



# 2019 Financial Results



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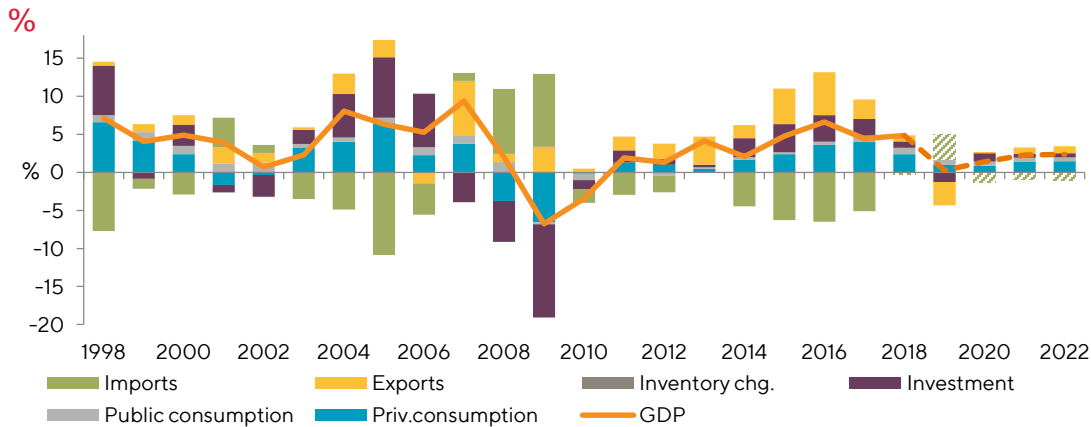
# 1. 2019 highlights



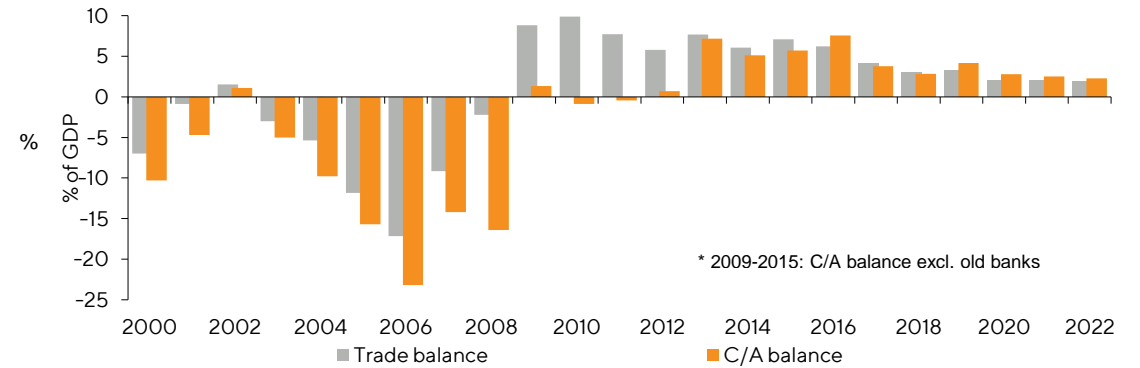
# Gradual economic recovery ahead in the new decade

## Economic highlights

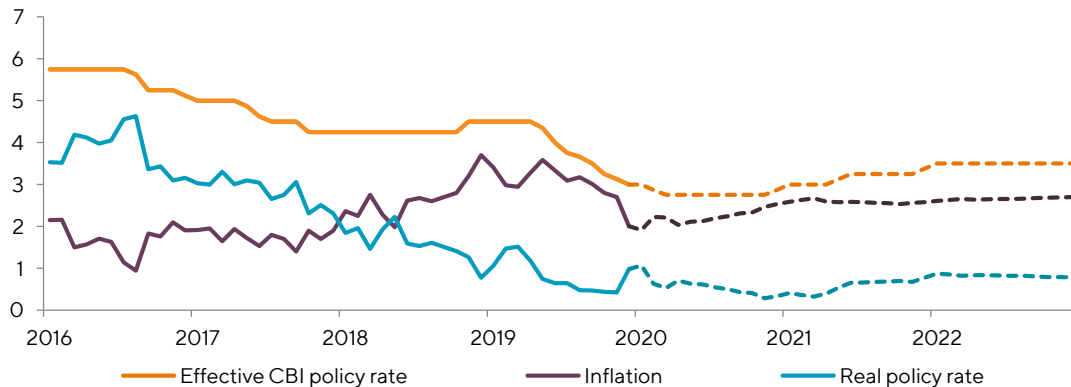
### Gradual economic recovery after a setback in exports...



