

Deposits

- Increased customer deposits in the period from all customer groups, mostly from retail customers and pension funds
- Debt issued and other borrowed funds increased mainly due to ISK depreciation
- Íslandsbanki issued covered bonds totalling ISK 8bn in 9M20 in three auctions
- In 2Q20, the Bank bought back SEK 75m of an FRN maturing in February 2021, following successful buybacks in 1Q20
- September saw the maturity of the EUR 500 million benchmark bond, the first that the bank had issued. The bond was the subject of two liability management exercises – a clear demonstration of the Bank´s commitment to optimising its balance sheet and its engagement with investors

Equity

- The annual AGM approved that dividend should not be paid in light of COVID-19 uncertainties

Liabilities & Equity, ISKm	**30.9.2020**	30.6.2020	Δ	Δ%	31.12.2019	Δ	Δ%
Deposits from Central Bank and credit institutions	**36,438**	35,461	977	2.8%	30,925	5,513	17.8%
Deposits from customers	**698,610**	681,223	17,387	2.6%	618,313	80,297	13.0%
Derivative instruments and short positions	**8,406**	7,519	887	11.8%	6,219	2,187	35.2%
Debt issued and other borrowed funds	**324,752**	321,803	2,949	0.9%	306,381	18,371	6.0%
Subordinated loans	**26,798**	25,834	964	3.7%	22,674	4,124	18.2%
Tax liabilities	**7,137**	6,438	699	10.9%	7,853	(716)	-9.1%
Other liabilities	**44,074**	45,256	(1,182)	-2.6%	27,063	17,011	62.9%
Total Liabilities	**1,146,215**	1,123,534	22,681	2.0%	1,019,428	126,787	12.4%
Total Equity	**182,509**	179,722	2,787	1.6%	180,062	2,447	1.4%
Total Liabilities and Equity	**1,328,724**	1,303,256	25,468	10.8%	1,199,490	129,234	10.8%

Deposits remain the main source of funding

Increase in deposits continued in 3Q20

Comments

Stable core deposit base

- Deposits remain the main funding source for the Bank and the deposit to loan ratio remains high
- At the end of the period, 75% of the deposits were in non-indexed ISK, 13% CPI linked and 12% in foreign currencies

Deposits concentration stable

- 18% of the Bank's deposits belonged to the 10 largest depositors and 33% belonged to the 100 largest depositors at the end of September 2020, compared to 17% and 32% respectively at year-end 2019

Deposits development

- Total increase in deposits is ISK 86bn since year-end 2019, there of 12bn from depreciation of ISK. Most significant increase in retail and pension funds

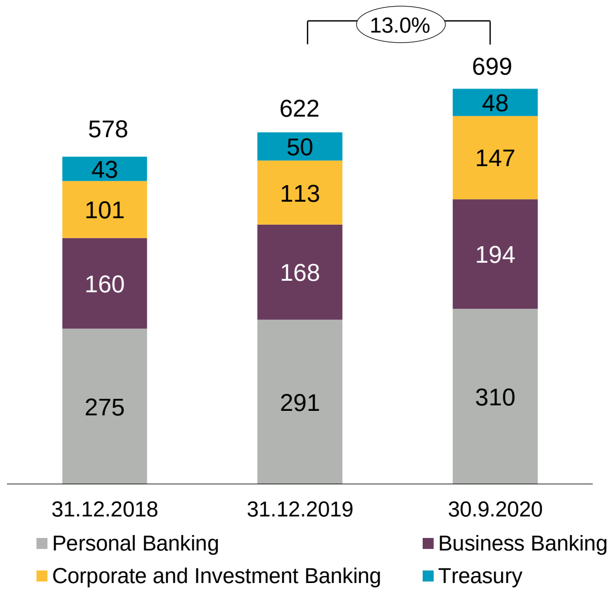
Customer and credit institutions deposits by LCR category

30.09.2020 compared with year end-2019, ISK bn, consolidated

	Deposits maturing within 30 days							
Customer type	Less stable	Δ	Stable	Δ	Term deposits	Δ	Total deposits	Δ
Retail	**227**	(1)	**124**	40	**89**	10	**440**	49
Operational relationship	**4**	1	**-**	-	**-**	-	**4**	1
Corporations	**76**	2	**0**	0	**23**	(2)	**100**	1
Sovereigns, central-banks and public sector entities	**11**	4	**0**	0	**1**	0	**12**	4
Pension funds	**67**	31	**-**	-	**21**	(3)	**88**	28
Domestic financial entities	**38**	9	**-**	-	**39**	(7)	**77**	2
Foreign financial entities	**5**	(3)	**-**	-	**10**	4	**15**	1
Total deposits	**426**	43	**125**	40	**184**	3	**735**	86

Deposits from customers

By business divisions, ISKbn, consolidated



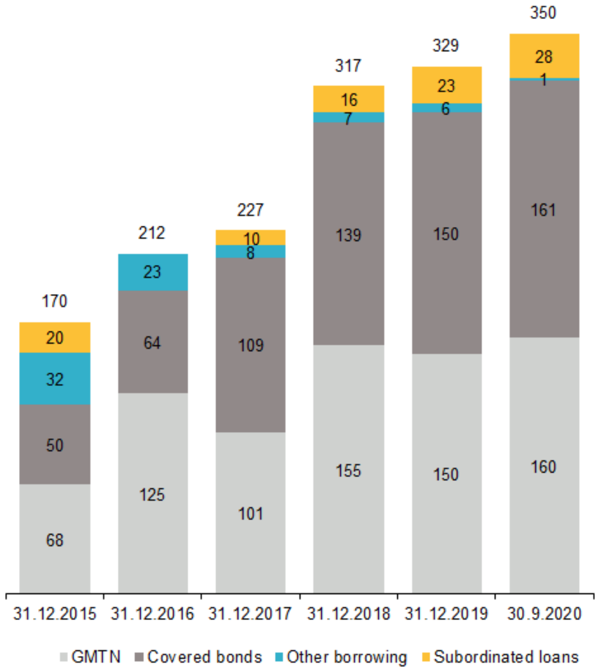
Successful funding journey

Modest funding requirement during 9M20

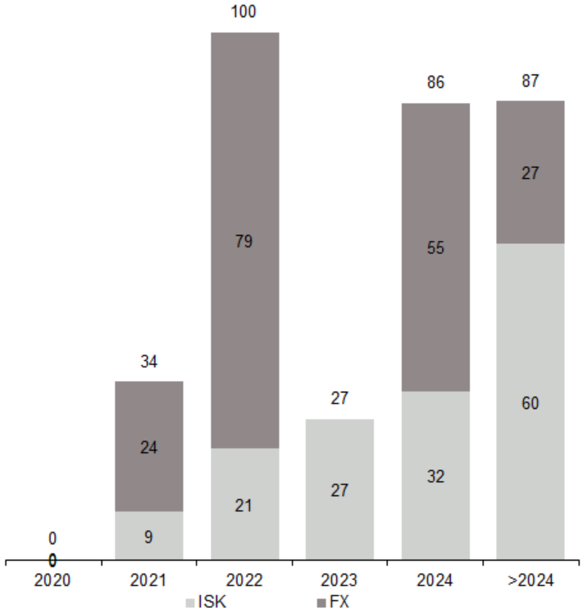
Comments

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

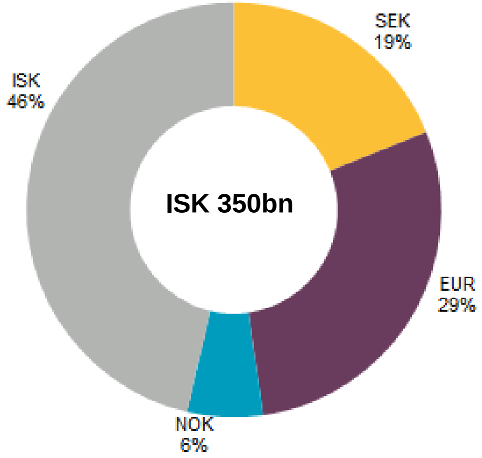
Sources of market borrowings
Book value, ISKbn



Maturity profile of long-term debt
30.09.2020, Nominal value, ISKbn



Currency split of market borrowing sources
30.09.2020, Nominal value, ISKbn



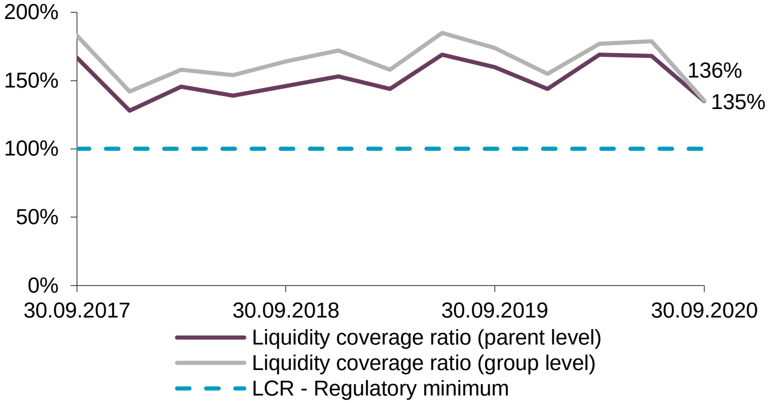
Sound management of liquidity – all ratios above requirements

Liquid assets of ISK 267bn are prudently managed

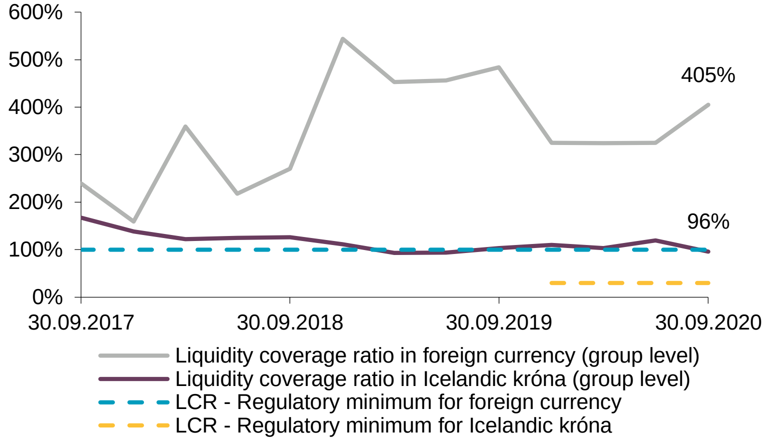
Comments

- All liquidity measures above regulatory requirements
- After the sale of the subsidiary Borgun hf. in July 2020 the difference between Parent and Group LCR is negligible

Total liquidity coverage ratio (LCR)

