



9M 2019 Financial Results



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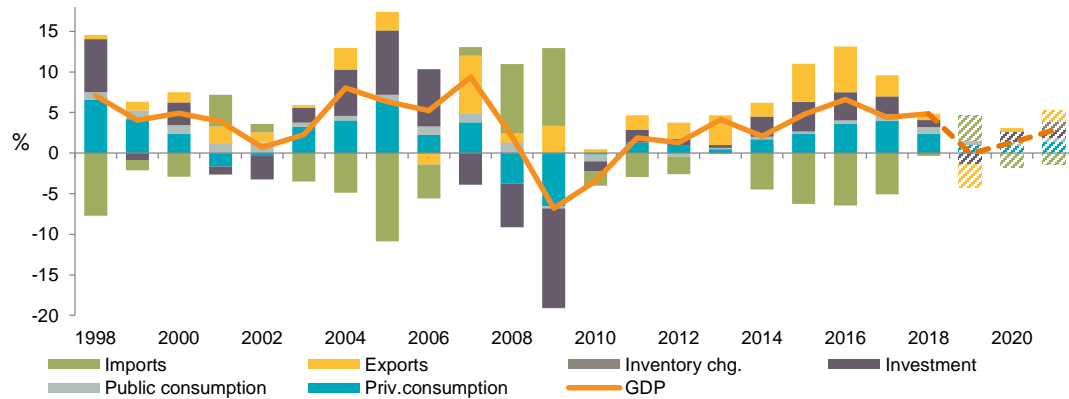
1. 9M 2019 highlights



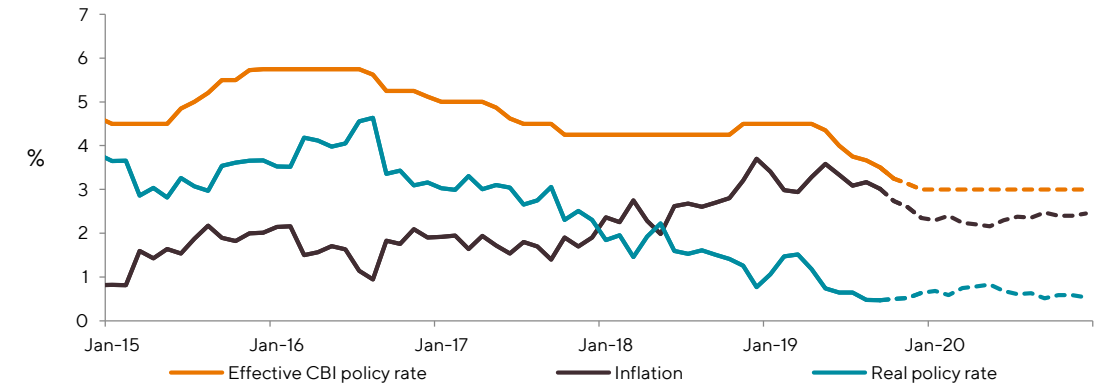
Economic highlights

The decade ends with a period of consolidation after a long and prosperous upswing

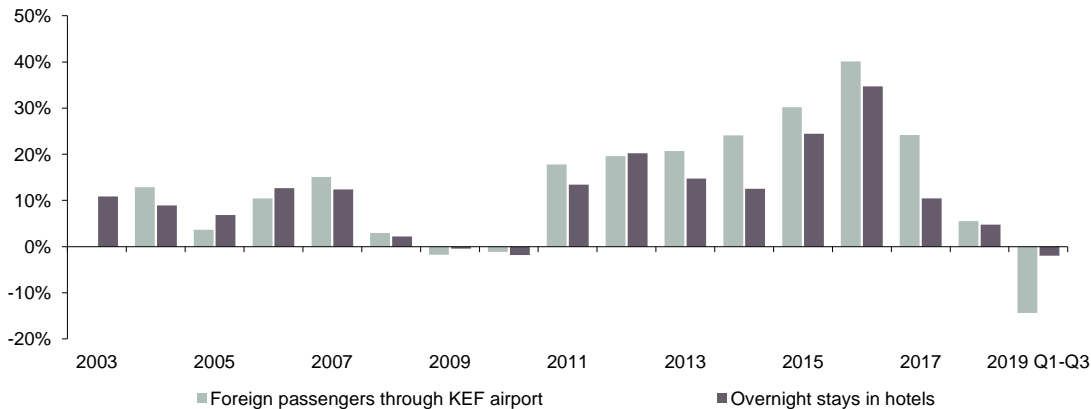
GDP growth takes a breather in 2019 due to contraction in tourism...



Cooler economy and declining inflation has led to lower interest rates...

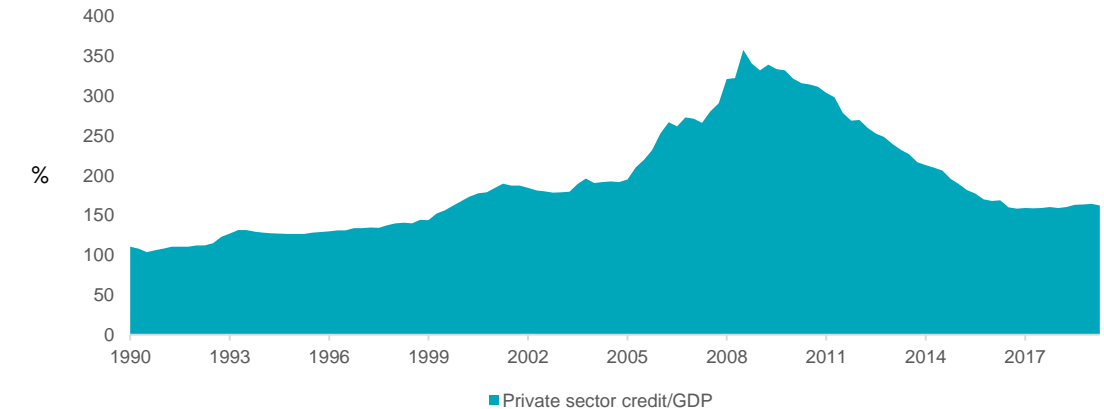


...although revenues in the sector are holding up better than expected



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

...and less economy-wide leverage has increased economic resilience





Overview

Key figures & ratios

| | | 9M19 | 9M18 | 3Q19 | 3Q18 | 2018 |
|----------------------|------------------------------------------------------|------------------|-----------|-----------|------------|-----------|
| PROFITABILITY | ROE 16% CET1 (regular operations) ¹ | 7.3% | 9.0% | 7.9% | 8.1% | 8.0% |
| | ROE (after tax) | 5.1% | 7.1% | 4.7% | 4.9% | 6.1% |
| | Net interest margin (of total assets) | 2.8% | 2.9% | 2.7% | 3.0% | 2.9% |
| | Cost to income ratio ² | 61.3% | 65.6% | 59.7% | 62.1% | 66.3% |
| | After tax profit, ISK m | 6,795 | 9,241 | 2,086 | 2,111 | 10,645 |
| | Earnings from regular operations, ISK m ³ | 8,692 | 8,979 | 2,986 | 2,928 | 12,042 |
| | | 30.9.2019 | 30.6.2019 | 31.3.2019 | 31.12.2018 | 30.9.2018 |
| BALANCE SHEET | Total assets, ISK m | 1,233,855 | 1,229,976 | 1,205,228 | 1,130,403 | 1,162,639 |
| | Loans to customers, ISK m | 909,175 | 894,446 | 873,530 | 846,599 | 835,582 |
| | Deposits from customers, ISK m | 610,281 | 615,869 | 611,303 | 578,959 | 608,646 |
| | Customer deposit / customer loan ratio | 67.1% | 68.9% | 70.0% | 68.4% | 72.8% |
| CAPITAL | Total equity, ISK m | 177,984 | 175,784 | 173,621 | 176,313 | 174,630 |
| | Tier 1 capital ratio | 19.0% | 18.8% | 19.1% | 20.3% | 19.9% |
| | Total capital ratio | 21.4% | 21.4% | 20.9% | 22.2% | 21.7% |
| | Leverage ratio | 13.6% | 13.4% | 13.5% | 14.6% | 14.0% |

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%. adjusted for risk free interest on excess capital.

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

3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs and income. As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations.



This is Íslandsbanki

A leader in financial services in Iceland with a clear vision to be #1 for service

Moving Iceland forward by empowering our customers to **succeed** articulates the Bank's role in shaping and progressing society. Driven by the **vision to be #1 for service**, the Bank provides services to its customer through three business divisions that manage and build relationships with customers

Universal banking



Awards

Leading the Icelandic Customer Satisfaction Index for **six consecutive years**
ÍSLENSKA ÁNÆGJUVOGIN 2013-2018

Credit ratings

S&P Global Ratings
BBB+/A-2
Negative outlook

9M19 Key figures for the Group

ROE (Regular operations) **7.3%**
Cost to income ratio **61.3%**
Total Capital Ratio **21.4%**
Total Assets **ISK 1.234bn**

Employees of the Bank

784 Number of **FTE's** for parent company at end of 3Q19
91% **Job satisfaction** among Íslandsbanki's employees
5 training courses a year per employee

Market share ¹

31% Individuals
37% SMEs
33% Large companies and investors

Ways to bank

57 ATMs
14 Branches
92.000 Total app users
113.000 Online banking users

1. Based on Gallup surveys regarding primary bank.



Ongoing societal impact work

A strong commitment to the implementation of four of the United Nations' sustainable development goals (SDGs) continued in the third quarter of 2019

Nordic CEOs for a sustainable future

An alliance of the leaders of the Nordic region's leading businesses, including Íslandsbanki, met with the Prime Ministers of the five Nordic countries in Iceland in August

The CEOs presented their vision for achieving the United Nations' SDGs through greater public-private sector collaboration and the transition to purpose-driven business practices. The alliance will initially focus on climate action, and diversity and inclusion in the workplace



Grants awarded to entrepreneurs

A total of ISK 30.5m in grants was awarded from the Íslandsbanki Entrepreneur fund to entrepreneurs and startups

140 applications were received and 9 selected

Special consideration is paid to projects which promote the four UN global compact initiatives the bank has decided to implement in its strategy. Those are quality education, gender equality, climate action and innovation and infrastructure



600 guests attended the Bank's retirement conference

The chairman of the Icelandic association of senior citizens and the CEO of the Social Insurance Administration were among speakers at the Bank's retirement conference at Harpa conference centre

600 guests attended the meeting bringing the total number of guests at Íslandsbanki's retirement events over 10,000 in the past nine years, during which over 100 events have been held at various locations around the country



Responsible investing

IS Funds, a subsidiary of Íslandsbanki, manages funds and assets according to responsible investing principles

Special consideration is made to environmental factors, social factors and governance

IS Funds helps its clients to achieve their financial goals in a responsible way





2. Income statement



Income statement

Negative net impairments main cause for lower profits between years

| ISKm | 9M19 | 9M18 | Δ | 3Q19 | 3Q18 | Δ |
|---------------------------------------------------------------|-----------------|----------|---------|----------------|---------|-------|
| Net interest income | 25,190 | 23,643 | 1,547 | 8,412 | 8,301 | 111 |
| Net fee and commission income | 9,713 | 8,749 | 964 | 3,090 | 2,939 | 151 |
| Net financial income (expense) | 23 | (325) | 348 | (598) | (420) | (178) |
| Net foreign exchange gain (loss) | 46 | (75) | 121 | 147 | (8) | 155 |
| Other operating income | 1,217 | 1,664 | (447) | 44 | 64 | (20) |
| Total operating income | 36,189 | 33,656 | 2,533 | 11,095 | 10,876 | 219 |
| Salaries and related expenses | (12,083) | (11,453) | (630) | (3,720) | (3,501) | (219) |
| Other operating expenses | (8,698) | (8,732) | 34 | (2,698) | (2,962) | 264 |
| Administrative expenses | (20,781) | (20,185) | (596) | (6,418) | (6,463) | 45 |
| Contribution to the Depositor's and Investors' Guarantee Fund | (720) | (874) | 154 | (210) | (295) | 85 |
| Bank tax | (2,714) | (2,541) | (173) | (900) | (944) | 44 |
| Total operating expenses | (24,215) | (23,600) | (615) | (7,528) | (7,702) | 174 |
| Profit before net impairment on financial assets | 11,974 | 10,056 | 1,918 | 3,567 | 3,174 | 393 |
| Net impairment on financial assets | (2,078) | 1,881 | (3,959) | (230) | (53) | (177) |
| Profit before tax | 9,896 | 11,937 | (2,041) | 3,337 | 3,121 | 216 |
| Income tax expense | (3,071) | (3,616) | 545 | (1,292) | (1,136) | (156) |
| Profit for the period from continuing operations | 6,825 | 8,321 | (1,496) | 2,045 | 1,985 | 60 |
| Discontinued operations, net of income tax | (30) | 920 | (950) | 41 | 126 | (85) |
| Profit for the period | 6,795 | 9,241 | (2,446) | 2,086 | 2,111 | (25) |

Highlights

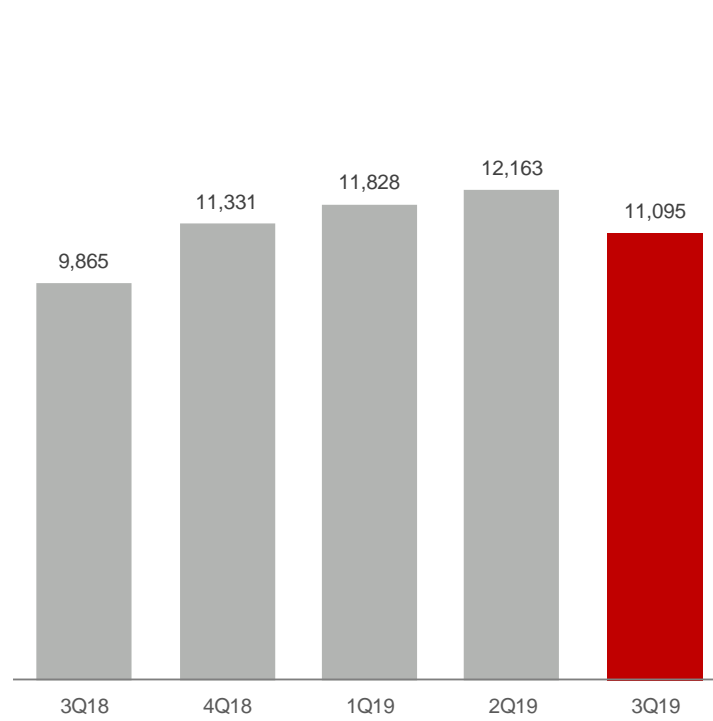
- Total income amounted to ISK 36.2bn in 9M19, an increase of 7.5% between years as a result of strong interest and fee income
- Positive changes in the CPI index and continuous loan growth contribute to higher net interest income
- Overall net fee income showed a 11% increase year on year
- Other operating income is ISK 1.2bn, a result from settlement with old Byr bank and the Icelandic Government
- Administrative expenses increase by 3.0% which can be attributed to employment terminations, collective wage increases and higher depreciations due to heavy investment in the core banking system
- Profit for the period is ISK 6.8bn which is a decrease of 26.5% from 9M18
 - Largely caused by negative net impairment of ISK 2.1bn compared to positive impairment of ISK 1.9bn for the same period in 2018