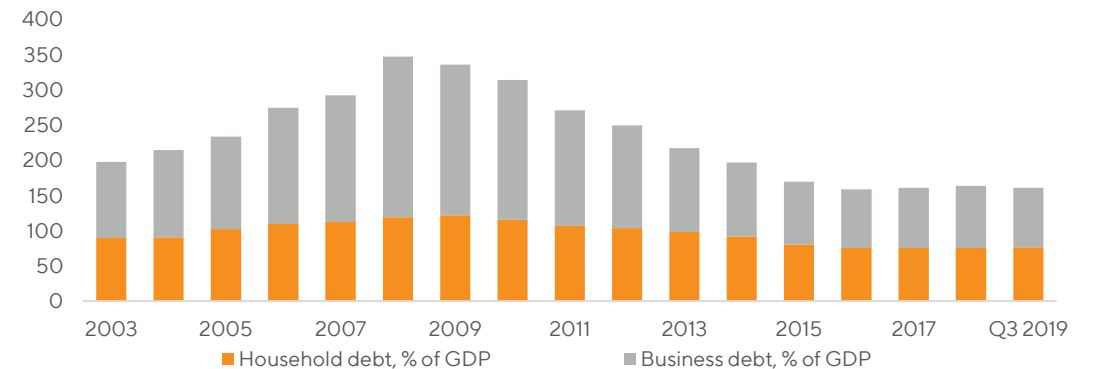
### ...although foreign trade remains in positive territory.