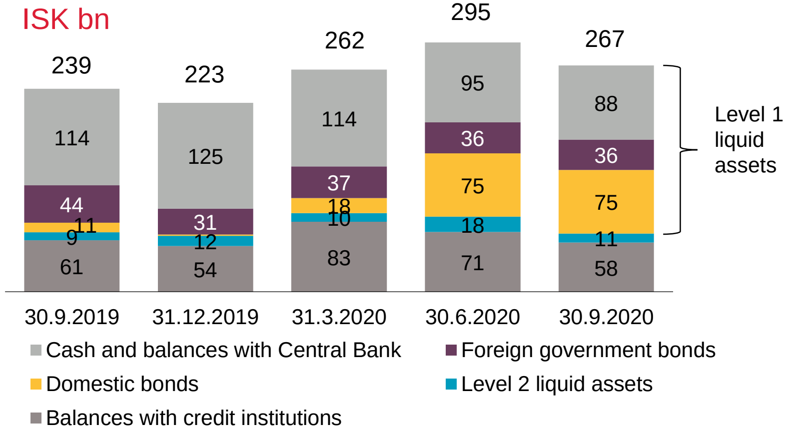


Liquidity coverage ratio – foreign currencies and ISK

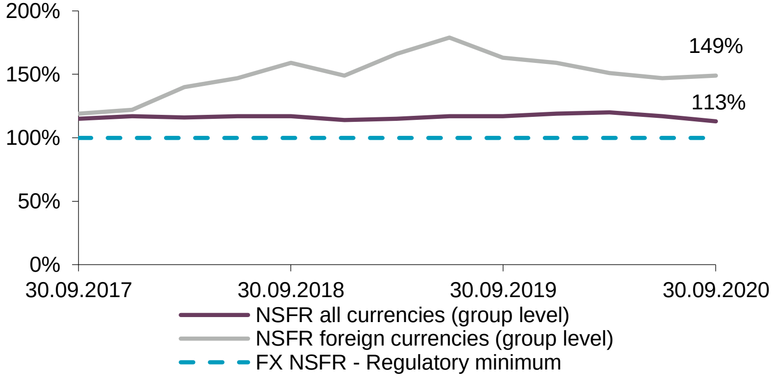


Liquid Assets

ISK bn



Net stable funding ratio (NSFR)

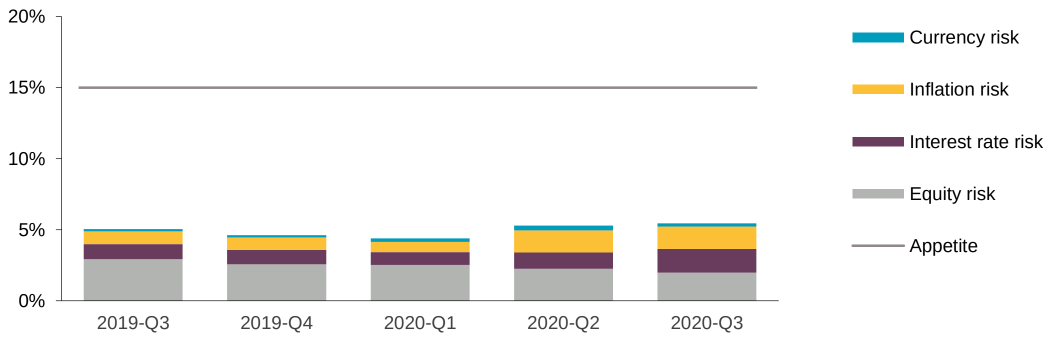


Market risk well controlled

The Bank has a very modest market risk profile

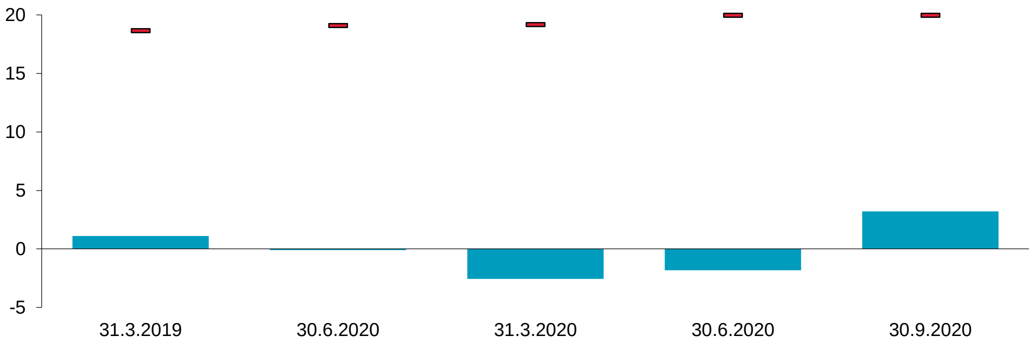
Market risk exposure and market risk appetite

Average positions per quarter, as percentage of total capital base, consolidated



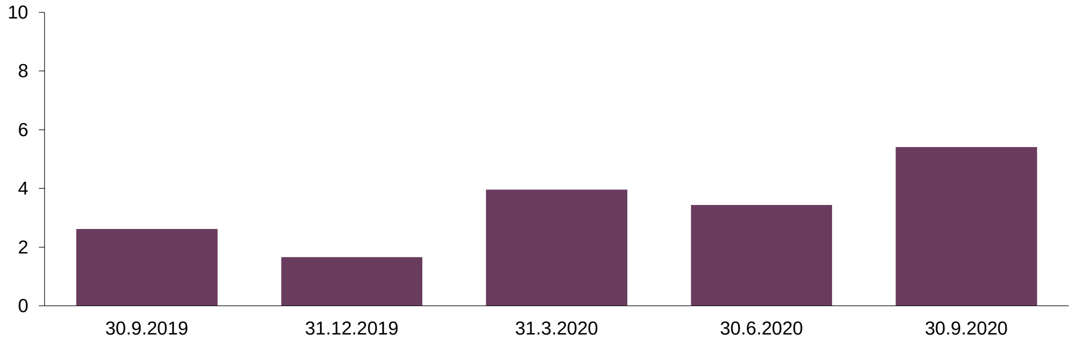
Development of the currency imbalance compared with regulatory limit

ISKbn, end of quarter, consolidated



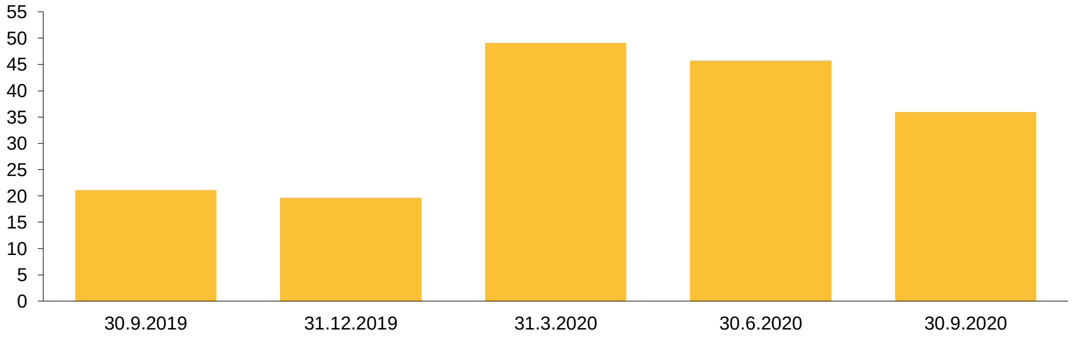
Development of interest rate risk in the banking book

Weighted average BPV, end of quarter, ISKm, consolidated



Development of the banking book inflation imbalance

ISK bn, end of quarter, consolidated



Sound capital position to navigate uncertain environment

High REA density and low leverage in international comparison

Comments

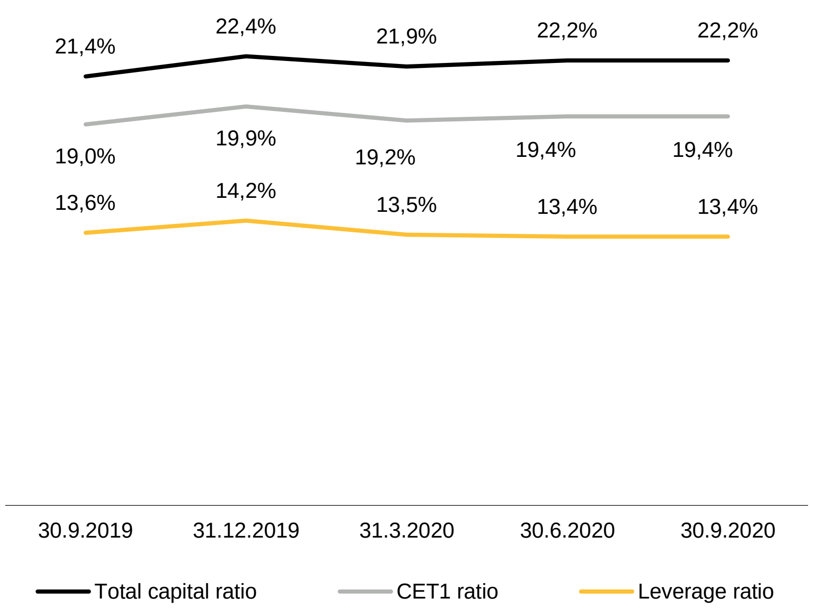
Capital ratios

- The CET1 capital was ISK 183bn at the end of September 2020 compared to 176bn at year-end 2019
- The capital base was ISK 209bn compared to ISK 198bn at year-end
- Implementation of IFRS 9 transitional rules in Iceland in May 2020, where IFRS 9 impairment is partially included as CET1, increase the CET1 capital by ISK 4.0bn
- 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 2019 financial year should not be paid in light of uncertainties due to the circumstances in the financial markets following COVID-19

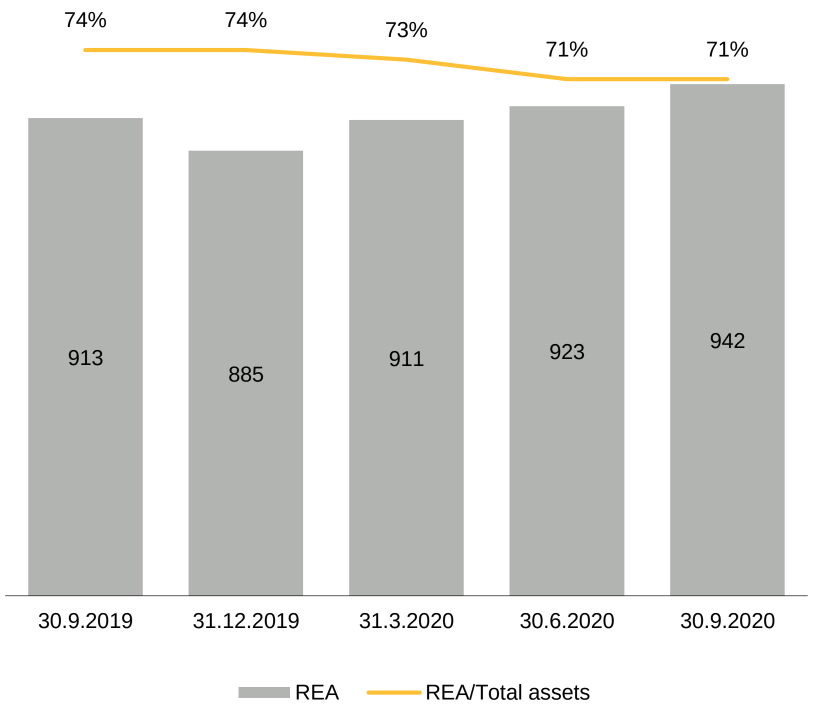
Risk exposure amount (REA)

- The REA increased during the period, mainly because of an increase in the size of the loan portfolio