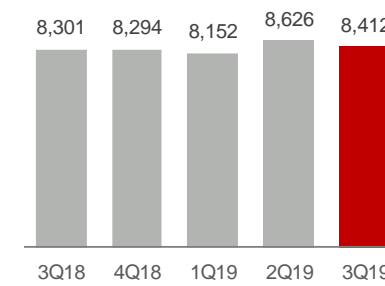
Operating income

Net fee and commission up by 5.1% and net interest income up by 1.3% compared to 3Q18

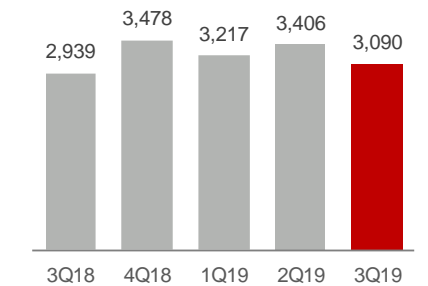
Total operating income¹
ISKm



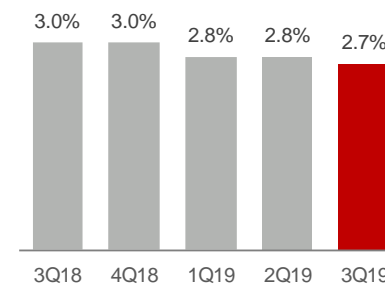
Net interest income
ISKm



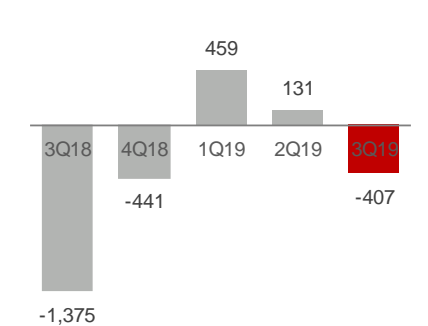
Net fee and commission income
ISKm



Net interest margin
%



Other income¹
ISKm



1. Excluding one-off income.



Net interest income and net fee and commission income

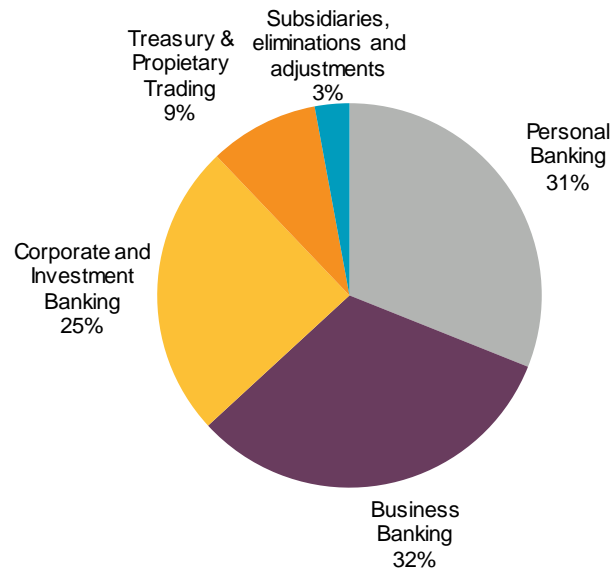
Breakdown by segments

Highlights

- Net interest income was ISK 25.2bn, an increase of 6.5% between years and the net interest margin was 2.8% compared to 2.9% in 9M18.
- Decrease in NIM is due to lower interest rate environment
- Net interest income evenly distributed between the three business divisions
- Net fee and commission income was ISK 9.7bn (9M18: ISK 8.7bn) an increase of 11% between years
- Personal Banking was the main contributor to net fee and commission income

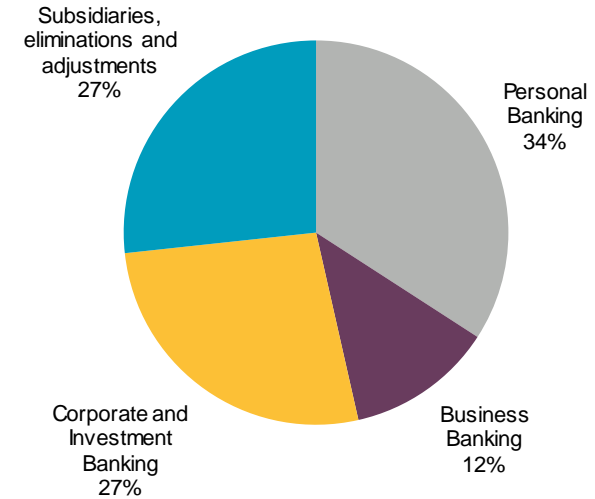
Net interest income

%



Net fee and commission income

%





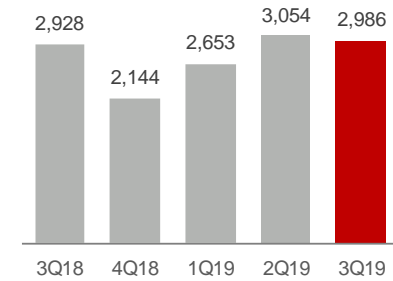
Earnings from regular operations

Excludes one-off items and ROE calculation is adjusted to normalised CET1 of 16%

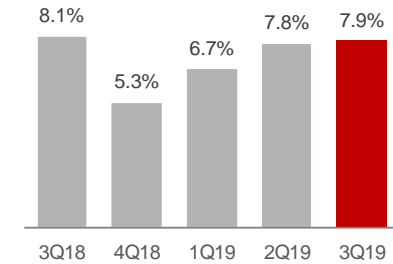
ROE from regular operations

| ISKm | 9M19 | 9M18 | Δ | 3Q19 | 3Q18 | Δ |
|------------------------------------------------|----------------|---------|---------|--------------|-------|------|
| Reported after tax profit | 6,795 | 9,241 | (2,447) | 2,086 | 2,111 | (25) |
| One-off revenue | (1,103) | (2,546) | 1,443 | - | - | 0 |
| One-off costs | - | - | - | - | - | 0 |
| Bank tax | 2,714 | 2,541 | 173 | 900 | 944 | (44) |
| Tax impact of adjustments | 287 | 662 | (375) | - | - | 0 |
| Earnings from regular operations ¹ | 8,692 | 9,899 | (1,206) | 2,986 | 2,928 | 58 |
| ROE 16% CET1 (regular operations) ² | 7.3% | 9.0% | | 7.9% | 8.1% | |
| ROA from regular operations (after tax) | 1.0% | 1.2% | | 1.0% | 1.0% | |
| Net interest margin adj. 16% CET1 | 2.7% | 2.7% | | 2.6% | 2.8% | |
| Cost / income ratio adj. 16% CET1 | 62.8% | 68.0% | | 61.4% | 64.3% | |

Earnings from regular operations ISKm



ROE reg. operations CET1 16% %



Earnings from regular operations

- The Bank recently revised its long term minimum capital target to 16% (CET1 16%)
- Lower earnings from regular operations largely explained by negative changes in net impairments

One off items 2019

- ISK 1.1bn from an agreement with Old Byr on the settlement of the dispute deriving from the acquisition with Byr savings bank in 2011
- As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations.

1. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax.

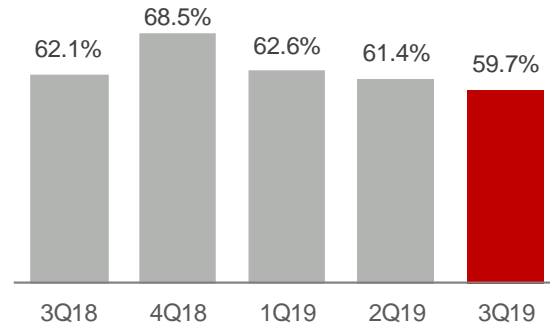
2. Return from regular operations and corresponding ratios on normalised CET1 of 16%. adjusted for risk free interest on excess capital.



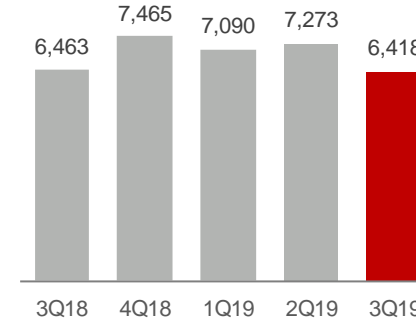
Administrative expenses

Cost to income ratio on the decline with parent company at 55% target

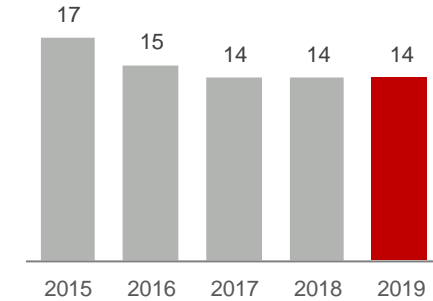
Efficiency – Cost to income ratio¹
Group



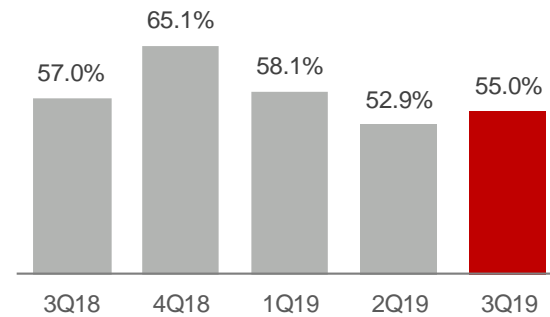
Administrative expenses
ISK m



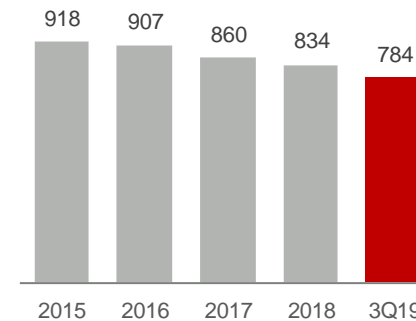
Branch network



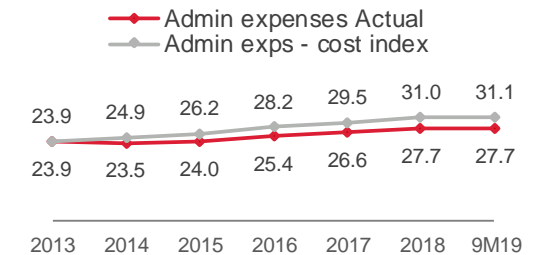
Efficiency – Cost to income ratio¹
Parent



Period end FTE numbers²
Parent



Annualised admin. exp. vs cost index³
ISK bn, excl. one-off cost, parent company



1. The cost to income ratio excludes bank tax and one-off cost and revenue items.
 2. FTE numbers exclude seasonal employees.
 3. Administrative expense - cost index is calculated as 40% inflation and 60% salary index excluding one-off items.



3. Balance sheet



Assets

Total assets are 9.2% up from year-end 2018

| Assets, ISK m | 30.9.2019 | 31.12.2018 | Δ |
|-------------------------------------|------------------|------------------|----------------|
| Cash and balances with Central Bank | 129,115 | 135,056 | (5,941) |
| Loans to credit institutions | 66,409 | 41,577 | 24,832 |
| Bonds and debt instruments | 73,899 | 69,415 | 4,484 |
| Derivatives | 5,438 | 4,550 | 888 |
| Loans to customers | 909,175 | 846,599 | 62,576 |
| Shares and equity instruments | 19,200 | 13,074 | 6,126 |
| Investment in associates | 687 | 682 | 5 |
| Property and equipment | 9,442 | 5,271 | 4,171 |
| Intangible assets | 4,709 | 5,002 | (293) |
| Other assets | 15,781 | 9,177 | 6,604 |
| Total Assets | 1,233,855 | 1,130,403 | 103,452 |

Highlights

Liquid assets

- The Bank lowered its cash level with the Central Bank by ISK 6.9bn from year-end 2018 largely due to the March 2019 ISK 5.3bn dividend pay-out
- Three line items – cash and balances with the Central Bank, loans to credit institutions and bonds and debt instruments – amount to about ISK 269bn of which ISK 230bn are liquid assets

Loans to customers

- Net increase in loan portfolio amounted to ISK 62.6bn since year-end 2018, an increase of 7.4%

Property and equipment

- On transition to IFRS 16, the Group recognised ISK 4,505 million of right-of-use assets and the same amount in lease liabilities. The Group's lease liabilities and right-of-use assets at transition and throughout the third quarter 2019 are mostly derived from CPI-linked real estate lease commitments for offices, branches and storage but a small minority stems from lease commitments for land.

Asset encumbrance

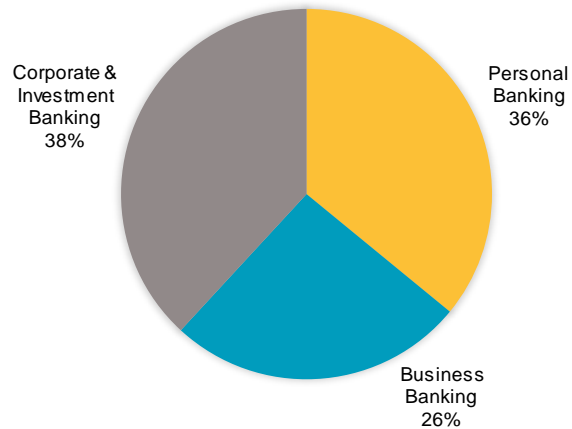
- The Bank's asset encumbrance ratio was 17.6% at end of 9M19 compared to 18.0% at end 2018



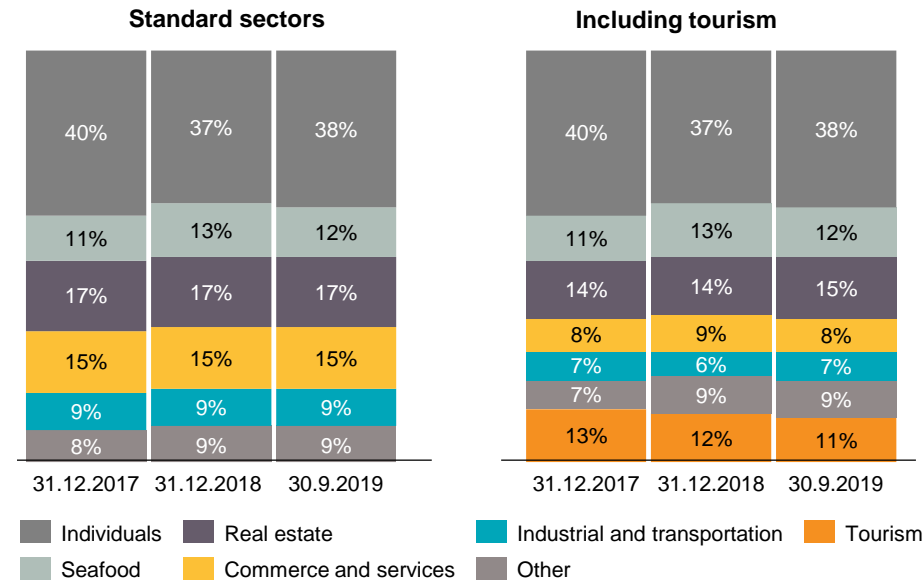
Diversified loan portfolio

Loans to customers grew by 7.4% in 9M2019, growth rate not expected to continue in Q4

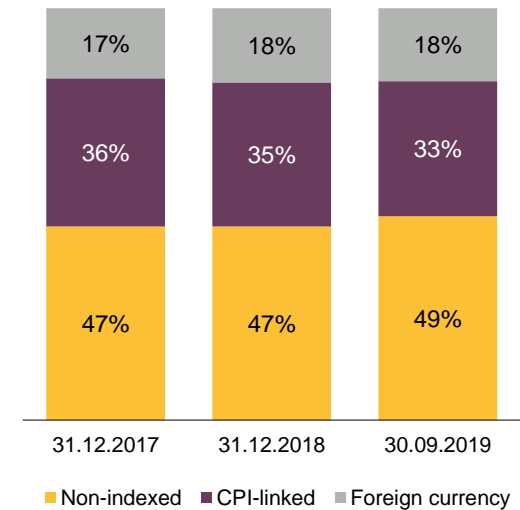
Loan portfolio broken down by business divisions
Consolidated



Loans to customers
By sector, consolidated



Loans to customers
% of loans by currency type, consolidated



Highlights

- Strong demand for loans across all sectors in first 9M of 2019
- The mortgage portfolio increased by 10% since year-end 2018
- Exposure to tourism is 11% of loans to customers, slightly decreasing from year-end 2018
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism
- Loan portfolio evenly spread out by the three business divisions although CIB is the largest
- The ratio of non-indexed loans has increased in 9M 2019
- Annualised growth of the Bank's loan book slowed down from 1Q19 (12.7%) highs to 9.6% in 2Q19 and 6.4% in 3Q19.