### Growing economic slack and lower inflation has been met by rate cuts...



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



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



# This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

## Vision and Values

Vision to be  
**#1 for service**



Passion



Professionalism



Collaboration

## Key Figures 2019

ROE (Regular operations)<sup>2</sup> **6.6%**

Cost to income ratio **62.4%**

Total Capital Ratio **22.4%**

Total Assets **ISK 1,199bn**

## The Bank

FTEs  
**749**

Parent company  
year-end 2019



**14 Branches**



ergo



## Market share<sup>1</sup>

**32%**

Personal banking

**35%**

Business banking

**34%**

Corporate and  
investment banking

## Sustainability



Environment

**1.62 CO<sub>2</sub>tn**  
Carbon emission per employee



Social

**1.14%**  
Gender pay gap



Governance

**67%**  
of women chairing  
committees at board level

## Ratings and certifications

**S&P Global**

Ratings

**BBB+/A-2**

Negative outlook



EQUAL PAY  
CERTIFICATE  
2018 - 2021



EXEMPLARY IN  
CORPORATE GOVERNANCE

## Digital milestones in 2019



**97%** of all customer visits are digital



Digital onboarding in Personal Banking



**New unified** banking app



Automated credit scoring for individuals



**25m customer** visits via app during 2019



Simplified customer experience



**12m visits** to updated Íslandsbanki web



Open banking foundations in place

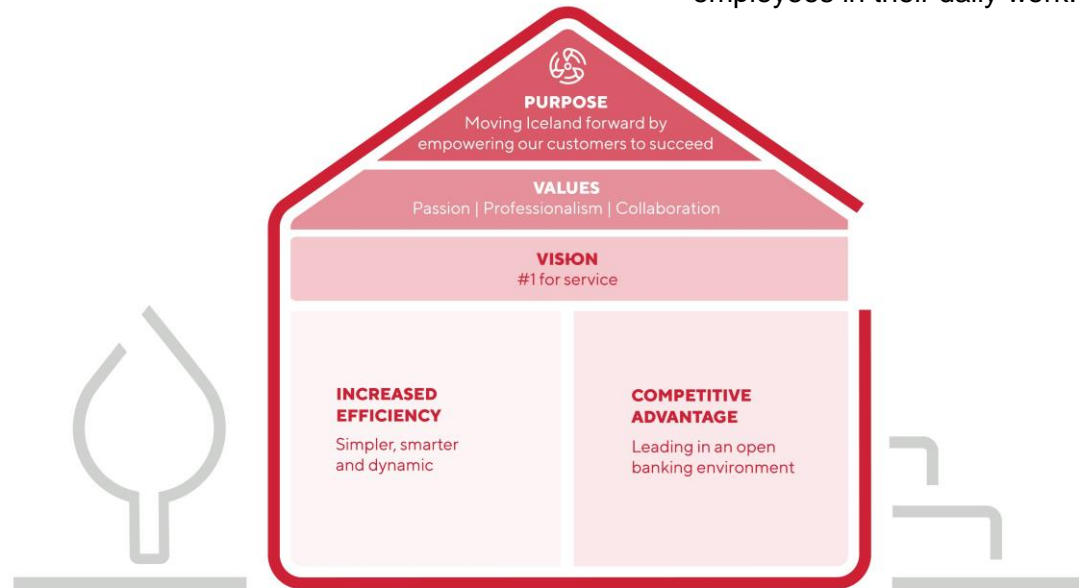
1. Based on Gallup surveys regarding primary bank

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



# From a strategy pyramid to strategy house

- The Bank’s reviewed strategy replaces the pyramid with a strategy house.
- The Bank’s new collective purpose has now been defined as “moving Iceland forward by empowering our customers to succeed.”
- New corporate values have been selected, which form the core of the Bank’s culture and shape employees’ conduct and attitudes: **passion, professionalism, and collaboration.**
- On the Bank’s strategic summit in March 2019, employees voted to retain the same vision for Íslandsbanki — **to be #1 for service** —this is the vision that guides employees in their daily work.



## Strategic themes

Íslandsbanki defined 7 themes over five years, which will support the Bank’s objectives related to its reviewed strategy.

All of the strategic themes are aimed at increased efficiency and improved competitive advantage. Four of them were prioritised:



**Service:**  
What and how?

Increased differentiation and to ensure targeted and streamlined service offering



**Optimised pricing**

Offering the right products and services at the right price.



**Simpler and smarter**

Enhance efficiency, expedite decision-making, simplify processes and organisational structure