Capital and leverage ratios



Risk exposure amount (REA) ISKbn

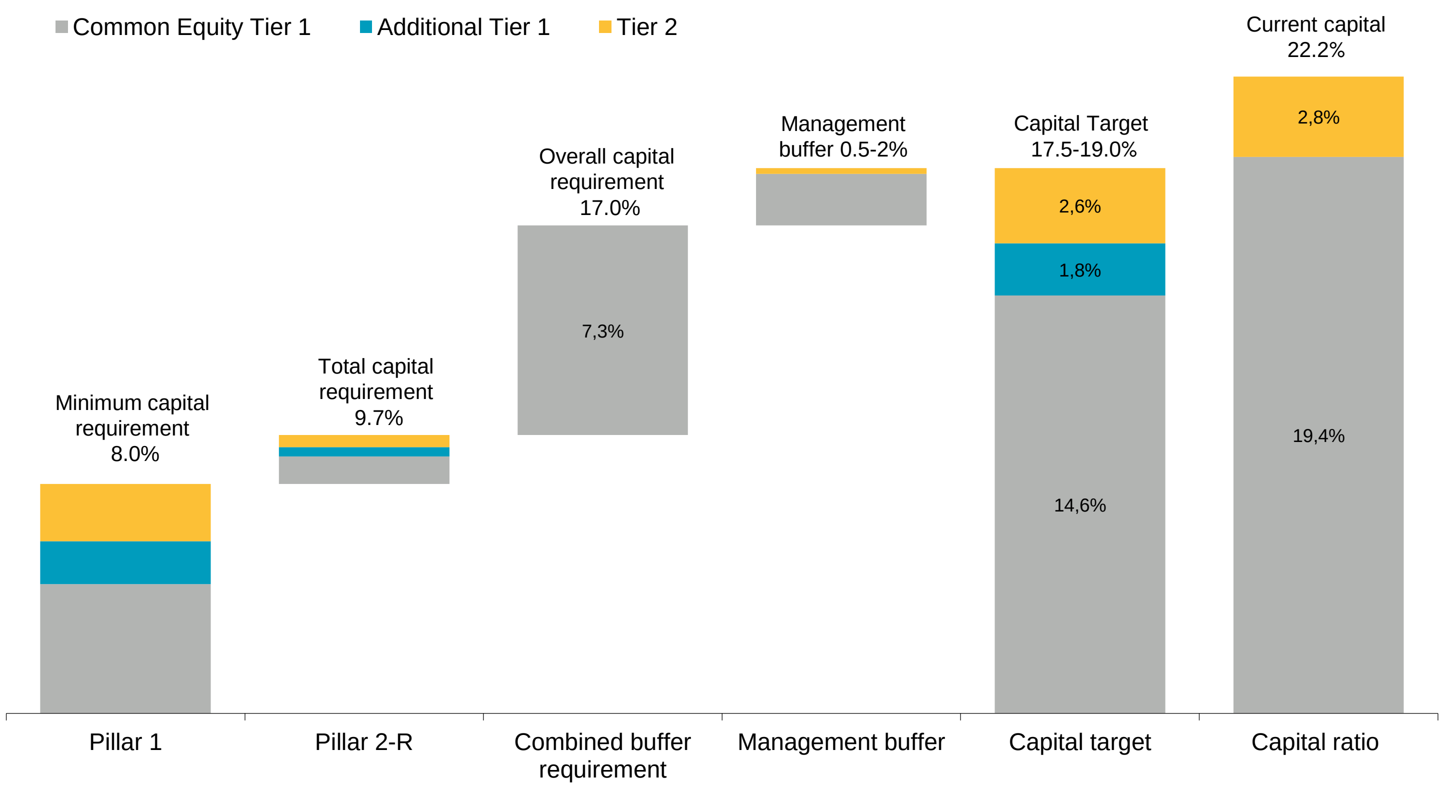


Íslandsbanki's capital ratios well above target

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

Comments

- The sum of Pillar 1, Pillar 2 and the combined capital buffers form the overall regulatory capital requirement
- The countercyclical capital buffer was lowered from 2% to 0% in March 2020 COVID-19
- The Financial Supervision Committee has decided that the results of 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
- The capital target is currently at 17.5–19.0%
- 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&P credit rating

Rating lowered in April 2020

Íslandsbanki

	S&P
Long-term	BBB
Short-term	A-2
Outlook	Stable
Rating action	April 20

Icelandic sovereign

	S&P	FITCH	MOODY'S
Long-term	A	A	A2
Short-term	A-1	F1+	P-1
Outlook	Stable	Negative	Stable
Rating action	Nov 19	May 19	April 20

BBB/A-2 Stable Outlook

Press Release 24 April 2020

In late April 2020 S&P lowered Íslandsbanki's rating to **BBB/A-2** with a **stable outlook** from previous BBB+/A-2 with a negative outlook

In its report, S&P expects Íslandsbanki to enter this crisis on a more solid foothold than the 2008 financial crisis. The 'BBB' rating level and stable outlook factor in the **solid market position** of the bank in Iceland, which has a relatively **advanced digitalised banking platform**. In S&P's view, the bank is well ahead of many other European banks in its preparation for technological disruption. S&P also notes the Bank's funding and liquidity metrics are adequate for the Bank's risk profile, with **comfortable liquidity ratios and liquid assets** covering more than 3x the average short-term funding in 2019. Moreover, S&P states that the wholesale funding needs are limited in 2020, which coupled with the additional central bank liquidity facilities announced recently by the Icelandic Central Bank, **eases pressure on liquidity needs**

S&P's rational for the change is mostly derived from its view that economic activity will reduce in Iceland and Europe in 2020 and thus could impair Íslandsbanki's asset quality, increase credit losses, reduce business and revenue generation, and potentially erode its capital. S&P's view is that Iceland's operating environment will remain challenging, affected by the 2020 economic recession, declining interest rates, stiff competition from pension funds in mortgage lending and thus contributing to the declining profitability of the Bank

4. Financial targets and next steps

Financial targets

ROE at 7.4% in the quarter and capital ratios remain sound

	Target	9M2020	2019	2018	Guidance
ROE in excess of risk-free rate	4-6%	1.0%	1.1%	2.1%	— Target of 4-6% on top of risk-free rate. Risk free-rate is currently 0.75% — 8-10% ROE is based on average expected risk-free rates through the business cycle. Based on the current risk-free rate of 0.75% the ROE target in the very short term is 4.75-6.75% — The COVID-19 pandemic will have a material adverse effect on the Bank's earnings in 2020 and it is therefore unlikely that the ROE target will 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%	2.4%	4.8%	6.1%	
Cost/ Income ratio[1]	<55%	55.3%	62.4%	66.3%	— This is a medium to long term target. C/I ratio can be expected to be higher than target in the near term due to the COVID-19 pandemic — The Bank continues to invest in IT infrastructure and process efficiency to improve the C/I ratio in the medium to long term
CET1	>13.2 – 14.7%	✔ 19.4%	✔ 19.9%	✔ 20.3%	— 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%	✔ 22.2%	✔ 22.4%	✔ 22.2%	— 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%	✔ 50%	— The Annual General Meeting approved that a dividend to shareholders for the 2019 financial year should not be paid in light of uncertainties due to unprecedented circumstances in the financial markets following COVID-19 — The Board of the Bank may convene a special shareholders' meeting later in the year to propose a dividend payment in 2020 if the economic conditions improve substantially.

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

Key takeaways

Strong 3Q20 result. Future economic uncertainty prevails but robust foundations ensure a vigorous rebound

1 Strong recovery after a temporary deep shock

- Macroeconomic forecast projects an 8.6% contraction in 2020 and 3.1% growth in 2021
- Policy rate expected to remain at 1.0% until mid-2021, ISK to appreciate with export sector recovery and unemployment predicted at 7.6% in 2021
- Tourism expected to pick up in 2021 but will take time to return to pre-pandemic levels

2 Íslandsbanki published a Sustainable Financing Framework

- The framework is built on Green/ Social Bond Principles issued by ICMA.
- It consists of 9 Green categories (environment), 3 Blue categories (ocean) and 5 Red (social) categories
- Project categories mapped against the Bank's loan portfolio, paving way for new sustainable loans and sustainable bond issuances

3 Strong ROE in 3Q20

- Net profit of ISK 3.4bn and a 7.4% annualised ROE in 3Q20
- Growth in NFCI in 3Q20 due to higher fees and related to sale of Borgun hf., but decrease in 9M20 mainly due to less card activity
- Admin cost fell by 8.9% in 3Q20 YoY due to continued cost reducing efforts. C/I ratio on target at 46.7%

4 Impairments a result of uncertain economic environment

- An additional impairment amounting to ISK 1.1bn was applied in 3Q20. This charge is mostly COVID-19 related
- 14% of the total loan book was in moratorium by end of 3Q20
- Support loans amounted to roughly ISK 1.7bn by end of 3Q20. About 85% of the amount is with full Government guarantee

5 Loans and deposits grew steadily

- Loans to customers grew by 7.9% from YE19 mostly due to mortgage lending and depreciation of the ISK
- Deposits from customers grew by 13% from YE19 largely from retail customers and pension funds
- NPL ratio was 3.3% for stage 3 loans (gross)

6 Sound liquidity ratios and strong equity

- Sound liquidity position with liquidity ratios above internal targets and regulatory requirements
- Total capital ratio high at 22.2%, substantially exceeding the Bank´s regulatory requirement of 17%
- High REA density and low leverage in international comparison

5. Annex – Icelandic economy update

COVID 19 economic impact will be deep

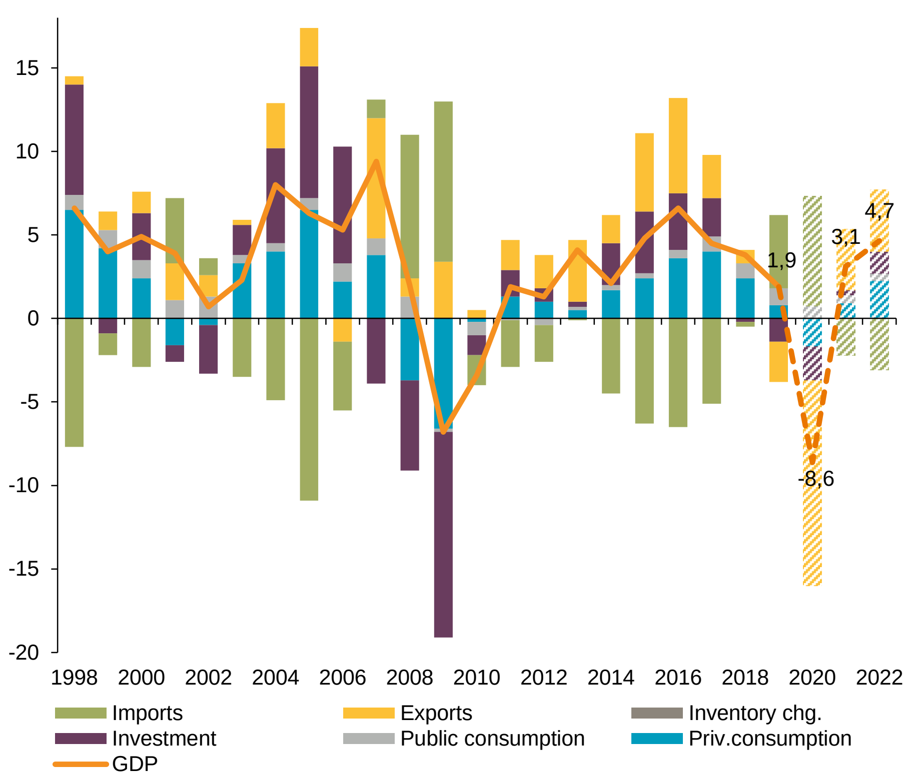
Very sharp GDP contraction likely in 2020 but robust growth could resume in 2021