LTV distribution of loan portfolio

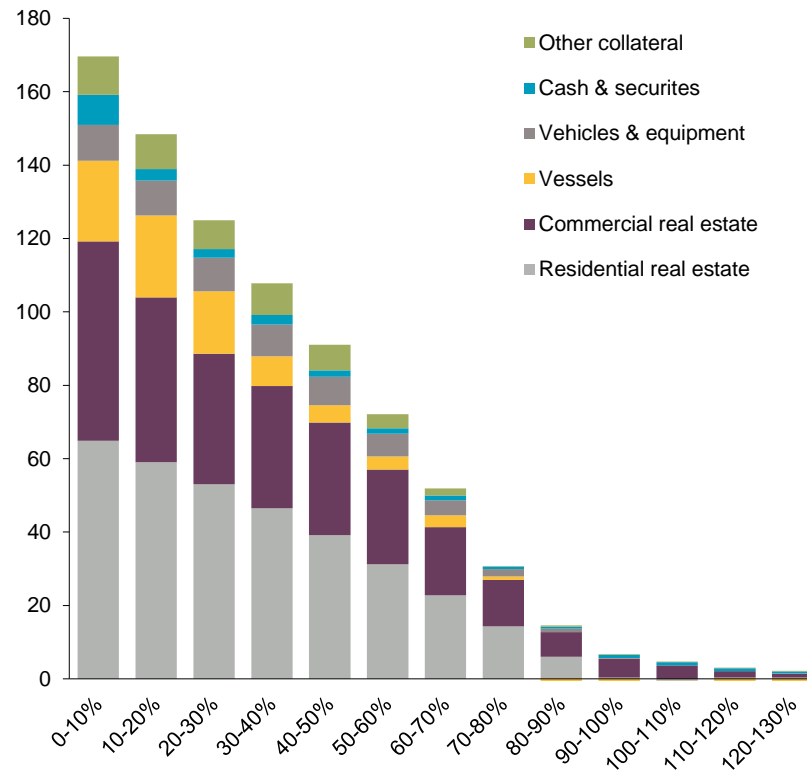
Loans generally well covered by stable collateral, majority in residential and commercial real estate

Highlights

- 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

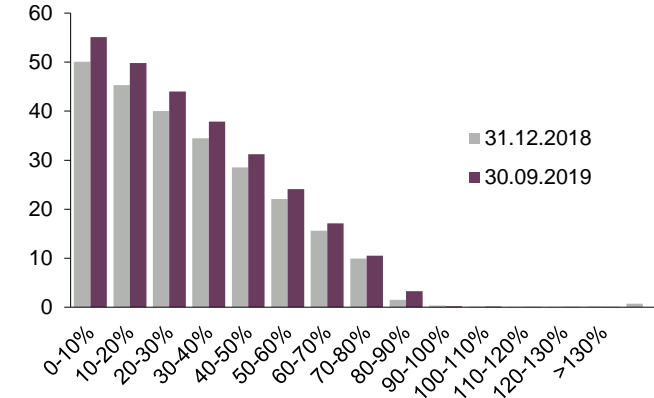
LTV distribution by underlying asset class

ISK bn, by type of underlying asset, as of 30.09.2019



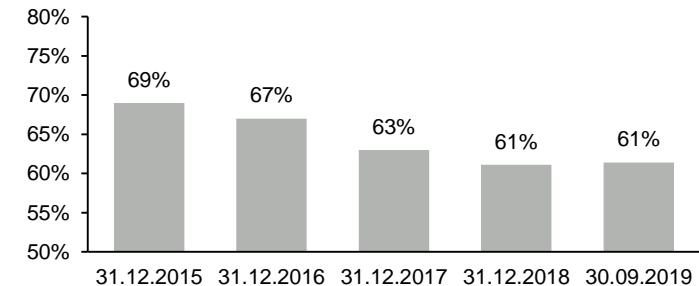
LTV distribution of mortgages to individuals

ISK bn, as of 30.09.2019



Average LTV of mortgages to individuals¹

Development of average LTV



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.



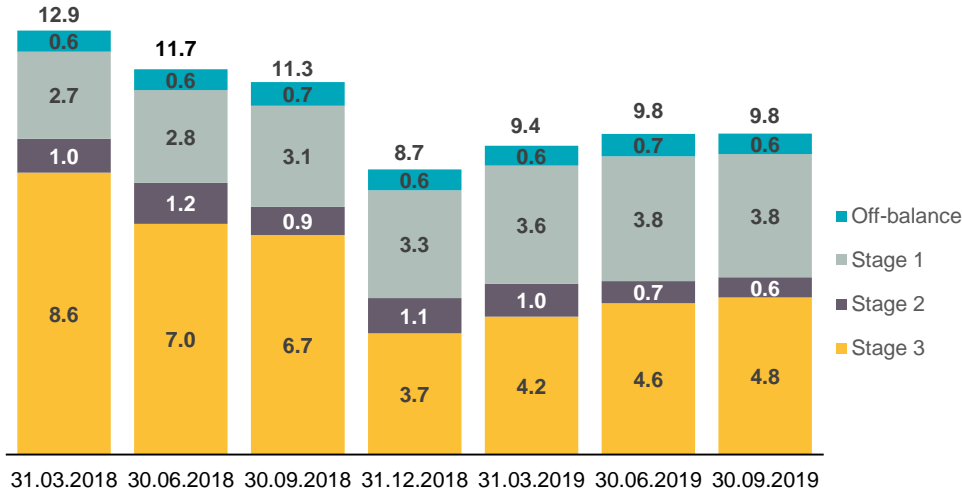
Asset quality

Asset quality stable with increased impairment allowance due to economic environment

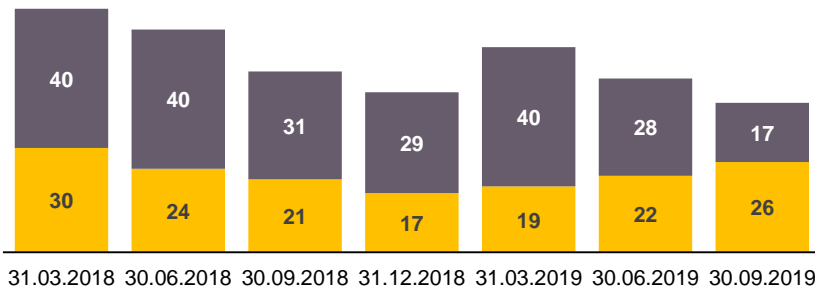
Highlights

- In 9M2019, the impairment allowance increased due to less favourable economic environment
- According to the forward-looking impairment model of IFRS 9 which is based on a probability-weighted average over several scenarios, it can be expected that such uncertainty will lead to an increase in the impairment allowance
- The gross carrying amount of loans in Stage 2 decreased in the first 9M, in part due to deterioration of credit quality to Stage 3 that in turn increased from ISK 17bn (2.0%) to 26bn (2.8%)
- Using the European Banking Authority's definition of NPL, which does not only include loans to customers but also loans and advances to central banks and credit institutions, the Bank's NPL ratio was 2.3% at the end of Q3 2019, compared to 3.0% average for European banks¹

Loans to customers & off-balance sheet items: impairment allowance account
Development of allowance account, ISK bn

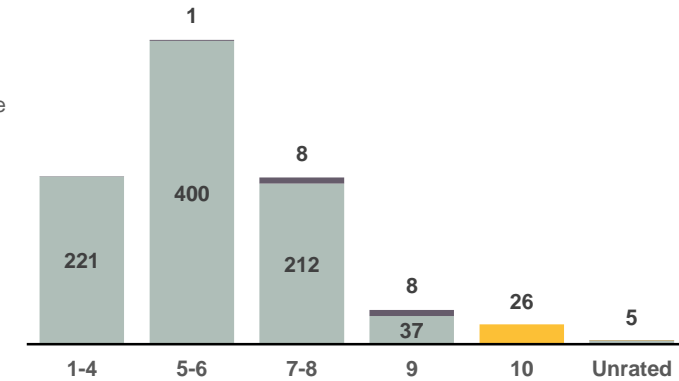


Loans to customers: Stage 2 and 3
Development of gross carrying amount, ISK bn



1. Source European Banking Authority, data as of Q2 2019.

Loans to customers: gross carrying amount
Risk class and impairment stage, ISK bn



Loans to customers: credit quality
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 | 875 | 95.3% | 3.8 | 0.4% | 871 | 95.8% |
| Stage 2 | 17 | 1.9% | 0.6 | 3.5% | 17 | 1.8% |
| Stage 3 | 26 | 2.8% | 4.8 | 18.3% | 21 | 2.3% |
| Total | 918 | 100.0% | 9.2 | 1.0% | 909 | 100.0% |



Liabilities

Diversified funding strategy

| Liabilities & Equity, ISK m | 30.9.2019 | 31.12.2018 | Δ |
|----------------------------------------------------|------------------|------------|---------|
| Deposits from Central Bank and credit institutions | 31,808 | 15,619 | 16,189 |
| Deposits from customers | 610,281 | 578,959 | 31,322 |
| Derivative instruments and short positions | 7,910 | 5,521 | 2,389 |
| Debt issued and other borrowed funds | 331,938 | 300,976 | 30,962 |
| Subordinated loans | 21,993 | 16,216 | 5,777 |
| Tax liabilities | 10,127 | 7,150 | 2,977 |
| Other liabilities | 41,814 | 29,649 | 12,165 |
| Total Liabilities | 1,055,871 | 954,090 | 101,781 |
| Total Equity | 177,984 | 176,313 | 1,671 |
| Total Liabilities and Equity | 1,233,855 | 1,130,403 | 103,452 |

Highlights

Deposits

- Customer deposits increased by 5.4% in the period
 - The increase in deposits was mainly from domestic financial entities
 - The customer deposit to customer loan ratio was 67.1% at end of 9M19

Debt issued and other borrowed funds

- The Bank continued to have good access to capital markets and issued ISK 29bn in covered bonds in 2019 and about ISK 69bn in foreign currency denominated senior unsecured debt
- In June, the Bank issued a SEK 500m Tier 2 bond, which was the Bank's third Tier 2 transaction

Equity

- At the March 2019 AGM, it was approved that ISK 5.3bn was to be paid in dividends to shareholders for the 2018 financial year. The dividend corresponded to about 50% of after tax profits for 2018, and was consistent with the Bank's dividend payout ratio target of 40-50%



Deposits remain the main source of funding

Core deposits continue to be stable

Highlights

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, 71% of the deposits were in non-indexed ISK, 15% CPI linked and 14% in foreign currencies

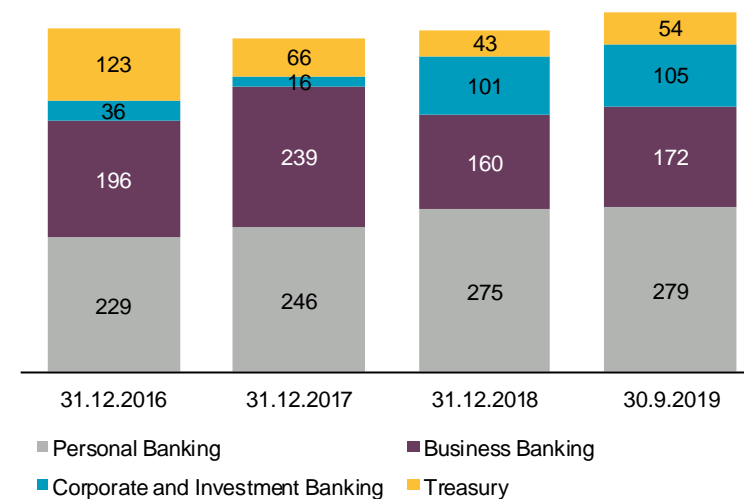
Deposits concentration stable

- 16% of the Bank's deposits belonged to the 10 largest depositors and 31% belonged to the 100 largest depositors at the end of September 2019, compared to 15% and 37% respectively for year-end 2018
- Total increase in deposits is 48bn since year-end 2018. Increase in all customer groups, but mostly in domestic financial entities

Customer and credit institutions deposits by LCR category 30.09.2019 compared with year end-2018, ISK bn, consolidated

| Customer type | Less stable | Δ | Stable | Δ | Term deposits | Δ | Total deposits | Δ |
|------------------------------------------------------|-------------|-----------|-----------|------------|---------------|-----------|----------------|-----------|
| Retail | 224 | 8 | 81 | (0) | 78 | (0) | 383 | 7 |
| Operational relationship Corporations | 3 | 1 | - | - | - | - | 3 | 1 |
| Sovereigns, central-banks and public sector entities | 70 | 6 | 0 | 0 | 24 | 2 | 95 | 8 |
| Pension funds | 11 | 4 | 0 | 0 | 1 | 0 | 12 | 4 |
| Domestic financial entities | 36 | 5 | - | - | 25 | (2) | 61 | 3 |
| Foreign financial entities | 29 | 1 | - | - | 45 | 20 | 74 | 22 |
| | 4 | 1 | - | - | 10 | 2 | 14 | 2 |
| Total deposits | 378 | 26 | 81 | (0) | 183 | 22 | 642 | 48 |