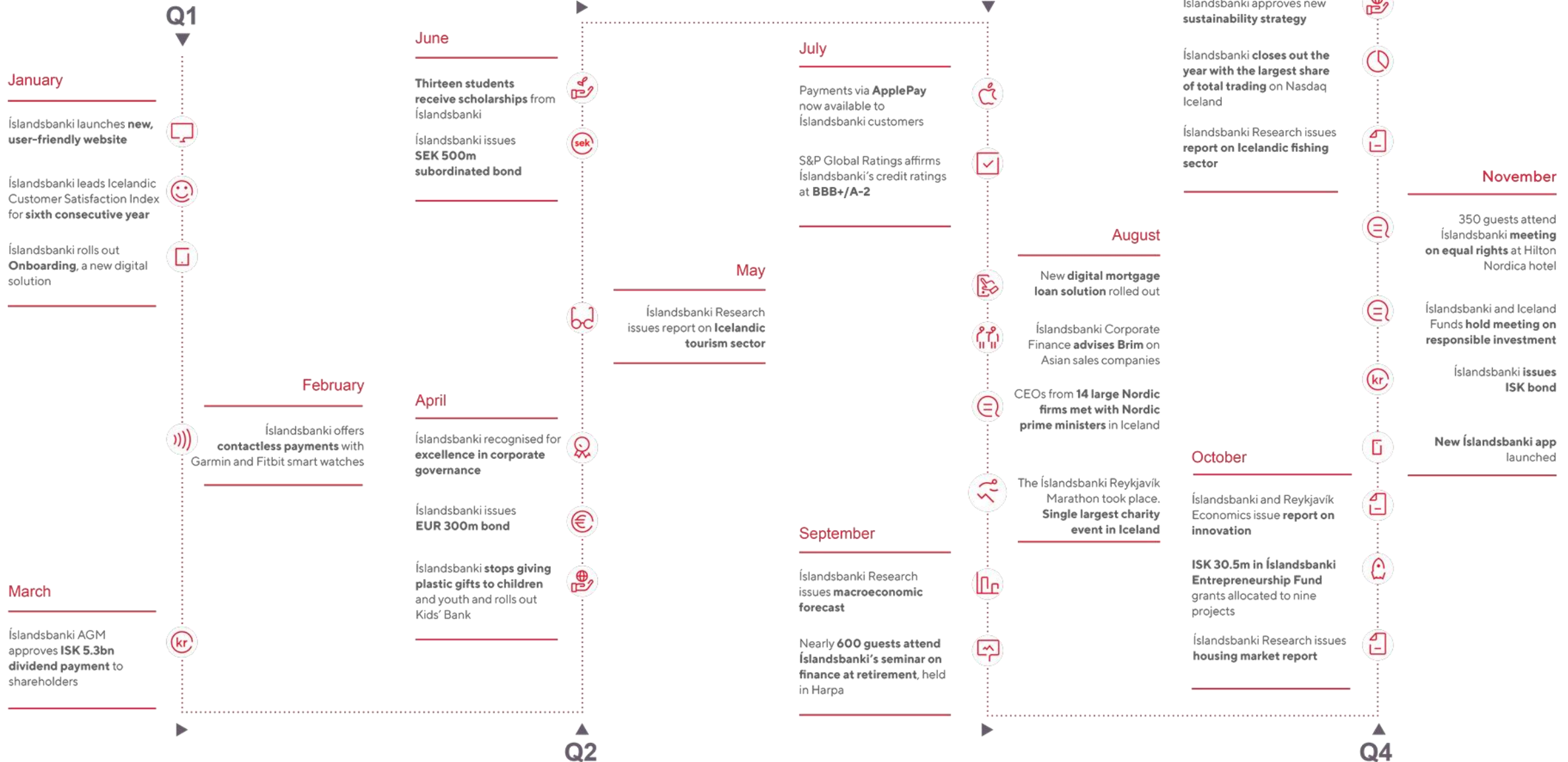


**Digital champions**

Improve processes related to product management and digital development



# 2019 Operational highlights





# Digital investments deliver higher service level

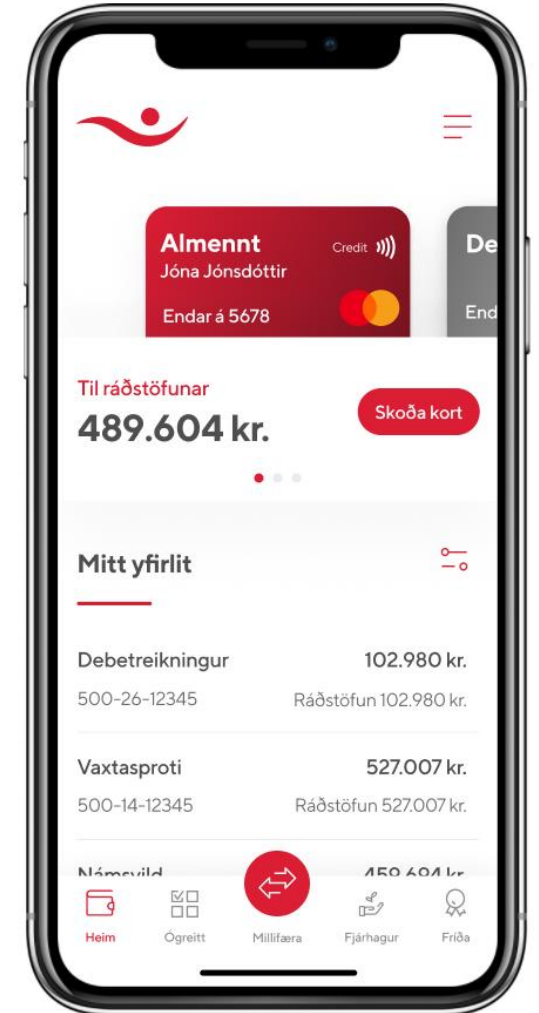
The customer journey is transforming to personalized digital services