Comments

- The COVID-19 pandemic has changed the near-term outlook for the Icelandic economy drastically
- ISB Research expects GDP to contract by 8.6% in 2020
- Around 2/3 of the contraction due to hit on exports, around 1/3 caused by contracting domestic demand
- A sharp fall in imports as well as increasing public sector activity moderates GDP fall
- Assuming the pandemic is in decline by the end of Q2 2021, growth of 3.1% is forecast for next year
- For 2022, robust growth of 4.7% is expected as domestic demand rebounds and export growth continues
- Recent forecasts paint a similar picture of a somewhat milder contraction in 2020 coupled with slower recovery than previously assumed as the pandemic has proven more resilient and expectations of widespread vaccine availability have been pushed back

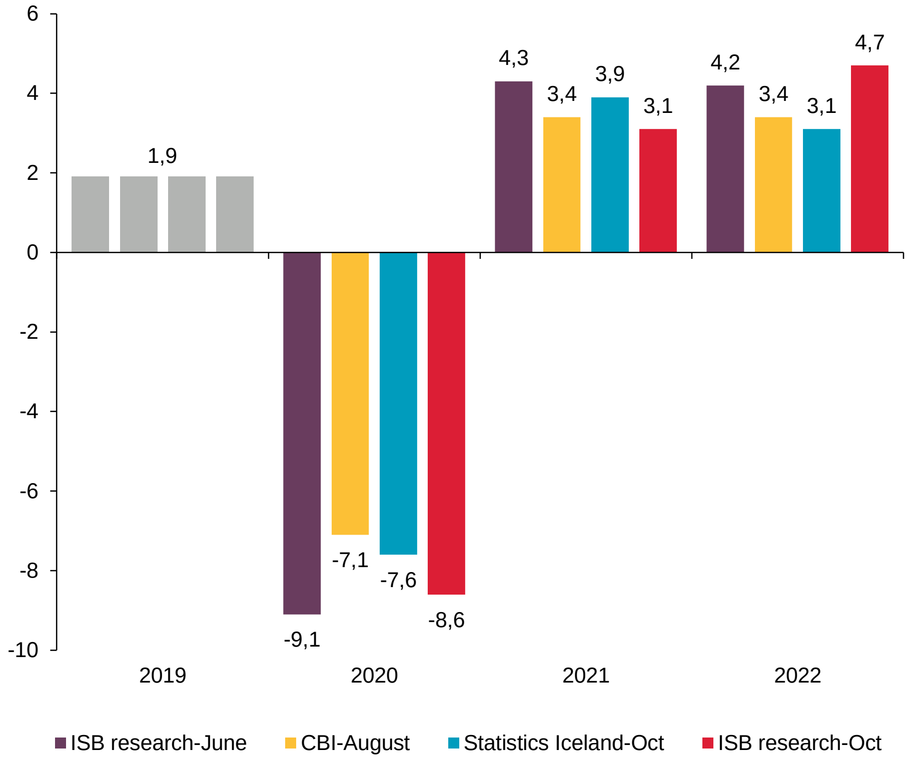
GDP and the contribution of major subitems [1]

YoY change (%)



GDP forecast comparison

YoY change (%)



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

Tourism sector hit hard by COVID pandemic

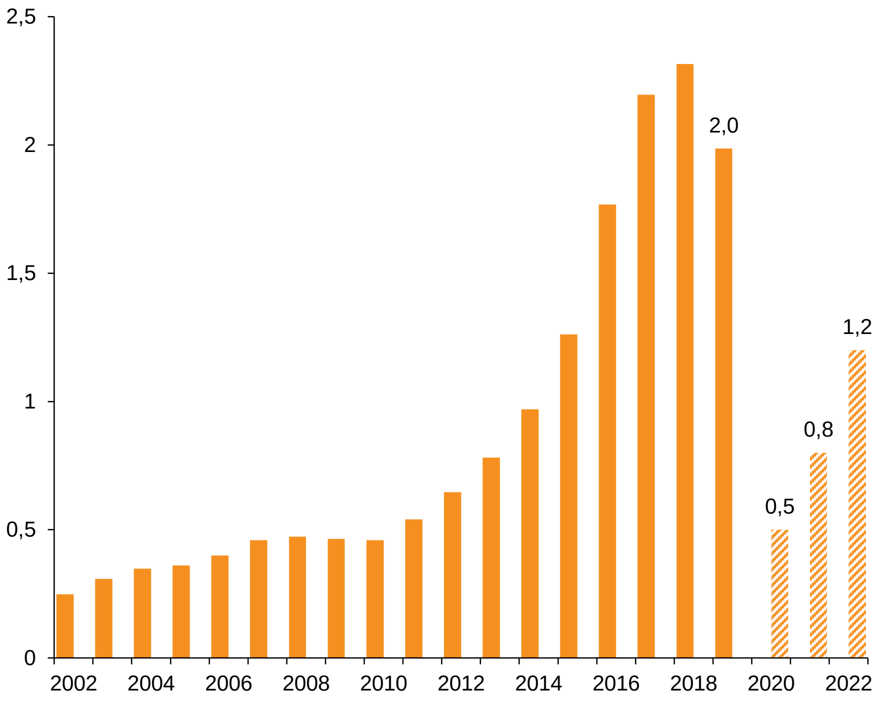
Number of tourists visiting Iceland shrinks by 75% in 2020

Comments

- In the first 9M of 2020, 460 thousand tourists visited Iceland, down by 70% YoY
- Since August, when border restrictions were tightened, few tourists have come to Iceland, and we project the total for 2020 as a whole at less than 500,000, the lowest in a decade
- Iceland's economy is quite exposed to pandemic effects on travel and tourism. In 2019 the sector contributed 8% to GDP and employed 14% of the workforce
- In light of this, the blow to Iceland's economy is perhaps less devastating than could have been expected. Most comparable economies were hit considerably harder when the pandemic struck
- Tourism is assumed to pick up again in 2021and be close to 2015 levels by 2022
- Uncertainty on medium term developments is great and the recovery of the sector will depend on the pandemic subsiding before spring 2021

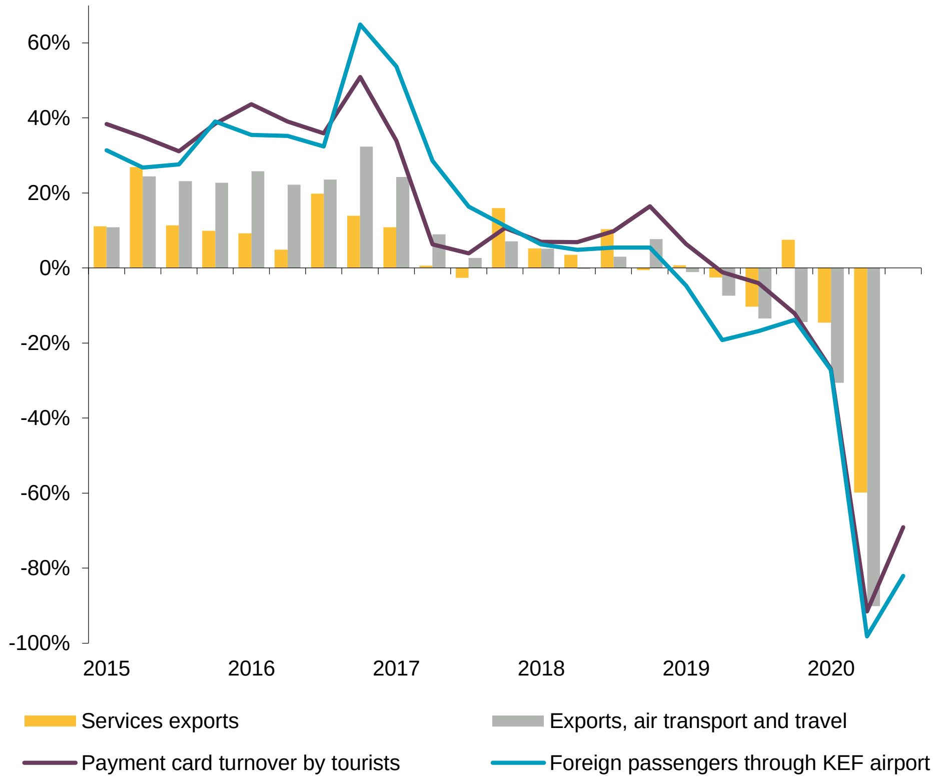
Foreign visitors

Departures through KEF airport (millions)



Services exports and foreign card turnover

YoY change



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

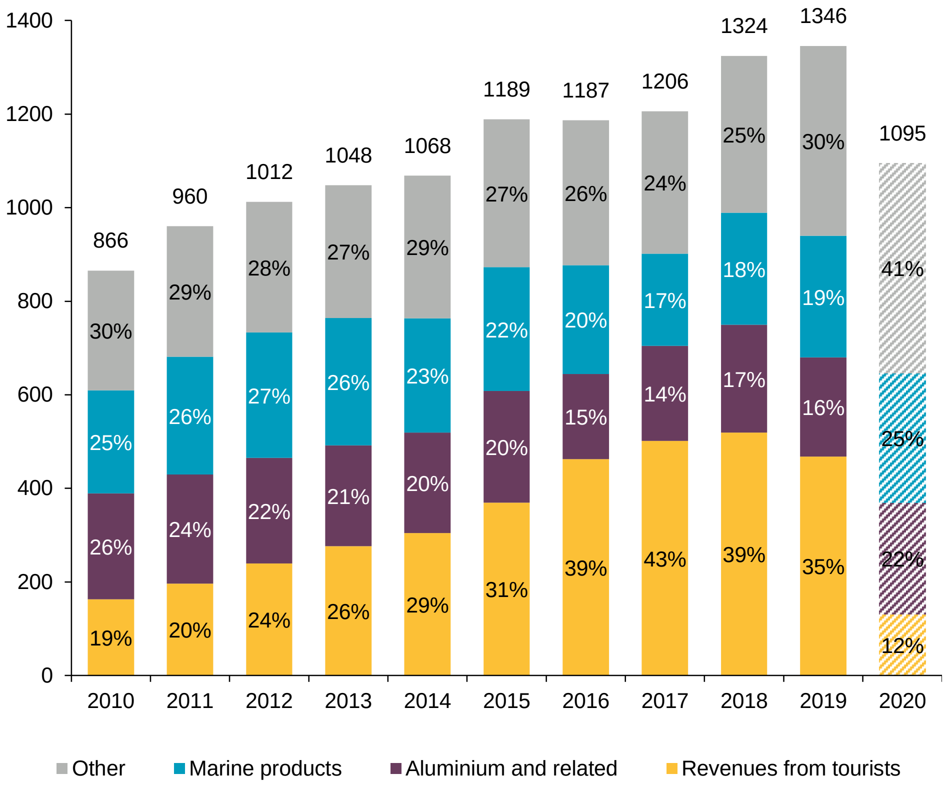
Current account resilient to export shock