Breakdown of deposits from customers by divisions ISK bn, consolidated





Borrowings

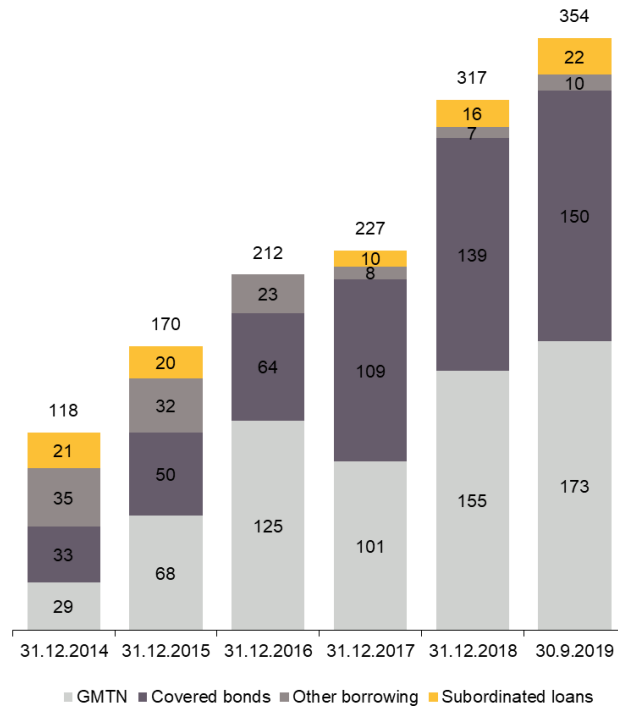
Successful international and domestic market transactions

Highlights

- Íslandsbanki has issued ISK 29bn of covered bonds in 2019
- Successful refinancing in April, the Bank issued a new public 3yr EUR 300m bond and bought back EUR 300m of the EUR 500m bond maturing in 2020 through a public tender
 - Thus reducing the 2020 maturity by approximately ISK 41 bn
- With an issuance of SEK 500m 10NC5 Tier 2 in June the Bank reached its Tier 2 target which is an important milestone in optimizing the Bank's long-term capital composition

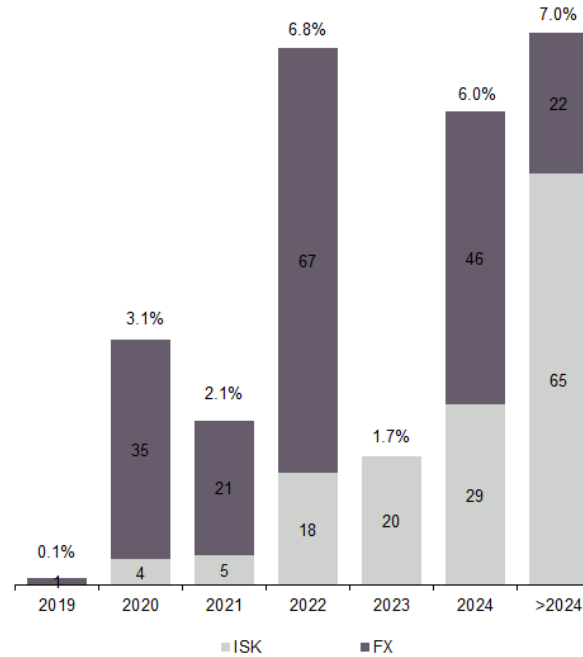
Borrowing sources

Book value, ISK bn



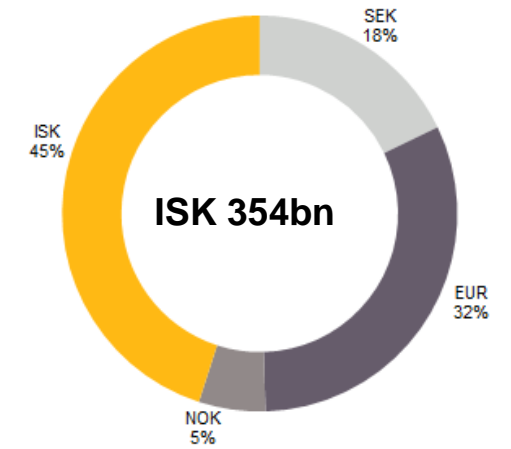
Maturity profile of long-term debt and repayment of long term debt as percentage of balance sheet¹

30.09.2019, Nominal value, ISK bn



Currency split of market borrowing sources

30.09.2019, Nominal value, ISK bn



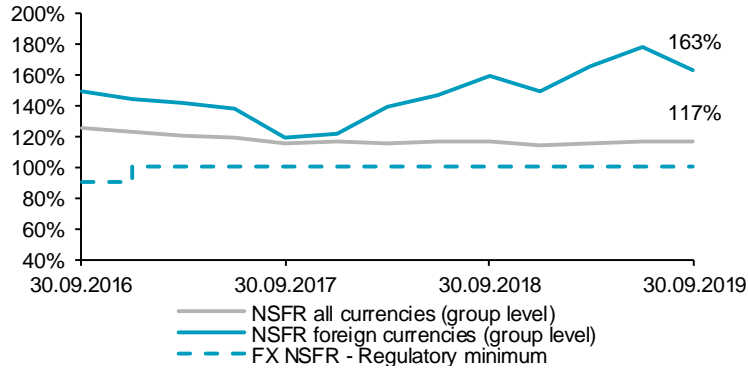
1. Final maturity assumed for callable bonds



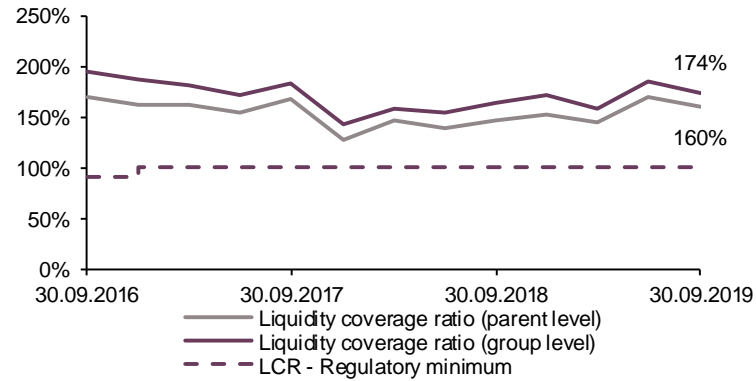
Sound management of liquidity

Liquid assets of ISK 230bn are prudently managed

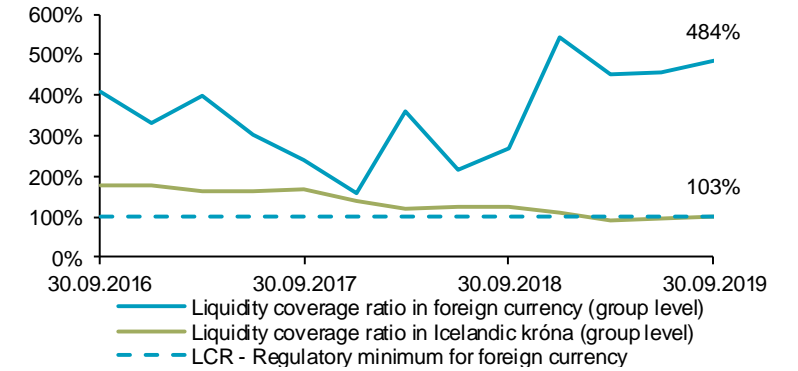
Net stable funding ratio (NSFR)



Liquidity coverage ratio (LCR)



Liquidity coverage ratio – foreign currencies and Icelandic króna



Highlights

- All liquidity measures well above regulatory requirements
- FX liquid assets are composed of government bonds that have a minimum requirement of AA rating and cash placed with highly rated correspondent banks
- Stress testing of liquidity position is an integrated part of the annual ICAAP/ILAAP process as well the annual regulatory stress test
- Liquidity Contingency Plan is in place and is tested regularly



Sound capital position

The capital ratio exceeds target

Highlights

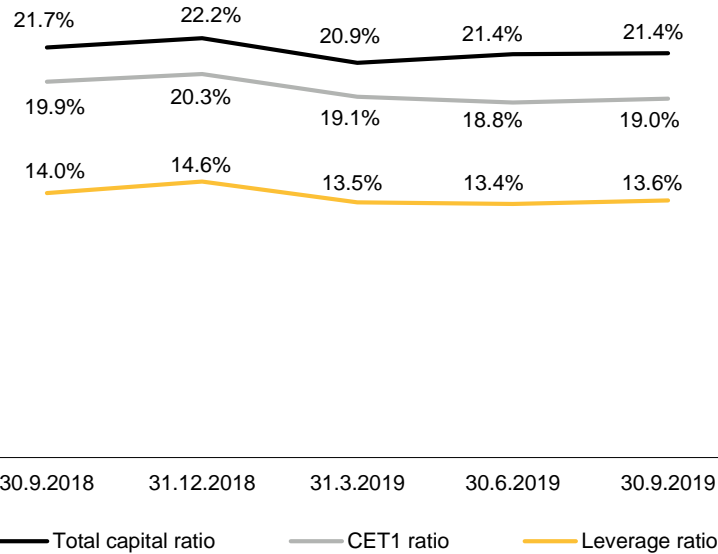
Capital ratios

- The capital base was ISK 196bn at end Q3 compared to ISK 188bn at year-end 2018
- The increase in the capital base is due to a subordinated loan issuance in June 2019
- The CET1 capital was ISK 174bn at the end of September compared to 171bn at year-end 2018 where the retained earnings for the period are offset by a ISK 5.3bn dividend payment in March 2019

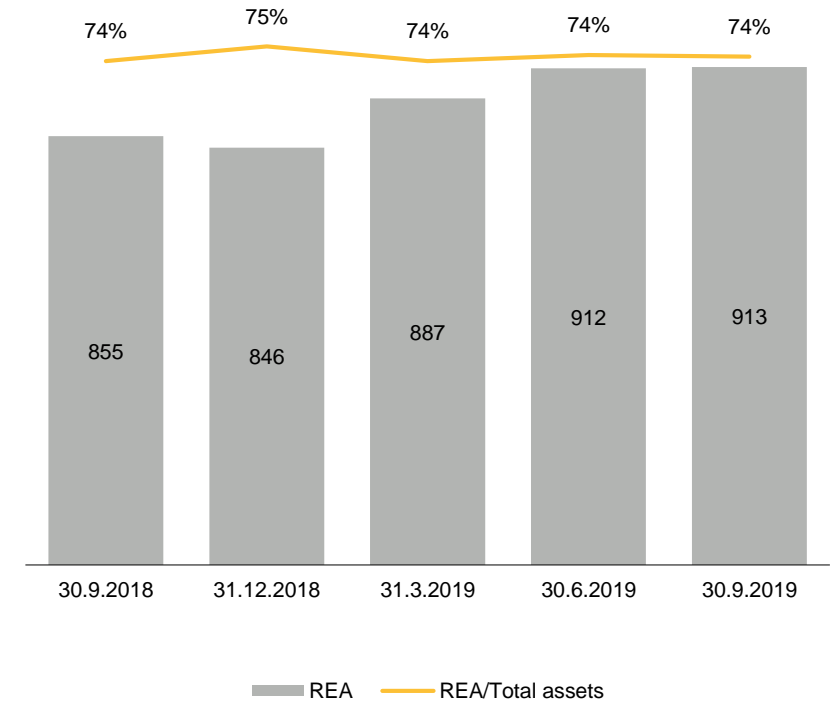
Risk exposure amount (REA)

- The REA growth is mainly due to increase in loans to customers during the period
- The implementation of IFRS 16, where the right-of-use assets is capitalised, contributes to an ISK 4.3bn increase of REA
- The ratio of REA of total assets remains fairly stable at 74%

Capital and leverage ratios



Risk exposure amount (REA) ISK bn





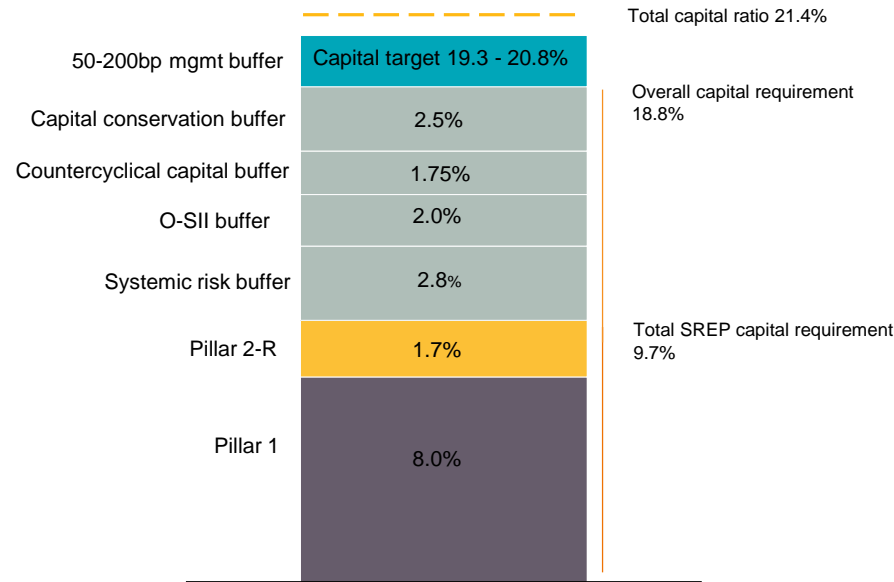
Íslandsbanki's capital target

Based on the regulatory requirement and 50 – 200bp management buffer

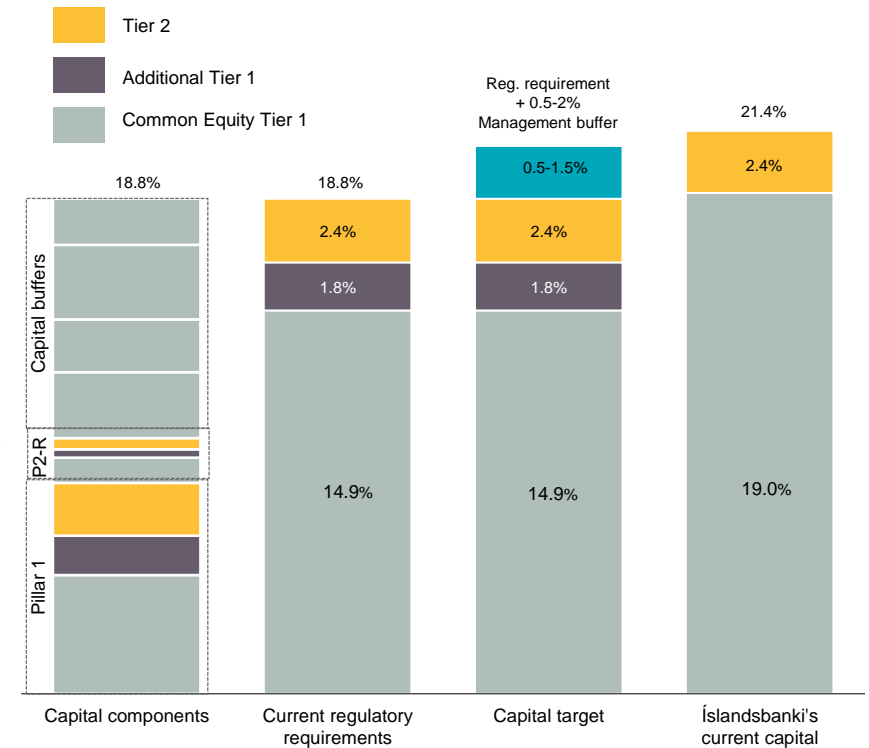
Íslandsbanki's capital target

- The sum of Pillar 1, Pillar 2-R and the combined capital buffers form the overall regulatory capital requirement
- Based on the SREP 2019 results, published in October 2019, the overall capital requirement for Íslandsbanki is 18.8% of risk exposure amount (REA)
- This is a decrease of 0.5% in Pillar 2-R between years, mostly due to lower risk profile.
- The countercyclical capital buffer increased from 1.25% to 1.75% effective May 2019 and will increase again by 0.25% in February 2020
- Íslandsbanki's total capital target ratio is based on the overall regulatory requirement in addition to a 50-200bp management buffer
- The size of the management buffer is based on factors such as volatility in the capital ratios due to currency fluctuations, volatility in earnings and REA and uncertainties in the regulatory or operating environment

Íslandsbanki's capital target



Capital requirement composition



**Íslandsbanki**

| | S&P |
|---------------|----------------|
| Long-term | BBB+ |
| Short-term | A-2 |
| Outlook | Negative |
| Rating action | Jul 19 |

Icelandic sovereign

| | S&P | FITCH | MOODY'S |
|---------------|----------------|--------------|----------------|
| Long-term | A | A | A3 |
| Short-term | A-1 | F1 | - |
| Outlook | Stable | Stable | Positive |
| Rating action | May 19 | Dec 18 | Jul 18 |

Íslandsbanki credit ratings

Ratings affirmed from S&P in July 2019

S&P**BBB+/A-2 Negative Outlook**

Press Release 23 July 2019

In July, S&P Global Ratings **affirmed** Íslandsbanki's ratings of **BBB+/A-2** but changed the outlook from **stable to negative** along with three other Icelandic financial institutions. S&P had in October 2017 upgraded the Bank to this rating.