New digital solutions in 2019 bring Íslandsbanki to the forefront of digital services in Iceland<sup>1</sup>

- Digital onboarding launched
- Fully digital and automatic credit score evaluation and mortgage application/refinancing. Securites trading signup in the pipeline
- New and unified Íslandsbanki app launched in November 2019
- Unsecured funding under ISK 2m fully digital
- Open banking initiatives, e.g. developer sandbox

## Customers continue to engage via digital solutions

- 99% of customer interaction is now via digital channels
- 57% of new account openings are now via the digital onboarding solution
- Thereof is ~80% via app, where 1 out of 2 customers are 90 day active
- 56% of limit changes were executed via app in 2019
- 84% increase in transactions via app in 2019
- 130% increase in bills paid via app in 2019



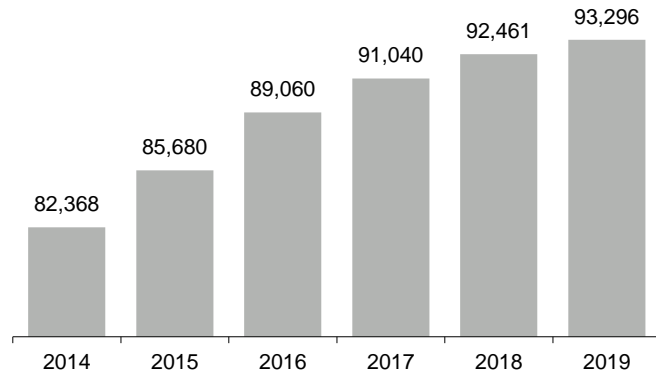
1. Finalta by McKinsey: Digital & Multichannel Banking Benchmark Study 2019