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

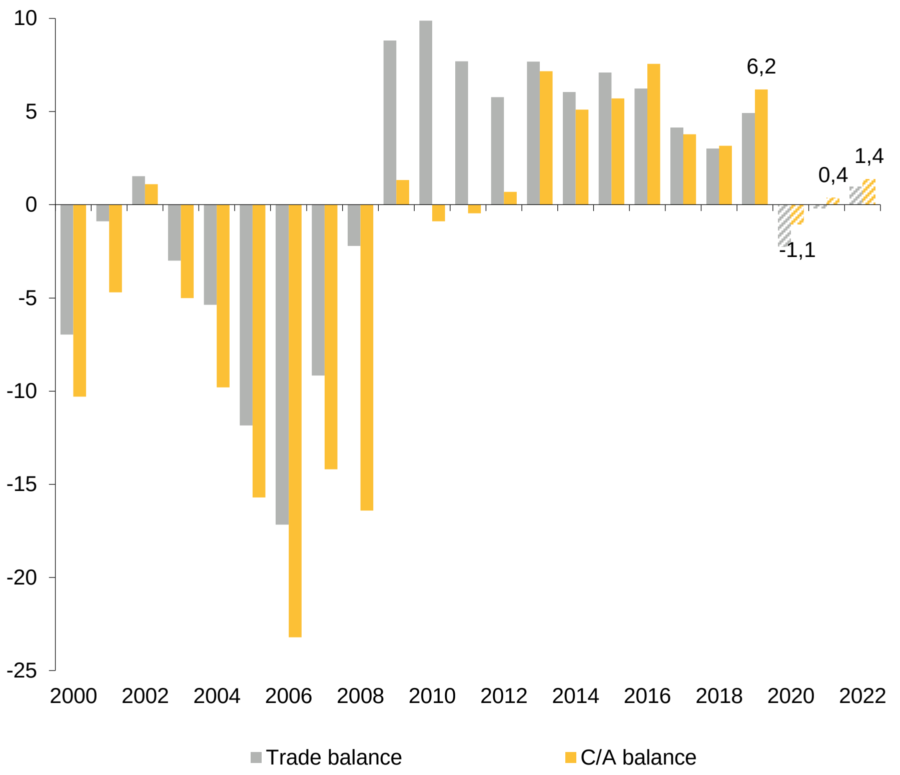
Comments

- Inevitably, services export revenues will decline considerably in 2020 as tourism sector generated over 1/3 of total export revenues in 2019
- Goods exports are also likely to decrease somewhat in volume, although for the seafood sector, rising seafood prices and the recent depreciation of the ISK will offset volume cuts
- Goods imports on course to contract significantly in 2020 due to declining business investment and consumption
- Domestic card monthly turnover abroad in 2020 is less than half of 2019 averages
- ISB Research expects the current account to show a deficit amounting to 1.1% of GDP in 2020
- C/A balance to swing back into surplus in 2021 as tourism revenue recovers, aided by lower real exchange rate and a net positive external position of over 1/4 of GDP in recent quarters

Export revenues
ISK bn



Current account balance[1]
% of GDP

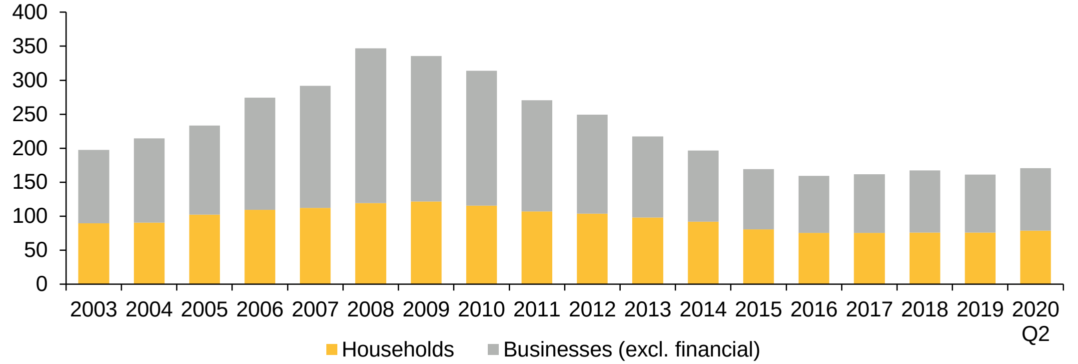


1. 2009-2015: C/A balance excl. old banks
Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Central bank of Iceland, Statistics Iceland and ISB Research

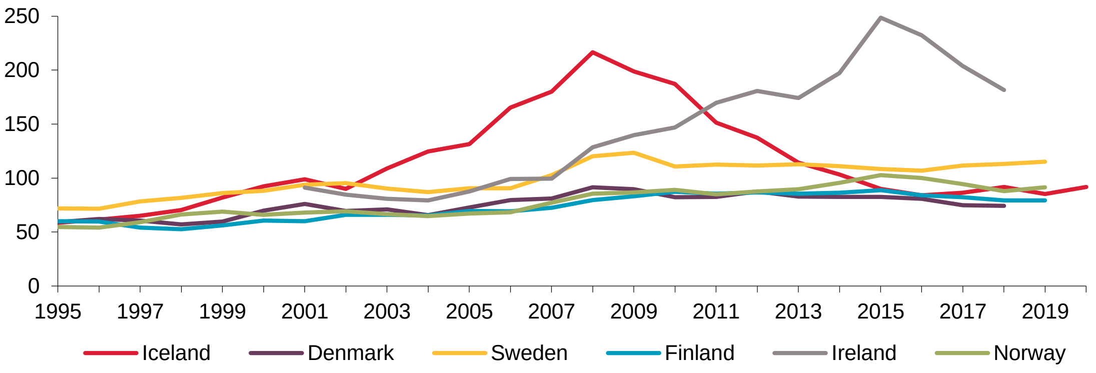
Domestic balance sheets healthy before COVID