In its press release, S&P refers to Íslandsbanki's **stable domestic market position** and acknowledges the Bank's **success in introducing new digital products and improving its IT infrastructure**, placing it well ahead of many other European banks. S&P also notes the Bank's **exceptional capitalisation, strong liquidity levels and robust asset quality**.

S&P's rationale for **the change to negative outlook** is mostly derived from its view that Iceland's **operating environment will remain challenging**, affected by the 2019 economic recession, declining interest rates, still-high taxation, and 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

Medium and long term strategies structured around achieving key financial targets

| | Target | 9M19 | 2018 | 2017 | Guidance |
|-------------------------------------------|----------------|---------|---------|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ROE regular operations¹ | 8-10% | 7.3% | ✓ 8.0% | ✓ 9.9% | <ul style="list-style-type: none"> — Target of 4-6% on top of risk free rate. Risk free rate expected to be at around 4% in the medium to long term and is currently 3.0% and 3.9% on average for 9M19 — As the Bank retains substantive liquid assets, interest rate levels in Iceland and abroad can have a substantial impact on ROE — The bank tax, excluded from target returns, will have an impact on profitability if kept at current high levels — ROE target will be challenging to reach in the near term in a slowing economy and before a full realisation of the Bank's planned efficiency gains |
| Cost/ Income ratio² | <55% | 61.3% | 66.3% | 62.5% | <ul style="list-style-type: none"> — This is a medium to long term target. C/I ratio can be expected to be higher than target in the near term — Headcount and non-headcount related cost control programmes in place — Lower C/I on parent company basis than on a consolidated basis (55.3% at 9M19) |
| CET1 | >16% LT | ✓ 19.0% | ✓ 20.3% | ✓ 22.6% | <ul style="list-style-type: none"> — Long term CET1 target is 16% |
| Total capital ratio | > 19.3 – 20.8% | ✓ 21.4% | ✓ 22.2% | ✓ 24.1% | <ul style="list-style-type: none"> — Based on the regulatory capital requirement with a 50 – 200 bp management buffer — Current capital requirement is 18.8% including recently increased countercyclical capital buffer |
| Dividend payout ratio | 40-50% | ✓ --% | ✓ 50% | ✓ 100% | <ul style="list-style-type: none"> — Dividend pay-out ability will be impacted if the bank tax will be kept at current high levels — The BoD agreed to pay out ISK 5.3 billion in dividend for the 2018 financial year which is in line with the Bank's dividend pay out target |

1. Return from regular operations and corresponding ratios on normalised CET1 of 16%, adjusted for risk free interest on excess capital.

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



Key takeaways

Íslandsbanki is well positioned to succeed in a slowing but stabilising Icelandic economy

1 Stabilising economy

- GDP growth expected to take a breather in 2019 due to contraction in tourism although revenues in the sector are holding up better than expected
- Cooler economy and declining inflation has led to lower interest rates
- Less economy-wide leverage has increased economic resilience

2 Digitalisation in full force

- Substantial IT investments, including a new core payment and deposit system
- Recent roll out of impressive new digital customer solutions in apps and online banking such as new digital mortgage credit assessment
- Already resulting in enhanced customer satisfaction and more automatisisation

3 Growth in core earnings and cost cutting

- Earnings from regular operations in line with long term targets
- Cost to income ratio for parent company now at 55% target ratio
- Digitalisation and IT investments expected to generate more cost savings going forward

4 Strong credit quality

- Stable asset quality with increased impairment allowance due to economic environment
- NPL ratio 2.3% at 9M2019, compared to 3.0% average for European banks using the EBA's NPL definition
- Robust risk management practices and conservative lending policies in place
- Exposure to tourism now a smaller proportion of loan portfolio than at year-end 2018

5 Exceptional capitalisation

- Capital ratio at 21.4% in line with Bank's long term target
- Regulator lowered the Bank's total capital requirement in October 2019 from 19.3% to 18.8%
- Risk exposure amount to total assets at 74% - capitalisation considered exceptionally high in international comparisons

6 Funding success and high liquidity ratios

- Leading issuer of covered bonds in Iceland
- Successful FX funding activities throughout the year
- Focus on stable deposit growth
- Strong liquidity position with liquidity ratios above internal targets and regulatory requirements



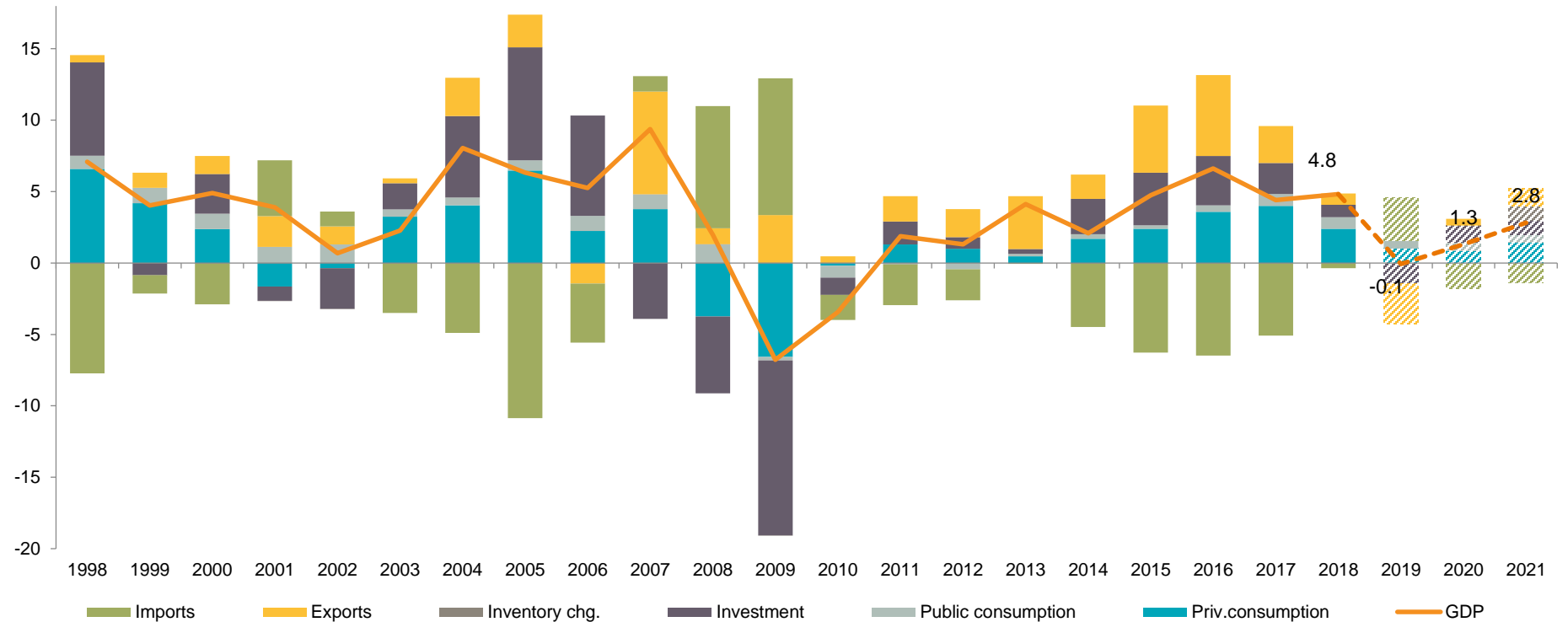
5. Annex – Icelandic economy update

Economic growth takes a breather in 2019

Economy more resilient to tourism setbacks in H1 2019 than many feared

- A long period of continuous upswing in the Icelandic economy appears to be at an end
- A similar growth rate in 2017 and 2018 masks significantly different growth drivers between 2017 and 2018
- Figures for H1/2019 indicate clearly that the economy is cooling. GDP growth measured 0.9% as 2.4% contraction in national expenditure was offset, however, albeit offset by an unusually favourable contribution from net trade
- The outlook is for GDP to contract by 0.1% in 2019. A sharp contraction in business investment and services exports counterbalances consumption growth, increasing investment in residential housing and infrastructure and a strong contraction in imports
- For 2020, ISB Research expects relatively slow growth of about 1.3%, driven by modest growth in domestic demand. GDP growth is then expected to pick up to about 2.8% in 2021, as private consumption and exports regain momentum

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



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

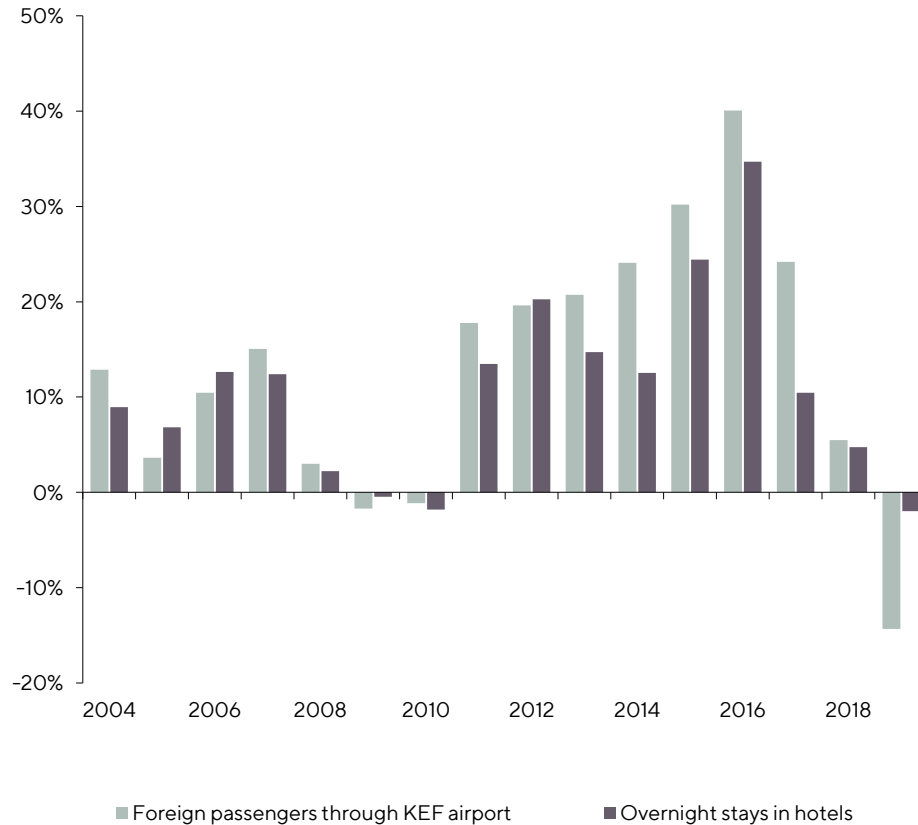


Tourism sector faces headwinds after rapid growth

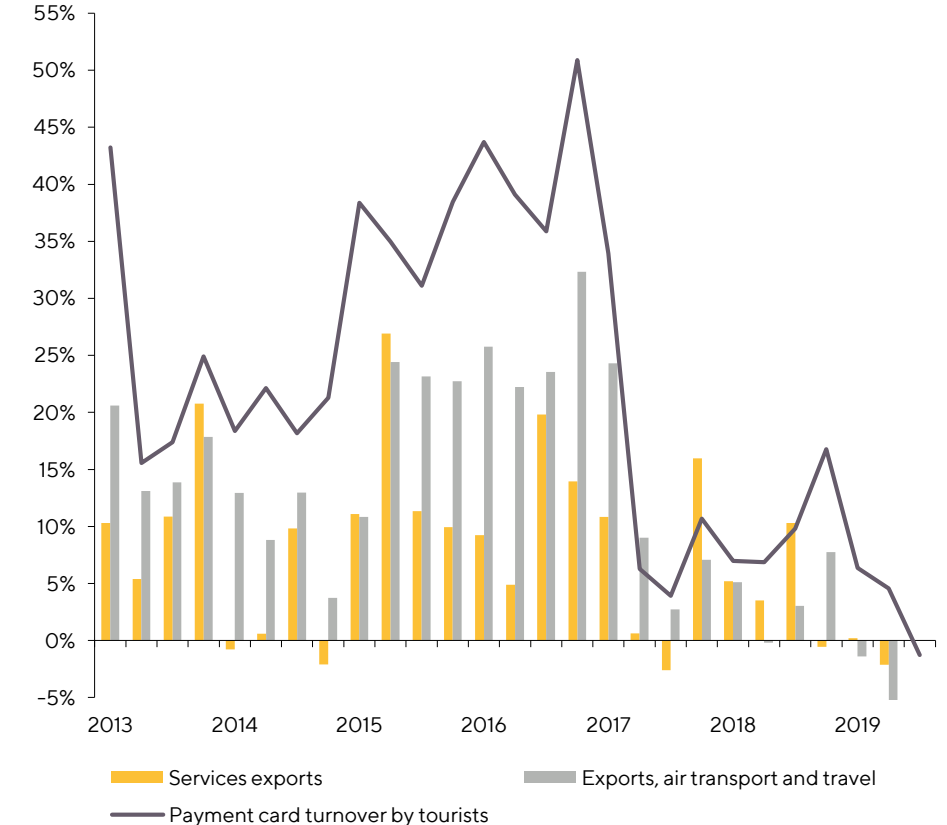
Largest export sector set to contract significantly in 2019 but more added value per head helps

- Following rapid expansion throughout most of the decade, the tourism sector has entered a phase of consolidation
- In the first nine months of 2019, tourist arrivals were down 14% year-on-year
- Tourist numbers had already begun to fall in Q1/2019 and the decline accelerated after WOW Air went out of business towards the end of March
- The outlook is for the number of passengers to decline by around 15% YoY in 2019. Still, the number of visitors will exceed all previous years except 2017 and 2018
- Spending per tourist is up, however, mitigating the impact of reduced visitor numbers. The average length of stay has increased, and payment card turnover figures suggest a steep rise in turnover per tourist in ISK terms
- Tourism is likely to return to moderate growth in the coming term as airlines gradually fill the supply gap left by Wow air and Icelandair's fleet becomes fully operational once more