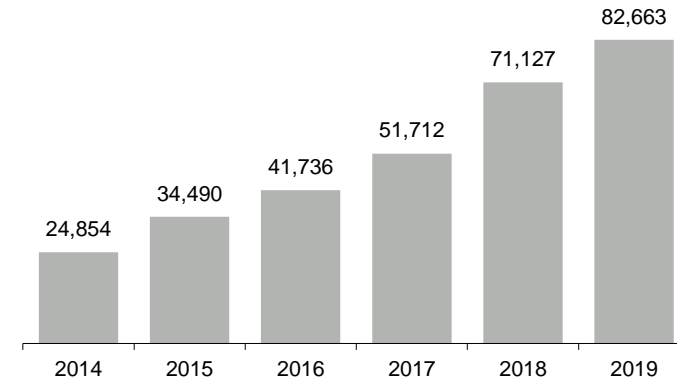


# Digital solutions are simplifying the customer journeys

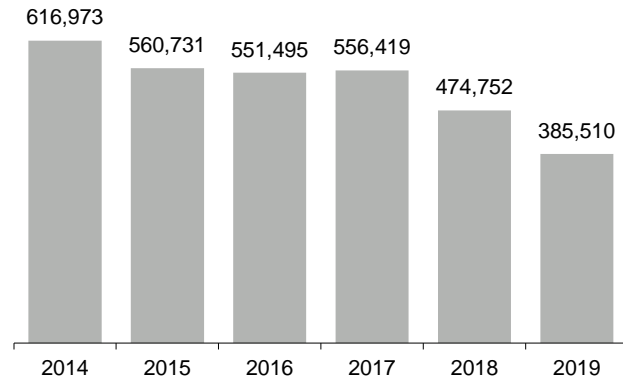
90 days active in the online bank



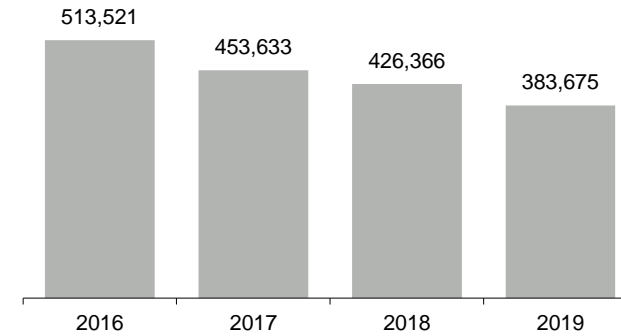
90 days active in the mobile app



Total number of calls to the call center



Total number of branch visits





# Íslandsbanki as a responsible and positive force in society

New sustainability policy outlines the Bank's priorities in this area



The Bank's 2019 Annual and sustainability report uses the Nasdaq ESG and GRI criteria

## „Get our house in order using ESG“

- Environment
- Social
- Governance

## „Integrate the business with sustainability“

- Responsible lending
- Responsible investing
- Responsible purchasing
- Support to innovation and SDGs

## „Align with and support international goals“



## „Contribute to and learn from others“<sup>1</sup>



1. Iceland Funds, which is owned 100% by Íslandsbanki is a member of PRI



# Overview

## Key figures & ratios

		2019	2018	2017	2016	2015
<b>PROFITABILITY</b>						
	ROE 16% CET1 (regular operations) <sup>1</sup>	6.6%	8.0%	9.9%	10.3%	11.9%
	ROE (after tax)	4.8%	6.1%	7.5%	10.2%	10.8%
	Net interest margin (of total assets)	2.8%	2.9%	2.9%	3.1%	2.9%
	Cost to income ratio <sup>2</sup>	62.4%	66.3%	62.5%	56.9%	56.2%
	After tax profit, ISKm	8,454	10,645	13,226	20,158	20,578
	Earnings from regular operations, ISKm <sup>3</sup>	10,539	12,042	13,848	15,138	16,198
		<b>31.12.2019</b>	31.12.2018	31.12.2017	31.12.2016	31.12.2015
<b>BALANCE SHEET</b>						
	Total assets, ISKm	1,199,490	1,130,403	1,035,822	1,047,554	1,045,769
	Loans to customers, ISKm	899,632	846,599	755,175	687,840	665,711
	Deposits from customers, ISKm	618,313	578,959	567,029	594,187	593,245
	Customer loans to customer deposits ratio	145.5%	146.2%	133.2%	115.8%	112.2%
<b>CAPITAL</b>						
	Total equity, ISKm	180,062	176,313	181,045	178,925	202,227
	Tier 1 capital ratio	19.9%	20.3%	22.6%	24.9%	28.3%
	Total capital ratio	22.4%	22.2%	24.1%	25.2%	30.1%
	Leverage ratio	14.2%	14.6%	16.2%	16.0%	18.1%

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.