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

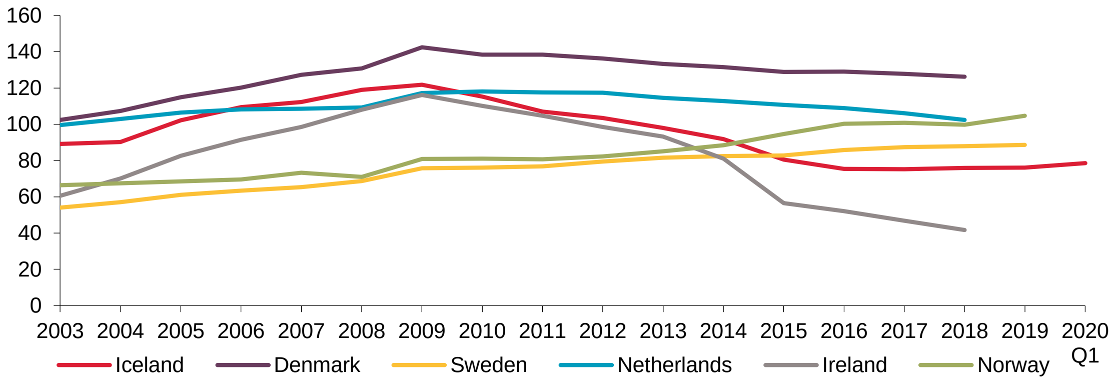
Private sector debt
% of GDP



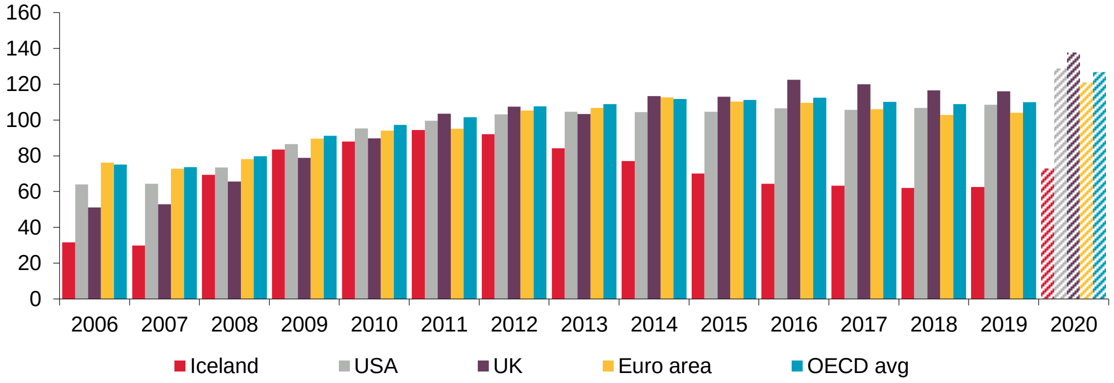
Corporate debt
% of GDP



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

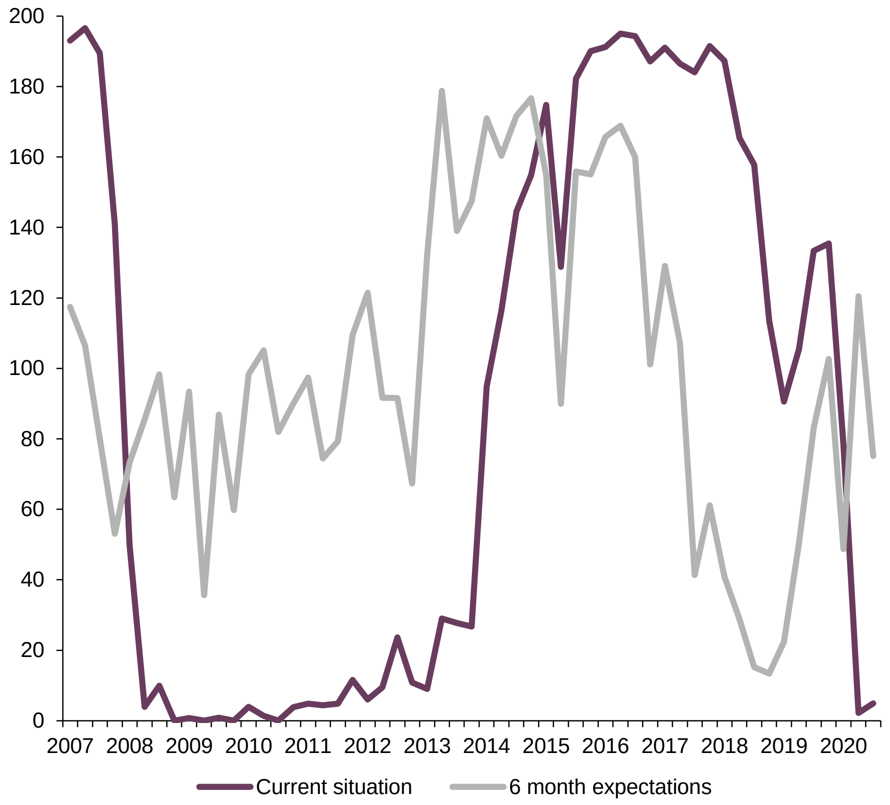
Businesses bracing for headwinds

Business investment is contracting and lending growth to businesses is minimal

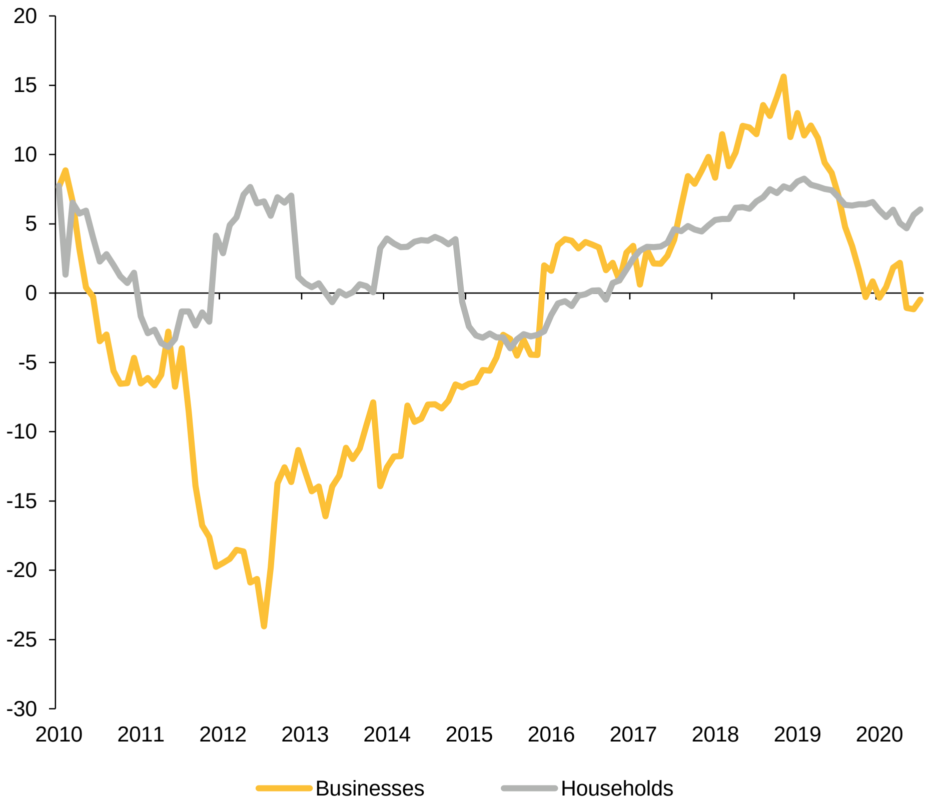
Comments

- Investment lost pace in 2019, after a five-year period of uninterrupted growth
- The outlook is for significant further contraction in investment in 2020 as private investment declines due to the impact of COVID-19
- Partially offsetting this, a counter-cyclical upturn in public investment is expected this year and through 2021
- Total investment is likely to contract by over 10% this year but recover in H2 2020 and increase by around 7% in 2020 and 2021
- Business sentiment has seesawed recently. After a sharp drop in sentiment as the pandemic hit, business executives generally seem cautiously 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

Chilly labour market ahead

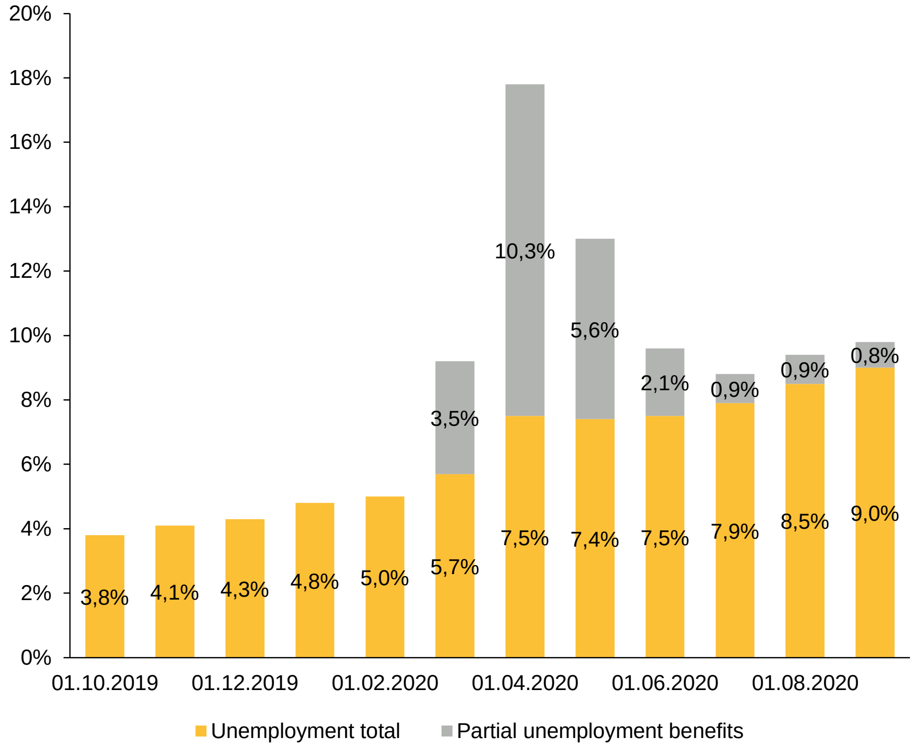
Unemployment rate likely to rise throughout 2020 but decline gradually thereafter

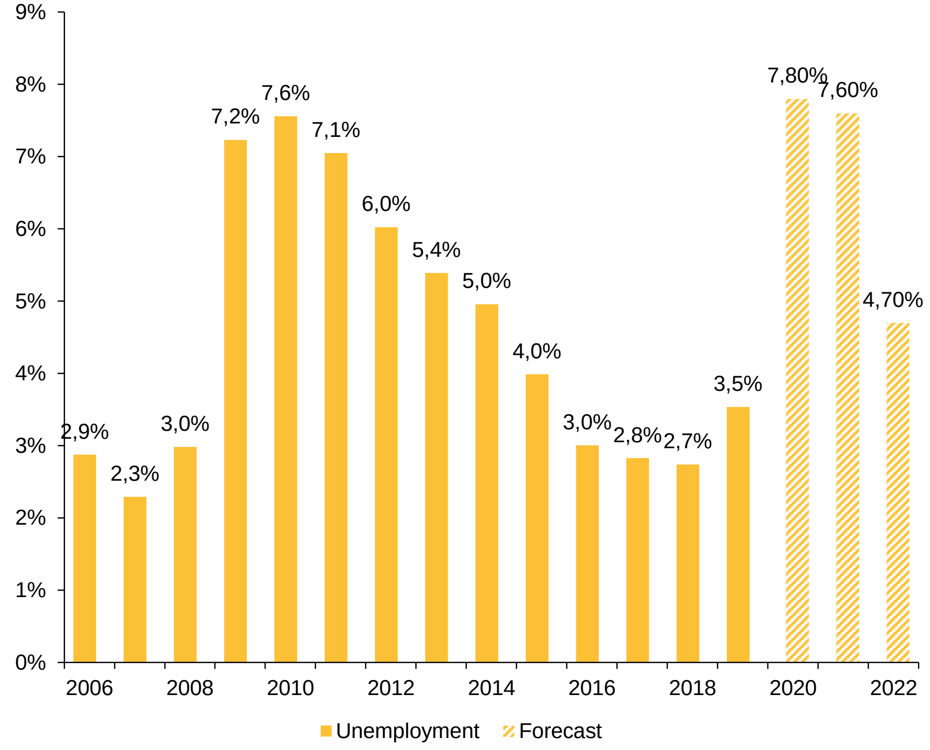
Comments

- Given the size of the impact of COVID-19 on the labour intensive tourism sector, it has been clear since the pandemic hit that the Icelandic labour market would be massively impacted
- Many firms have taken advantage of the Government's part-time unemployment benefits scheme, but participation in the programme peaked in April and has been on the decline since. About 0.8% of the labour market received part-time unemployment benefits in September, down from 10.3% in April
- By September 2020, unemployment had risen to 9.0%. Unemployment is mostly concentrated in tourism and related sectors as well as in areas where tourism is relatively large
- Unemployment will continue to rise through the year-end but start to fall gradually thereafter. We forecast average unemployment in 2020 at 7.8%
- The outlook is for unemployment decline gradually, and to average 7.6% in 2021 and 4.7% in 2022

Unemployment

% of workforce





1. Shaded areas and dotted lines indicate forecasts
Source: Statistics Iceland, the Directorate of Labour and ISB Research

Household consumption dips less than expected

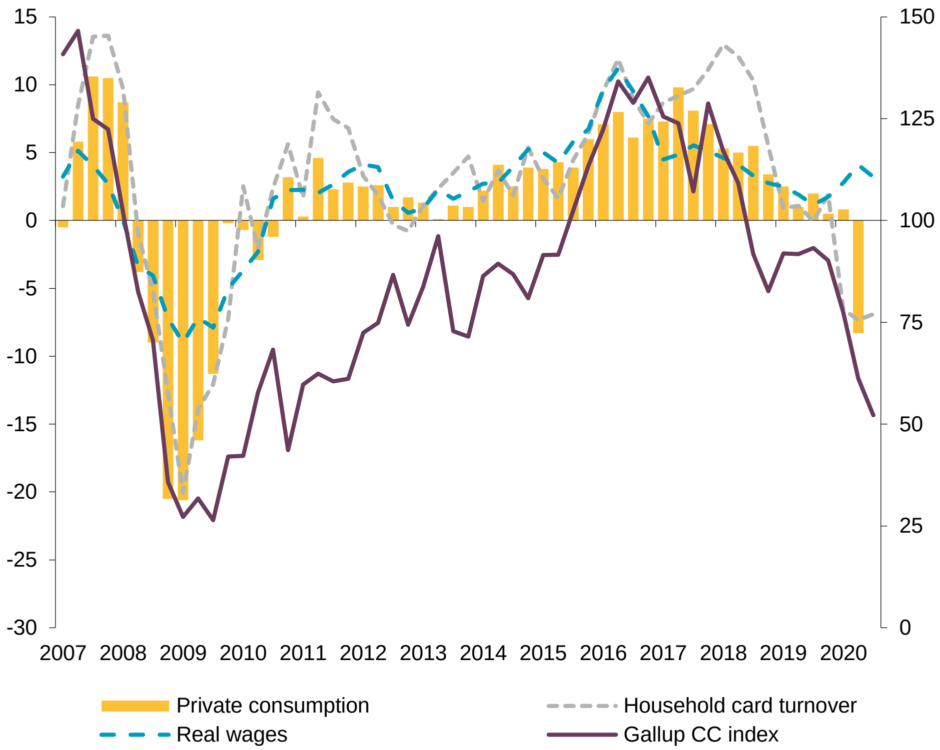
Consumption hit by rising unemployment but supported by sound household balance sheets

Comments

- Restrictions on travel and domestic activity have already made a profound impact on private consumption, which contracted by 8.3% in Q2
- Furthermore, there are signs of a continued uphill battle ahead, as can be seen in key high-frequency indicators
- Consumption staged a partial rebound over the summer as restrictions were eased and household spent pent-up disposable income domestically
- The relationship between private consumption and the labour market is unusually segmented: The real wages of those still employed will hold up relatively well, but the unemployed will face significant loss of income
- The strong financial position of most households will also enable them to absorb income losses more easily and then step up their consumption when the economy picks up again
- We expect private consumption to contract by 3.3% in 2020. For 2021, we project a growth rate of 1.6%,and 4.3% growth in 2022