Foreign visitors and overnight hotel stays YoY change (2019: Q1–Q3)



Services exports and foreign card turnover YoY change



Source: Statistics Iceland, Centre for Retail Studies and Icelandic Tourist Board

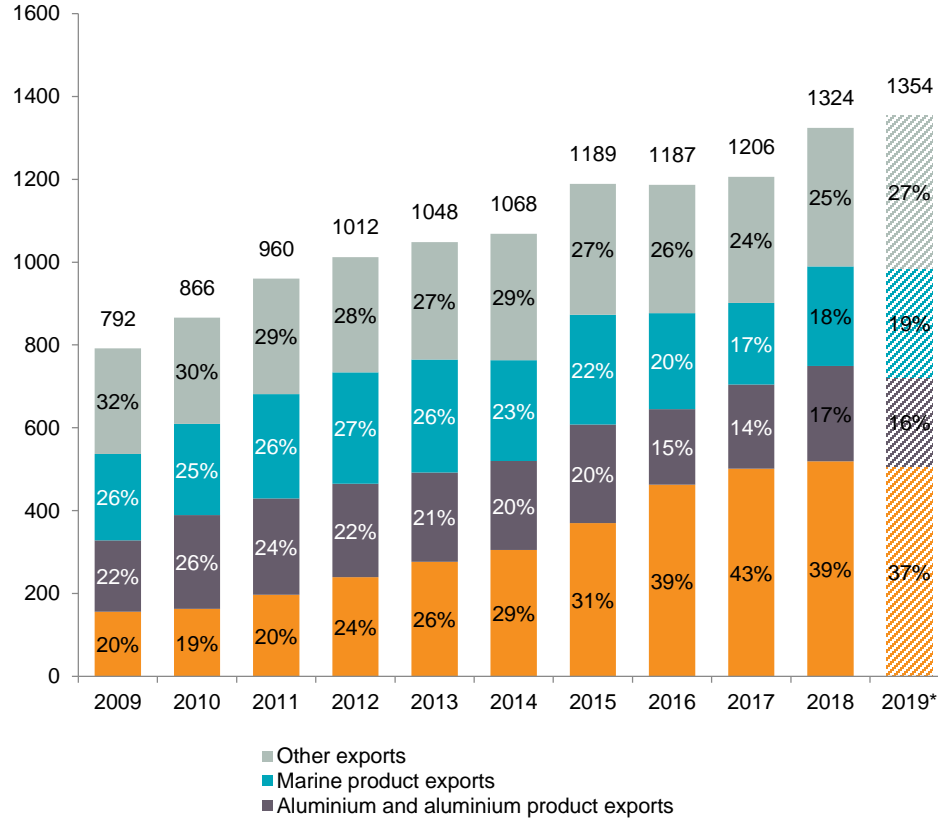


Current account outlook benign

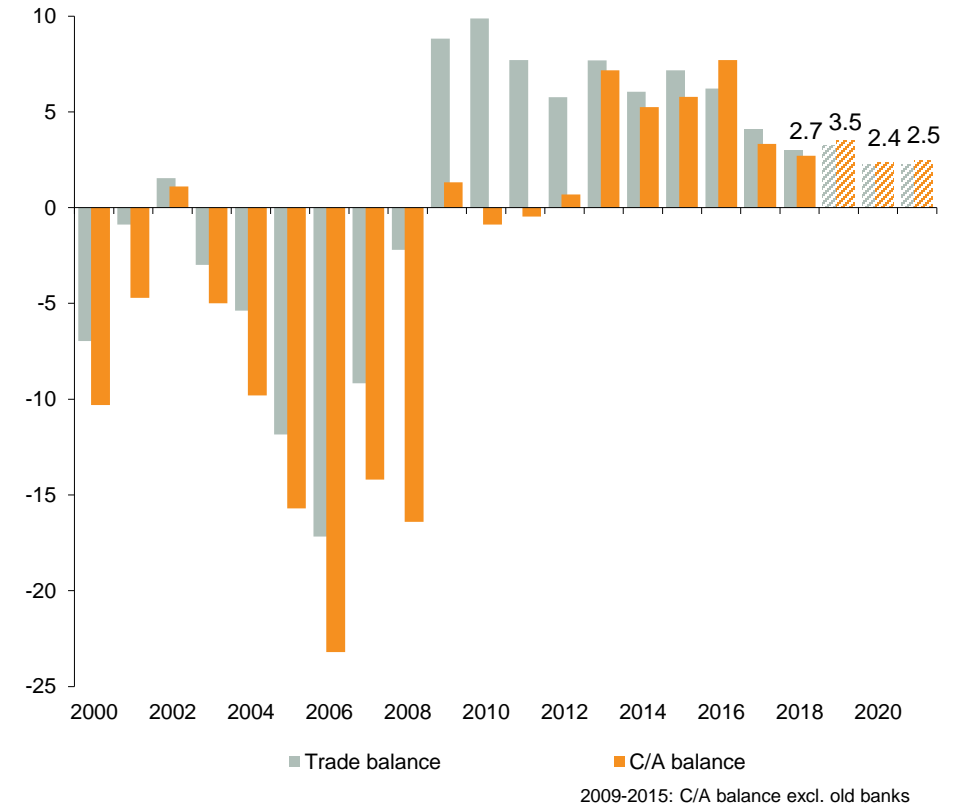
Strong net external position increases resilience

- The surplus on goods and services trade was sizeable in H1 2019, in spite of reduced tourist numbers and the failure of the capelin catch
- For 2019 as a whole, the outlook is for a marked contraction in both import and export volumes
- On the imports side, the contraction is due to reduced importation of investment and consumer goods, as well as a reduction in aircraft leasing expenses and other services imports
- On the exports side, a moderate contraction to goods exports adds to the impact of contraction in the tourist sector
- A current account surplus of 3.5% of GDP forecast for this year, followed by roughly 2.5% surplus in 2020 and 2021
- Iceland's net international investment position will remain positive, with external assets exceeding external liabilities by a full 1/5 of GDP as of end-June 2019

Export revenues ISK bn



Current account balance % of GDP



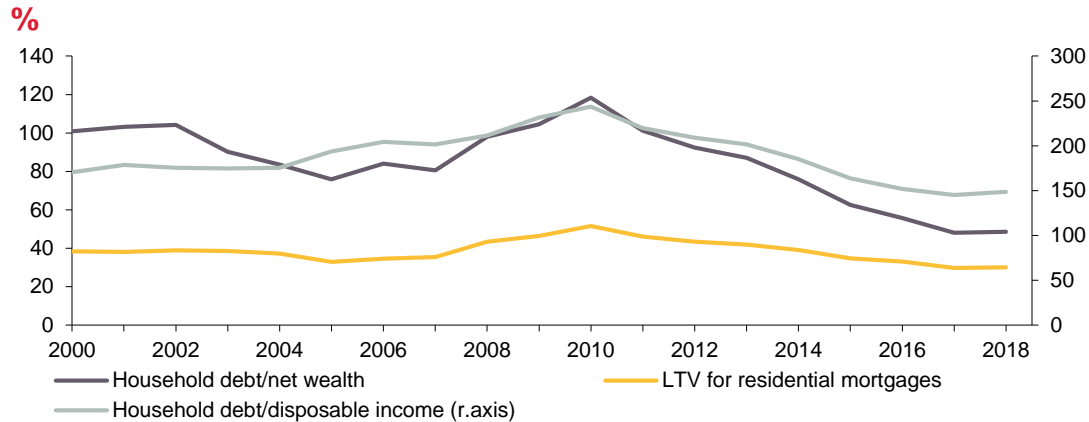
1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Central bank of Iceland, Statistics Iceland and ISB Research



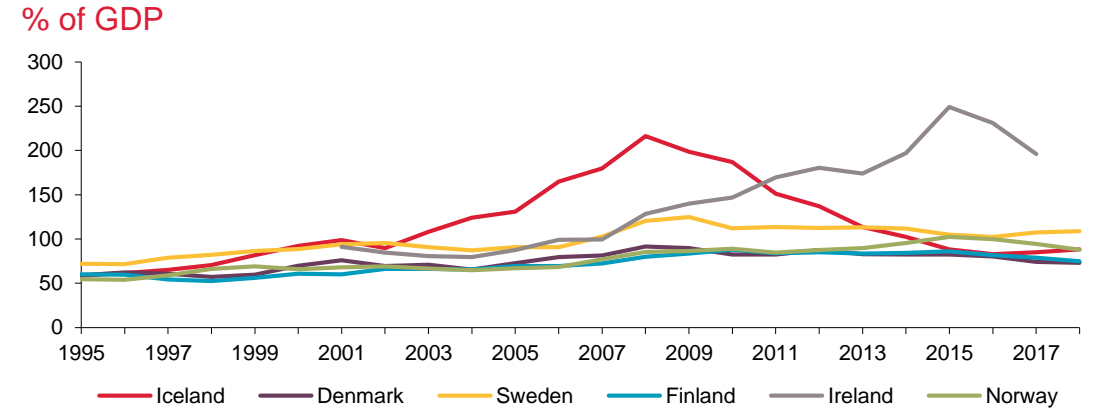
Domestic balance sheets strong overall

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

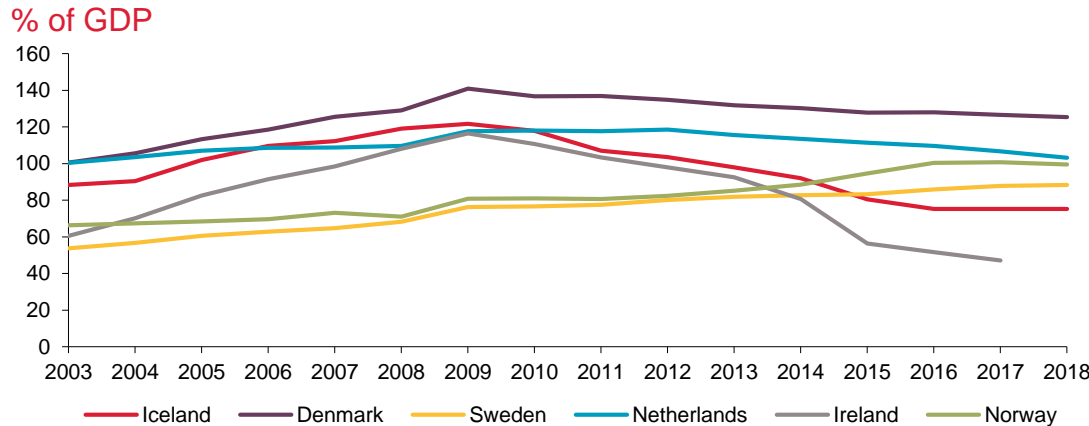
Household debt



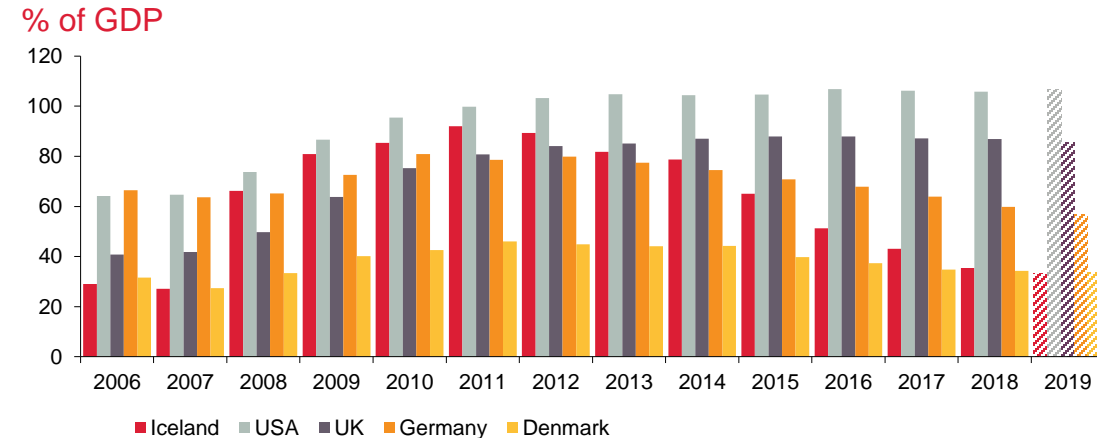
Corporate debt



Household debt



General government gross debt



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

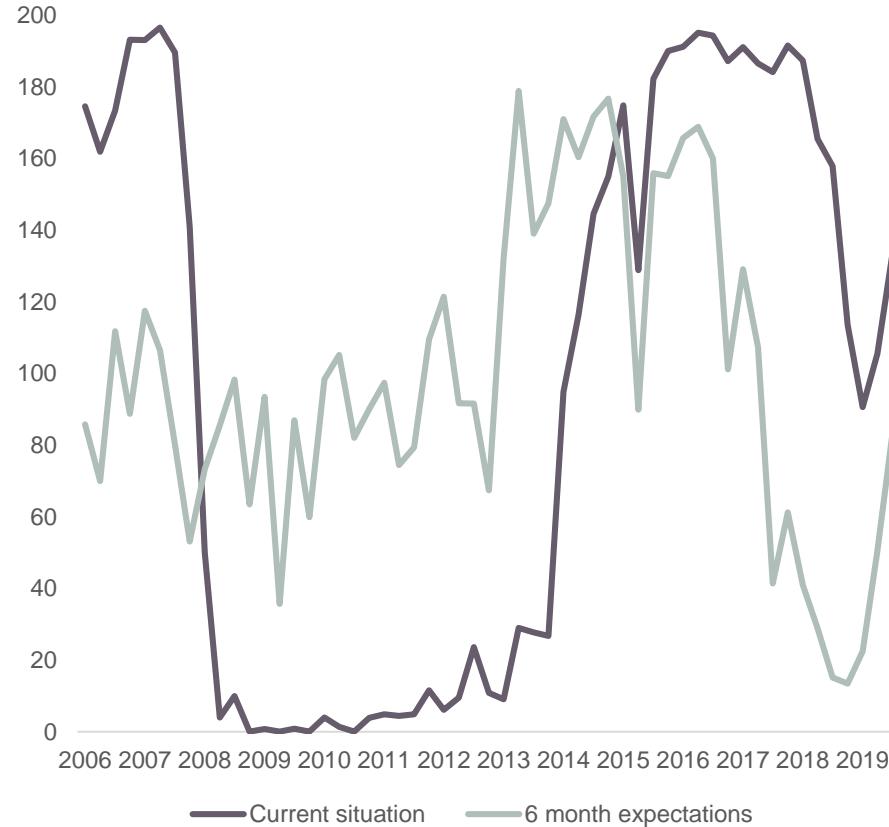


Businesses preparing for headwinds

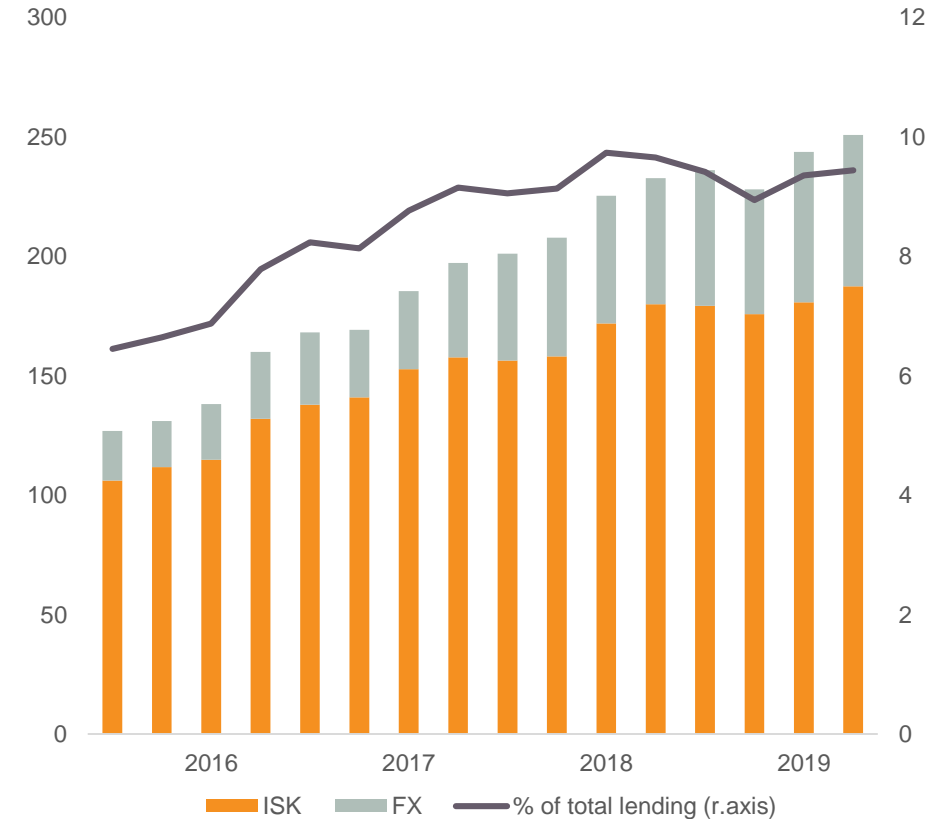
Lending growth to tourist sector in line with general lending growth