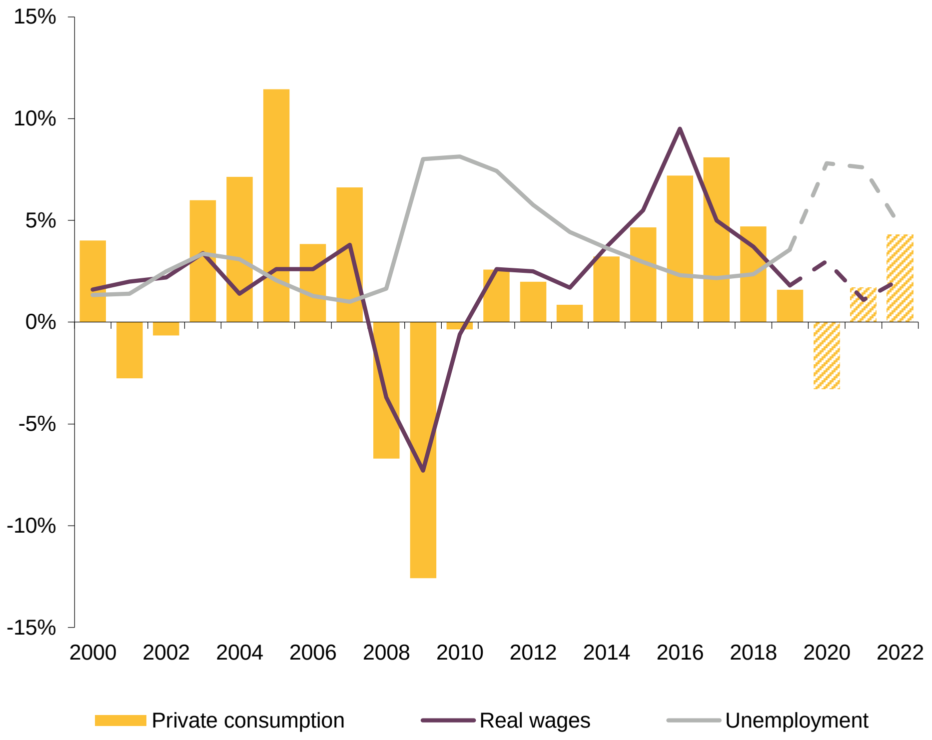
Private consumption and related indicators

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



Private consumption, unemployment and real wages

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

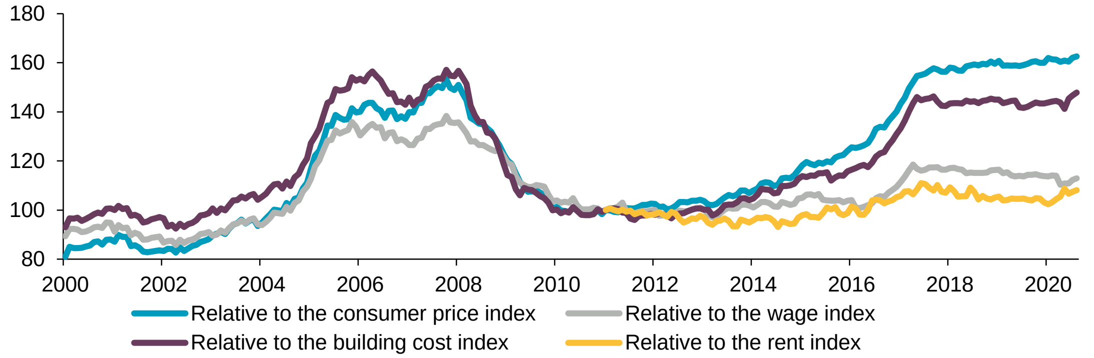


Source: Statistics Iceland, Gallup and the Central Bank of Iceland

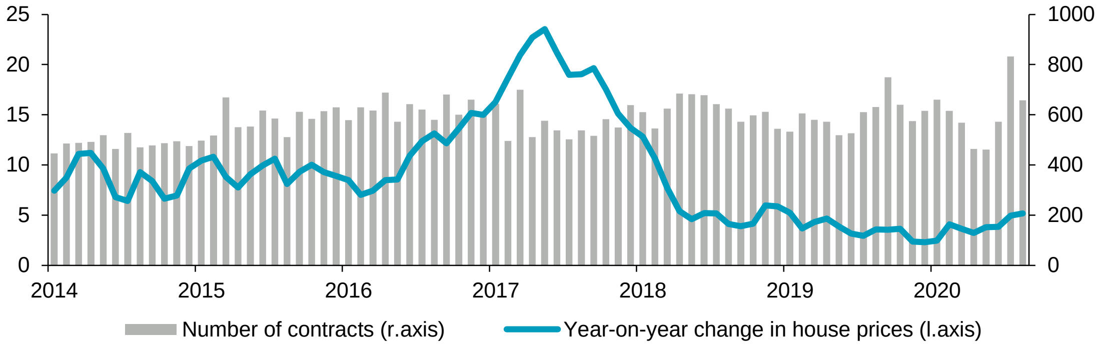
Real estate market in balance

Residential housing market is weathering pandemic much better than expected
Commercial property prices have declined as demand slumped

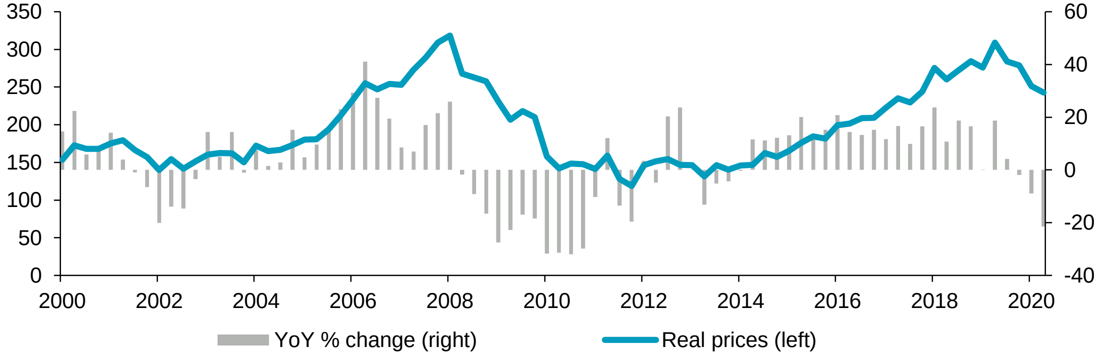
Capital area house prices relative to macroeconomic fundamentals
Index, January 2011=100



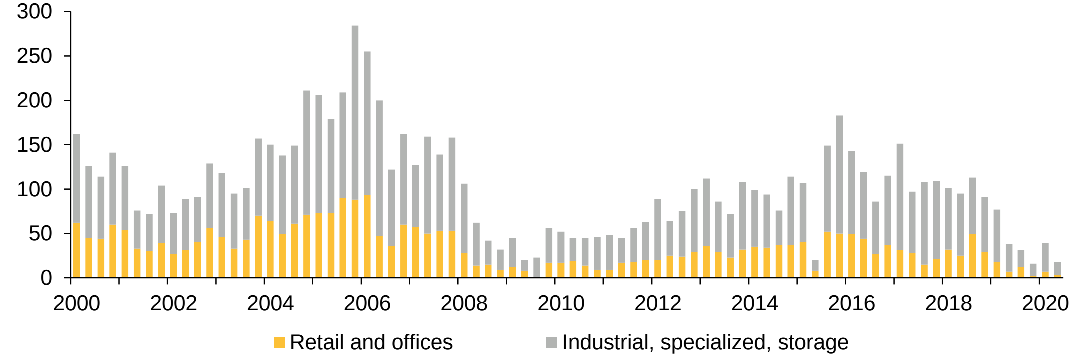
Residential house prices and turnover in greater Reykjavik
% change (left) and number (right)



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

28 October 2020

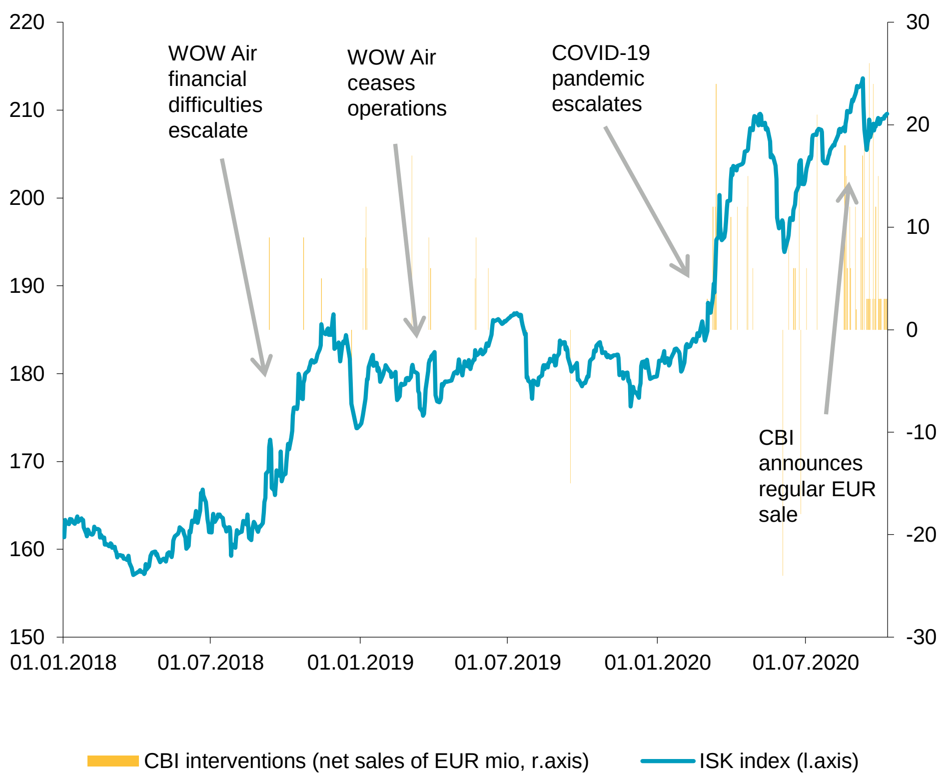
ISK has depreciated as pandemic impact has deepened