- Following 4 years of robust growth, business investment declined by 4% in 2018 and by 26.5% in H1 2019
- For 2019 as a whole, the outlook is for 16.5% contraction in business investment. In particular, investment in transport equipment and hotels will contract significantly
- After reaching a nadir in early 2019, business sentiment has been improving again as the economy has showed resilience to the tourist sector shock
- Investment in the tourist sector has slowed and lending into the sector has moderated. The share of the tourist sector in total lending seems to have stabilized
- Business investment expected to pick up moderately in the coming year with the pace of growth quickening in 2021
- Investment level to remain robust, at around 22% of GDP in coming years

Business sentiment, 400 largest companies Index



Deposit money banks' lending to tourist sector ISK bn



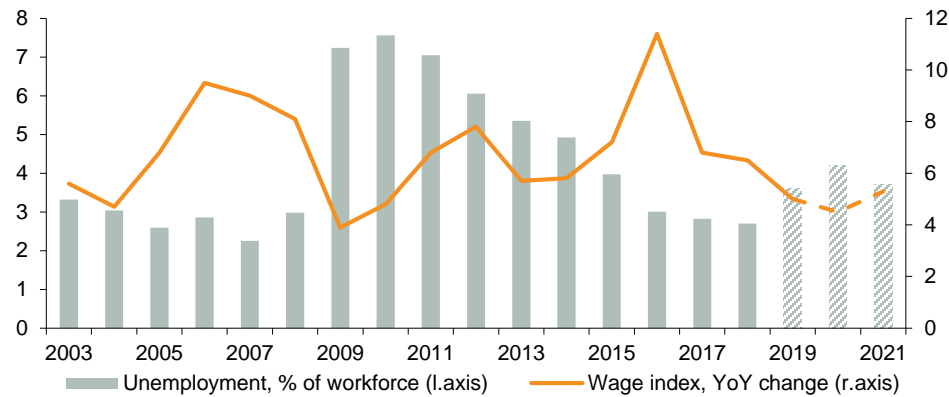
Source: Statistic Iceland, the Central Bank of Iceland and Gallup

Household consumption growth tapers off

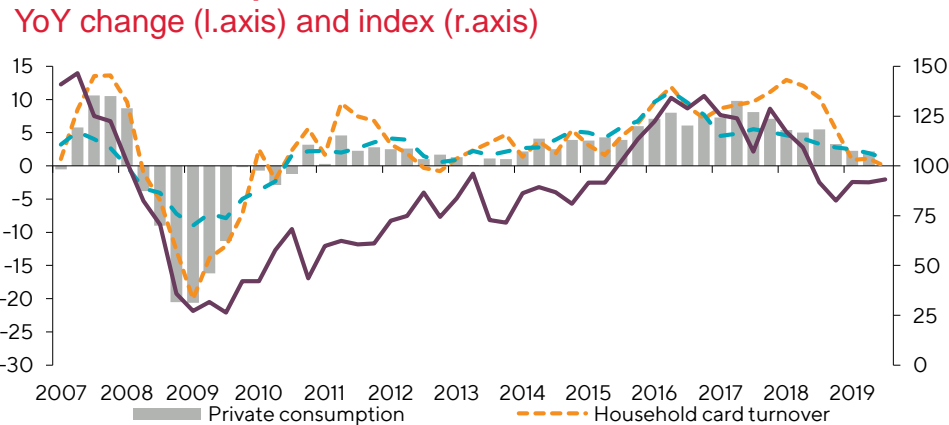
Labour market cooling and real wage growth moderating

- After peaking at 9.8% in Q2 2017, private consumption growth has eased in the recent term. In Q2/2019, it measured 2.2%, the slowest in five years
- Developments in key indicators suggest a further slowdown ahead. Both real wage growth and payment card turnover growth have eased, and households' expectations are more muted
- Tension in the labour market peaked in 2016-2018. In 2016, the wage index rose 11.4%, and in 2018 unemployment bottomed out at 2.7%. By now, however, the tension in the market has already begun to ease
- We also expect real wage growth to be considerably weaker than in the recent past
- Icelandic households have responded to slower real wage growth and darkening outlook by consolidating instead of taking on additional debt to finance spending
- Private consumption growth was 4.7% in 2019. ISB Research forecasts private consumption growth at 2.0% in 2019, 1.7% in 2020, and 2.8% in 2021

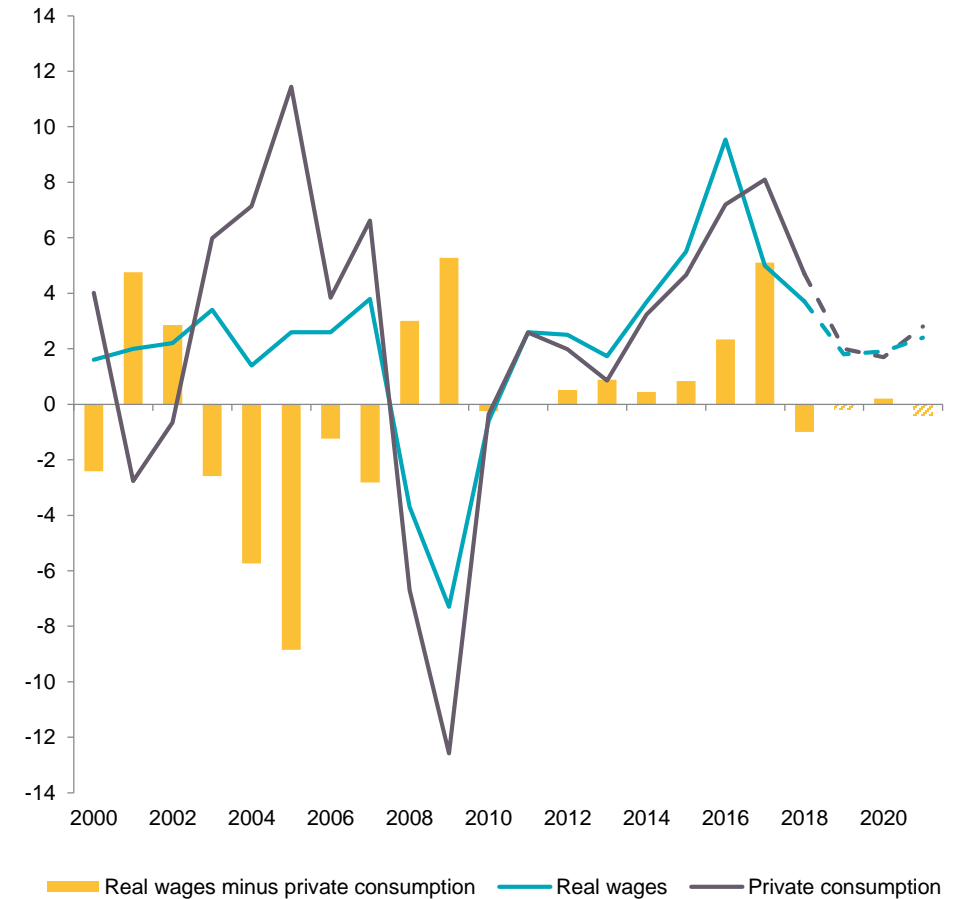
Unemployment and wage growth



Private consumption and related indicators



Real wages and private consumption



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

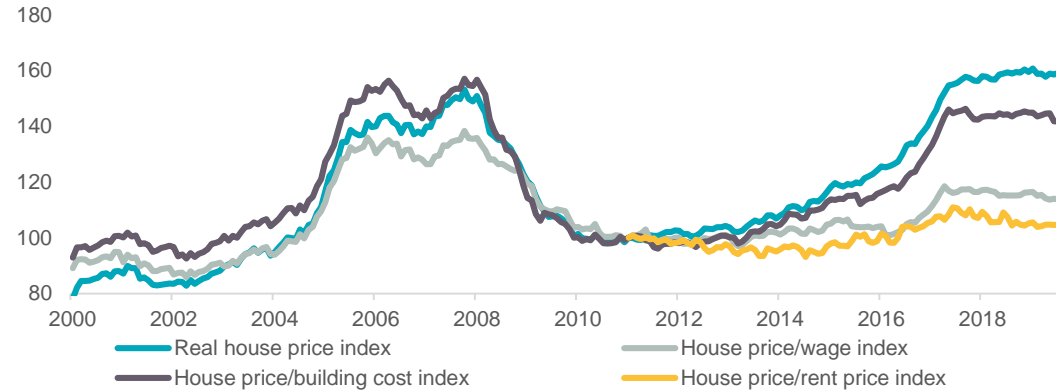


Real estate market approaching balance

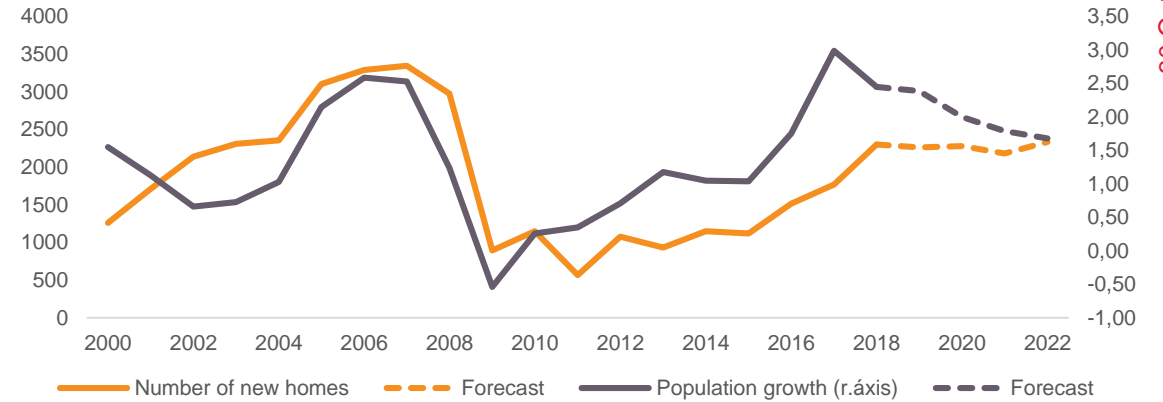
Supply is increasing, demand has been easing and the pace of residential price rises is moderating

Residential capital region house prices and determinants

Indices



New apartments and population increase in the capital region¹

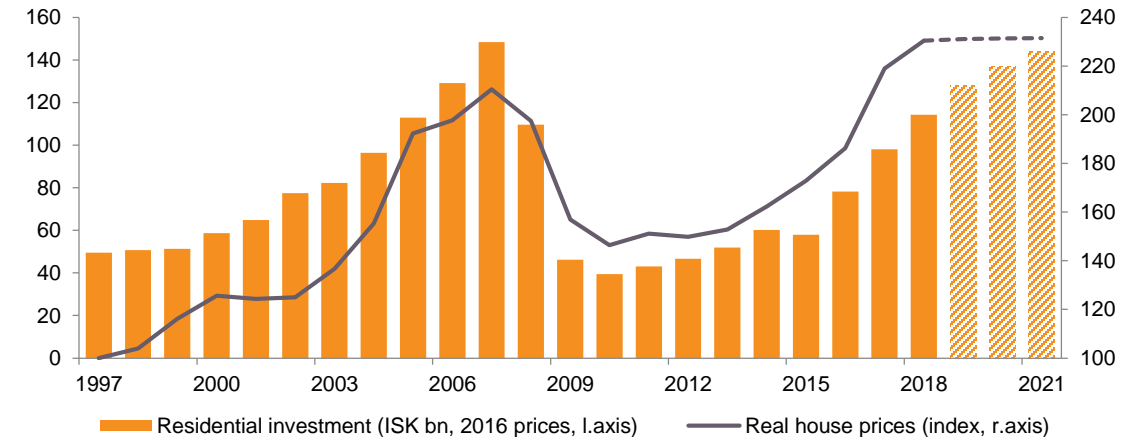


Commercial real estate real price and turnover index

1995=100



House prices and residential investment



1. Dotted lines: forecasts by Statistics Iceland and the Federation of Icelandic Industry
Source: Statistic Iceland and ISB Research

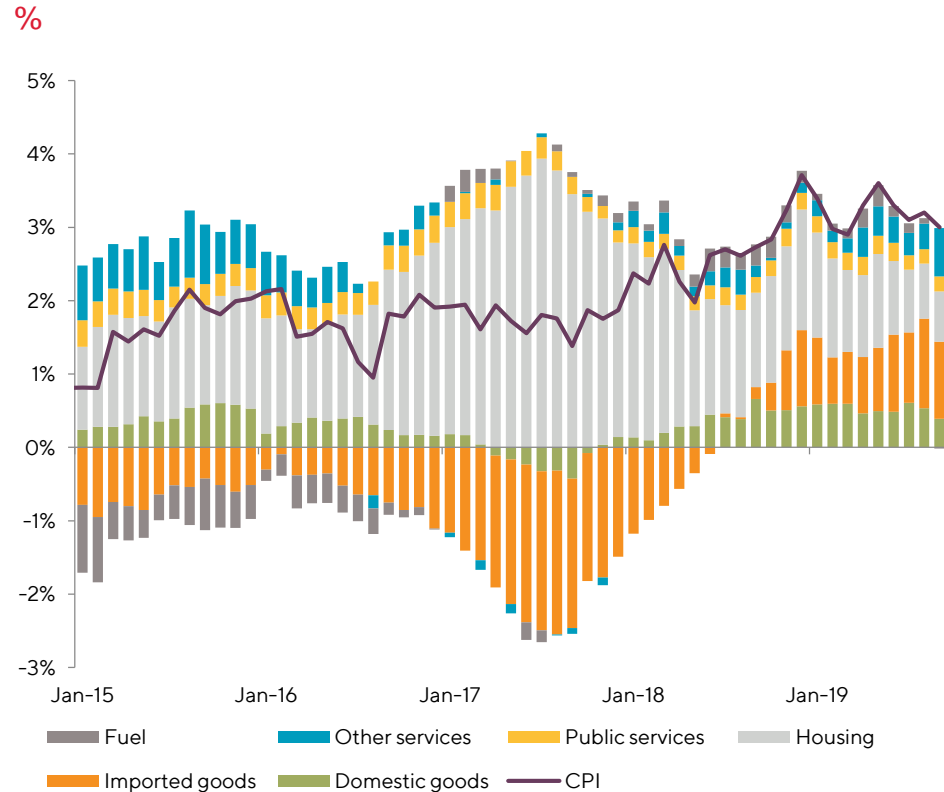


Inflation approaching target following a mild spike

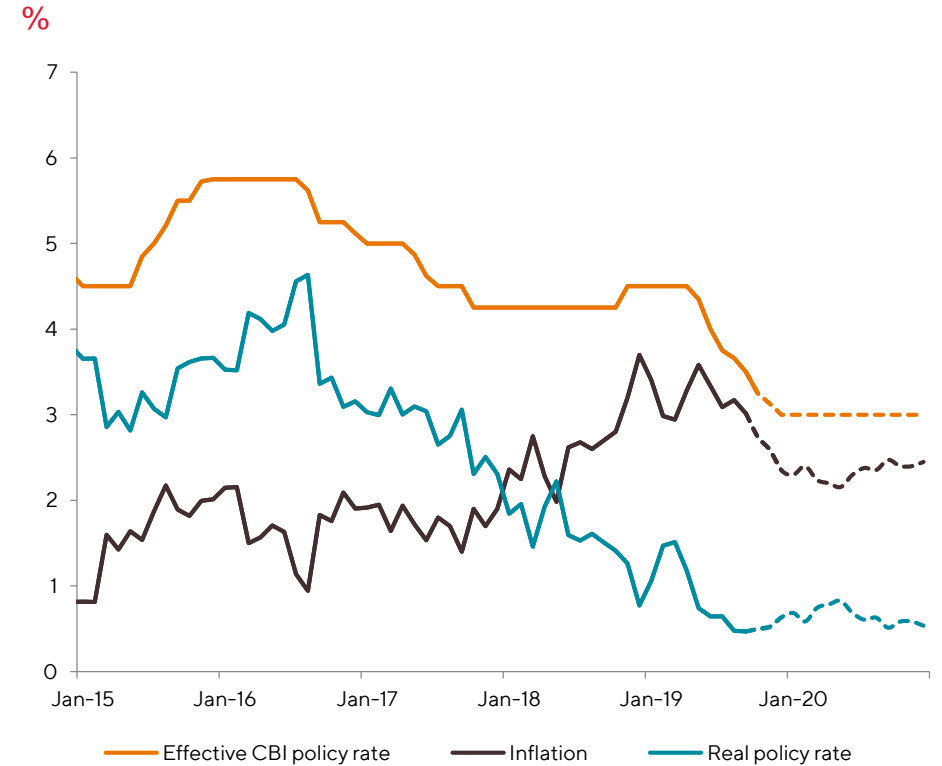
Policy rate becoming more accommodative as economy cool

- Inflation has begun to taper off again, after a relatively short-lived spike last winter. At year-end 2018, it measured 3.7%, the highest in five years
- By the end of Q3 2019, inflation had fallen to 3.0% as the pass-through from ISK depreciation in late 2018 subsided
- The outlook is for inflation to reach the Central Bank's 2.5% target by year – end, and stay close to target in 2020-2021
- A stable ISK, relatively modest short-term wage hikes in recent wage agreements and slower housing price rises all contribute to a benign inflation outlook
- The Central Bank of Iceland's policy rate is currently 3.25%, following rate cuts totalling 1.25% in 2019
- Re-anchoring of inflation expectations, a slowdown in domestic demand and improving inflation outlook facilitate a looser monetary policy in the near term
- Policy rate assumed to be lowered to 3.0% before end-2019, then hold at that rate throughout 2020

Inflation and contribution of main subitems



Inflation, policy rate and real policy rate



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

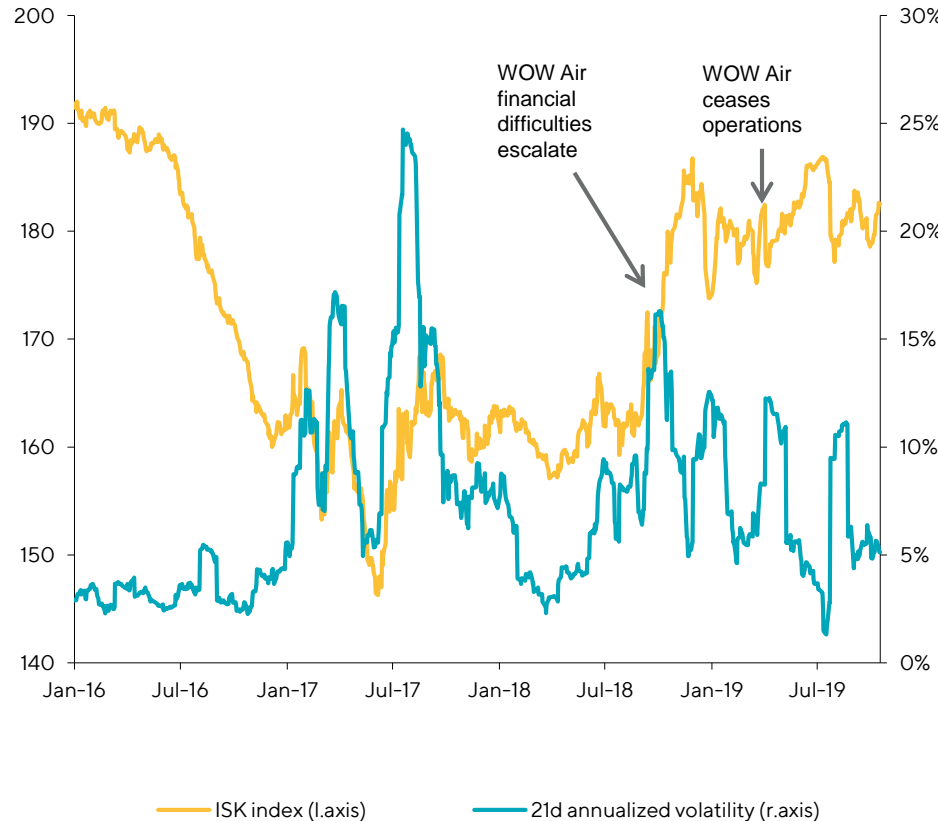


ISK seems to be close to equilibrium

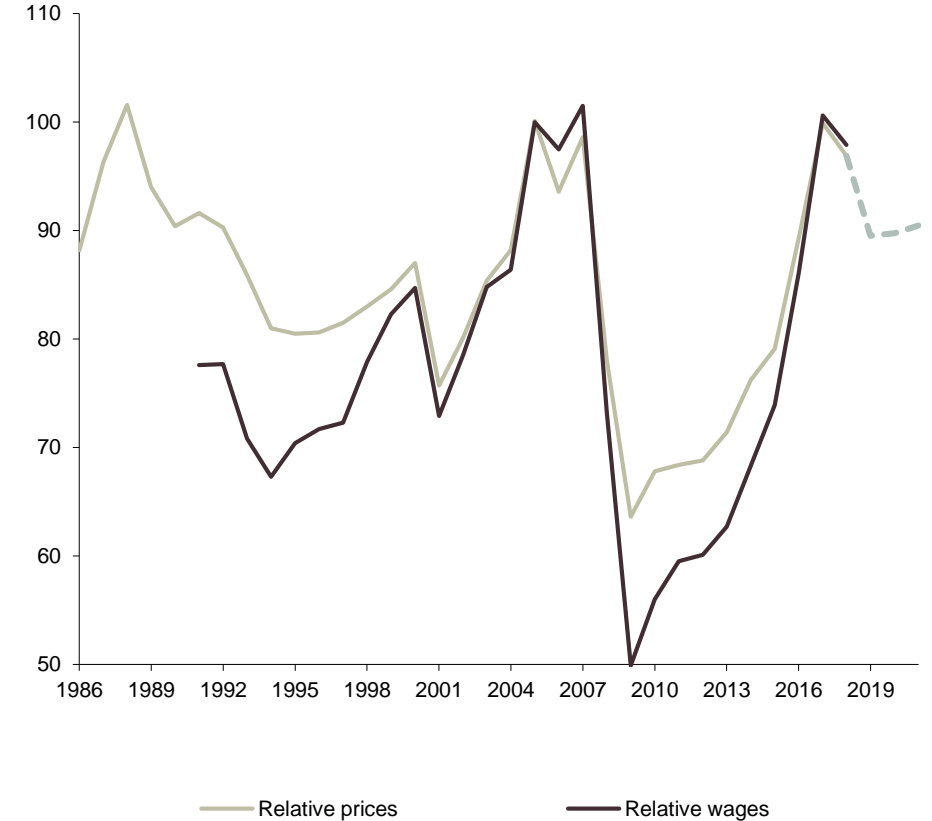
Real exchange rate likely to remain relatively high in the near term

- The ISK depreciated by 9% in H2/2018, concurrent with the deterioration in the outlook for Iceland's key export sectors.
- In 2019 to date, however, it has held steady within a relatively narrow band
- Export sectors have welcomed the depreciation, as it makes manufacturing sectors' more competitive and makes Icelandic prices more tolerable for foreign tourists
- The current real exchange rate, while somewhat over its historical average, seems to reflect a real exchange rate consistent with a balanced eternal trade
- The uncertainty for the ISK FX rate for the near term is broadly symmetrical. A relatively high real exchange rate is supported by the vast improvement in Iceland's net external position, a combination of ample FX reserves and modest short-term external debt, favourable outlook for the current account and robust medium-term economic prospects

ISK exchange rate, daily values and volatility



Real exchange rate indices



1. Dotted lines indicate ISB Research forecasts

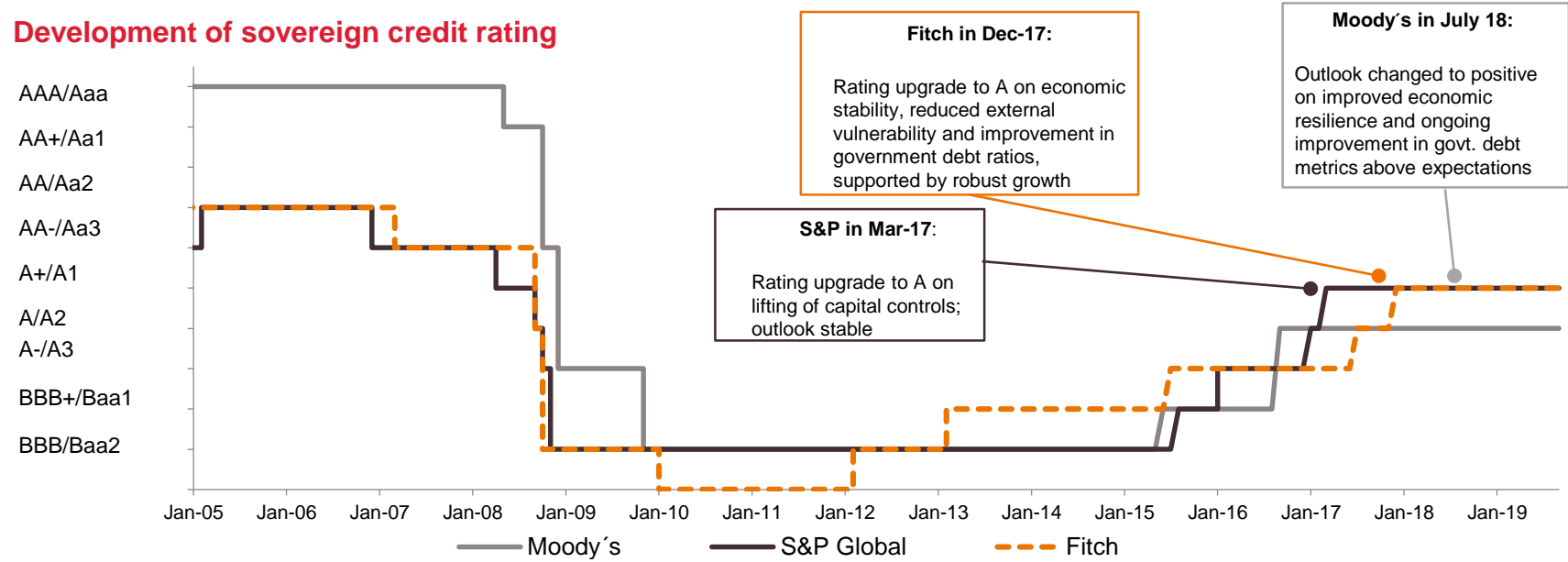
Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research



Iceland's credit rating has remained stable

Setbacks in the tourist sector has not affected the sovereign ratings

Development of sovereign credit rating



MOODY'S IN JULY 2018

- The positive outlook also reflects progress made in the past two years on the major preconditions we laid out at the time of the upgrade to A3 in September 2016, including the smooth removal of capital controls and the settlement of the offshore krónur situation

FITCH IN MAY 2019

- Short-term rating upgraded to F1+
- The A rating balances the economy's high income per capita, strong performance on governance, human development and doing business indicators against its high commodity export dependence, vulnerability to external shocks and experience of macroeconomic and financial volatility

S&P IN MAY 2019

- S&P Global Ratings affirmed its 'A/A-1' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Iceland. The outlook is stable.
- The stable outlook reflects strong fiscal and external buffers, mitigated by risks stemming from the volatility of Iceland's small open economy and a potentially abrupt slowdown in tourism

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



Forward looking statements

All information contained in this presentation should be regarded as preliminary and based on company data available. Due care and attention has been used in the preparation of forecast information. However, actual results may vary from their forecasts, and any variation may be materially positive or negative. Forecasts, by their very nature, are subject to uncertainty and contingencies, many of which are outside the control of Íslandsbanki.

Íslandsbanki cannot guarantee that the information contained herein is without fault or entirely accurate. The information in this material is based on sources that Íslandsbanki believes to be reliable. Íslandsbanki can however not guarantee that all information is correct. Furthermore, information and opinions may change without notice. Íslandsbanki is under no obligation to make amendments or changes to this publication if errors are found or opinions or information change. Íslandsbanki accepts no responsibility for the accuracy of its sources.

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The forward-looking statements represent Íslandsbanki's current expectations, plans or forecasts of its future results and revenues and beliefs held by the company at the time of publication. These statements are not guarantees of future results or performance and involve certain risks, uncertainties and assumptions that are difficult to predict and are often beyond Íslandsbanki's control. Actual outcomes and results may differ materially from those expressed in, or implied by, any of these forward-looking statements.

Forward-looking statements speak only as of the date they are made, and Íslandsbanki undertakes no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made.

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