ISK appreciation likely as the economy picks up

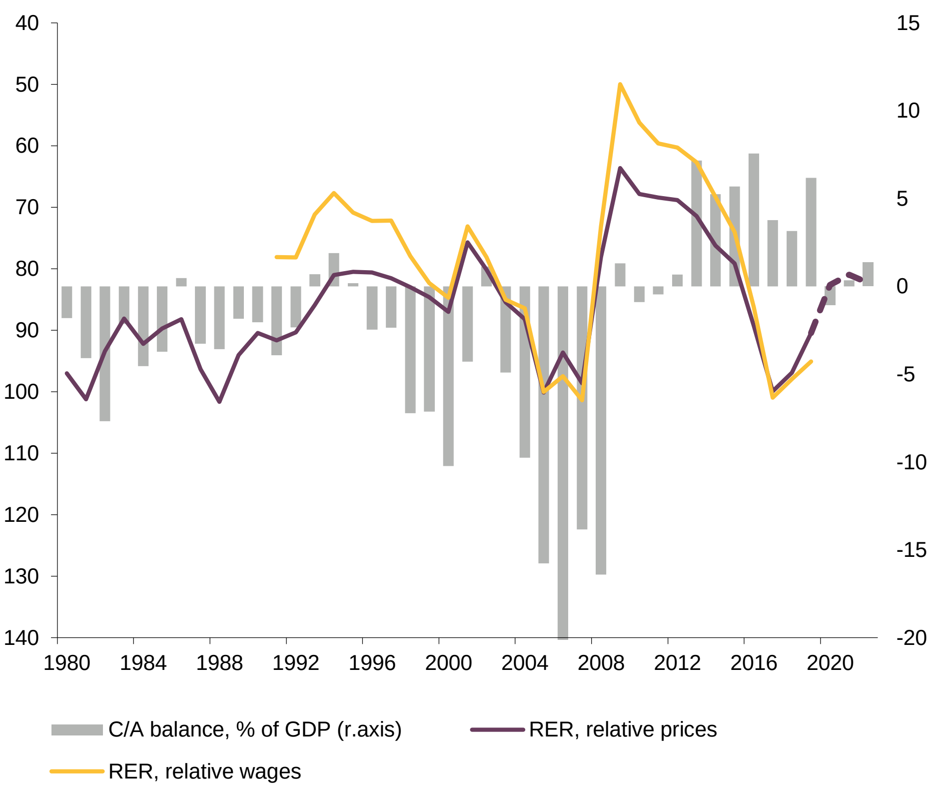
Comments

- The ISK has depreciated by about 15% against major currencies since the turn of the year. The depreciation took place primarily in March and April, although the exchange rate has been volatile since then
- The Central Bank (CBI) has intervened in the foreign exchange market to slow down the slide in the exchange rate and prevent short-term spiral formation
- The CBI's sales year-to-date total approximately EUR 400m. At the beginning of the year, the CBI's international reserves amounted to about EUR 6bn
- The real exchange rate of the ISK has fallen by about 1/5 from its peak at the height of the tourism boom three years ago. By this measure, Iceland is about as expensive a destination as it was in H1/2016
- Assuming that the shocks to the export sector are indeed temporary, and assuming that the external balance of the economy rests on stronger foundations than before, we expect the ISK to appreciate again over time. When and how much it appreciates is highly uncertain, however

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 likely to subside in 1H 2021

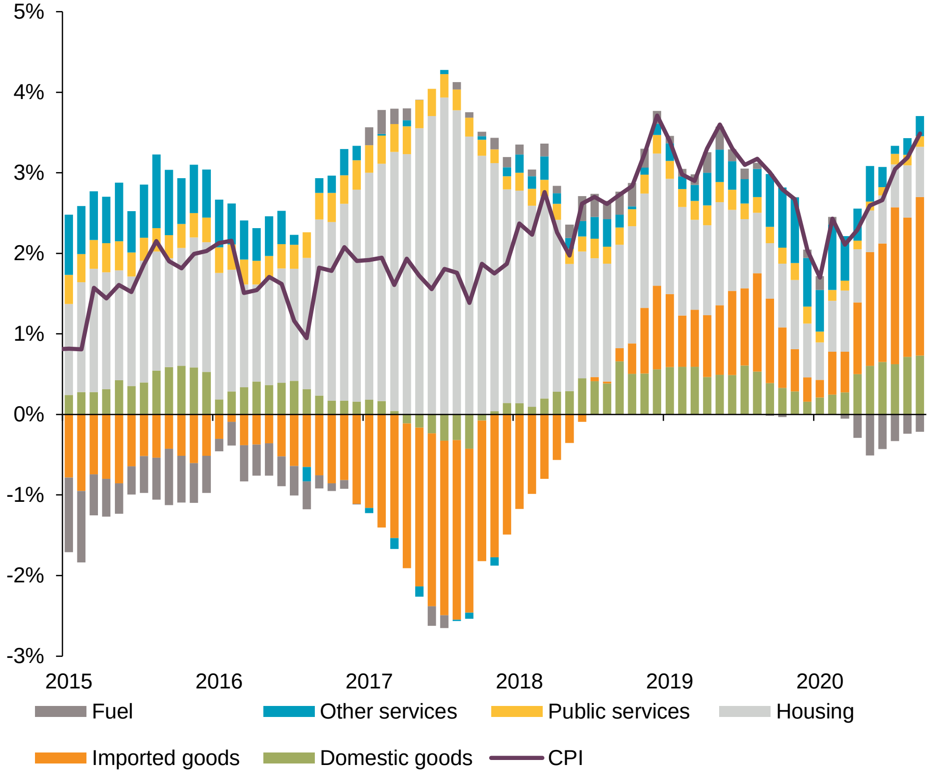
Policy rate historically low and likely to stay low in coming quarters

Comments

- Inflation measured 3.5% in September, double the January inflation rate
- The outlook is for inflation to remain above 3% until Q2/2021 as exchange rate pass-through from the rcent ISK depreciation and end-2020 wage increases fuel inflationary pressures
- The outlook is for inflation to taper off over the course of 2021, however, owing mainly to a growing slack in the economy and a stable, and then modestly rising, exchange rate
- We project that inflation will average 2.7% this year and next, and then average 1.9% in 2022
- The Central Bank's key interest rate is now at an all-time low of 1.0%. Alongside these rate cuts, the CBI has eased various financial conditions and announced a ISK150 bn bond purchase programme
- The policy rate is likely to remain at 1.0% until mid-2021. At that point, it will start to rise gradually as activity picks up and the slack in the economy narrows. Interest rates will nevertheless be low in historical context for the remainder of the forecast horizon

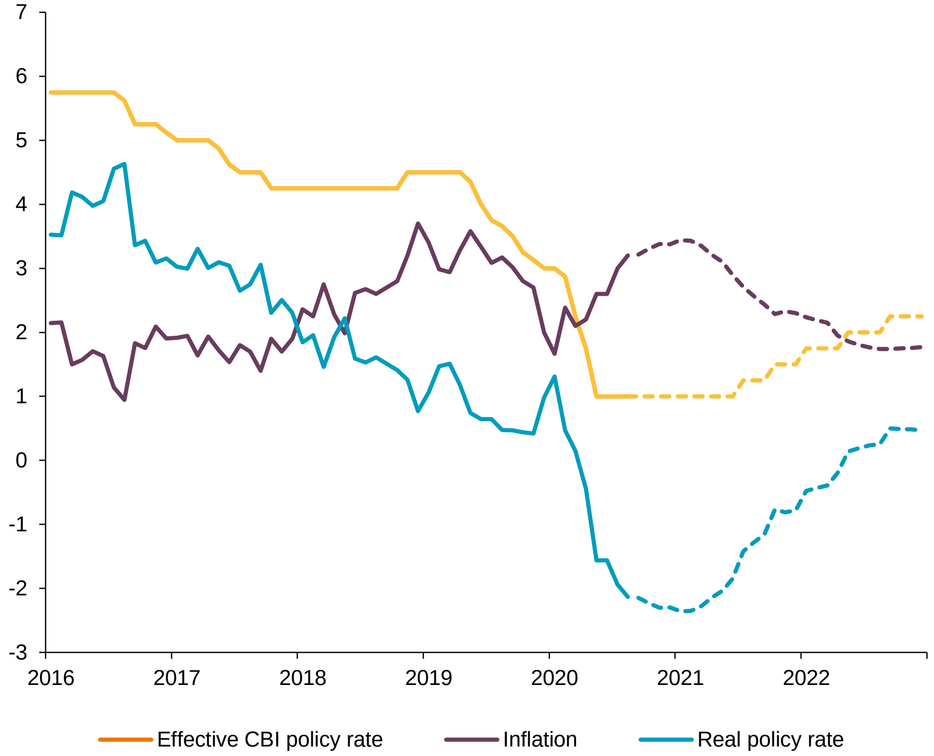
Inflation and contribution of main subitems

%



Inflation, policy rate and real policy rate

%



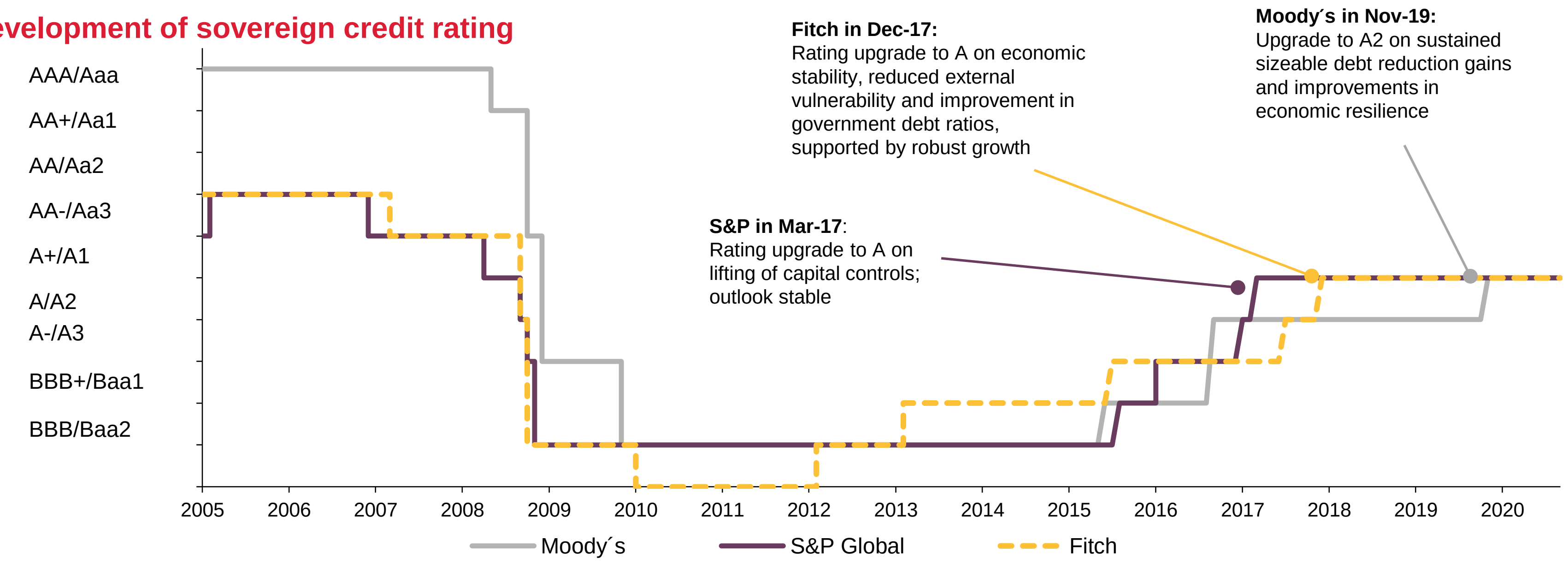
1. Dotted lines indicate ISB Research forecasts

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 APRIL 2020

- Iceland’s credit profile is supported by its wealthy and flexible economy, benefiting from a natural resource base that affords robust growth potential
- The stable outlook reflects downside risks stemming from the economy's small size and high concentration being mitigated by Iceland's relative macroeconomic and financial robustness

FITCH IN MAY 2020

- Rating affirmed at A, outlook on long-term FX debt revised to negative from stable
- The revision to negative outlook reflects the deterioration in Iceland’s near-term growth and public finance outlook caused by the coronavirus pandemic and risk of further adverse impact on the economy
- Iceland’s high level of wealth and relatively low indebtedness of the private sector are key rating strengths

S&P IN MAY 2020

- The stable outlook reflects our view that Iceland's strong fiscal and balance of payments buffers leave the authorities room for policy response over the next two years, while capturing that the country's small and open economy remains exposed to high COVID-19-related risks

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

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