## 2. Income statement



# Income statement

## Negative net impairments main cause for lower profits between years

ISKm	2019	2018	Δ	4Q19	4Q18
Net interest income	33,676	31,937	1,739	8,486	8,294
Net fee and commission income	13,359	12,227	1,132	3,646	3,478
Net financial expense	(817)	(962)	145	(840)	(637)
Net foreign exchange gain	143	1	142	97	76
Other operating income	2,134	1,784	350	917	120
<b>Total operating income</b>	<b>48,495</b>	<b>44,987</b>	<b>3,508</b>	<b>12,306</b>	<b>11,331</b>
Salaries and related expenses	(16,279)	(15,500)	(779)	(4,196)	(4,047)
Other operating expenses	(11,828)	(12,150)	322	(3,130)	(3,418)
<b>Administrative expenses</b>	<b>(28,107)</b>	<b>(27,650)</b>	<b>(457)</b>	<b>(7,326)</b>	<b>(7,465)</b>
Contribution to the Depositor's and Investors' Guarantee Fund	(936)	(1,173)	237	(216)	(299)
Bank tax	(3,528)	(3,281)	(247)	(814)	(740)
<b>Total operating expenses</b>	<b>(32,571)</b>	<b>(32,104)</b>	<b>(467)</b>	<b>(8,356)</b>	<b>(8,504)</b>
<b>Profit before net impairment on financial assets</b>	<b>15,924</b>	<b>12,883</b>	<b>3,041</b>	<b>3,950</b>	<b>2,827</b>
Net impairment on financial assets	(3,663)	1,584	(5,247)	(1,585)	(297)
<b>Profit before tax</b>	<b>12,261</b>	<b>14,467</b>	<b>(2,206)</b>	<b>2,365</b>	<b>2,530</b>
Income tax expense	(3,682)	(4,734)	1,052	(611)	(1,118)
<b>Profit for the year from continuing operations</b>	<b>8,579</b>	<b>9,733</b>	<b>(1,154)</b>	<b>1,754</b>	<b>1,412</b>
Discontinued operations, net of income tax	(125)	912	(1,037)	(95)	(8)
<b>Profit for the year</b>	<b>8,454</b>	<b>10,645</b>	<b>(2,191)</b>	<b>1,659</b>	<b>1,404</b>

## Highlights

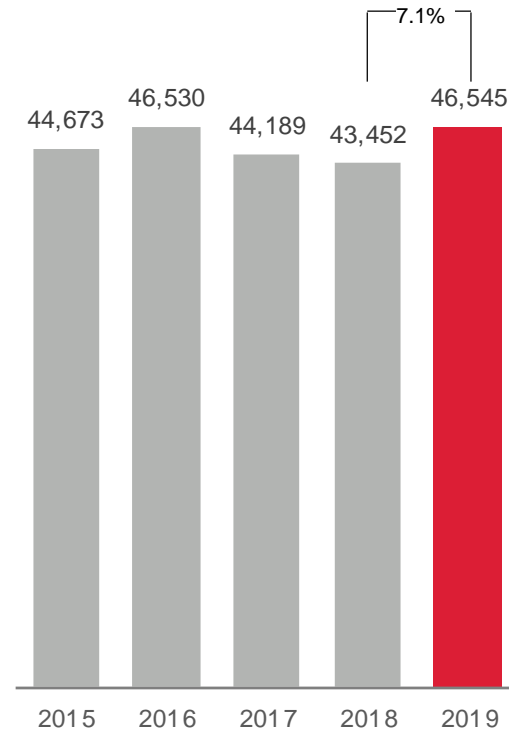
- Total income amounted to ISK 48.5bn in 2019, an increase of 7.8% between years as a result of strong growth in interest and fee income
- Continued loan growth contributes to higher net interest income
- Overall net fee income showed a 9.3% increase year on year
- Other operating income is ISK 2.1bn as a result of one-off items relating to settlement of a claim relating to the acquisition of Byr and a release of a provision related to deposit insurance
- Administrative expenses increase by 1.7% which can be attributed to employment terminations and higher depreciations due to heavy investment in the core banking system
- Profit for the year is ISK 8.5bn, a decrease of 19.8% from 2018
  - Largely caused by negative net impairment of ISK 3.7bn compared to positive impairment of ISK 1.6bn in 2018.
  - Cost of risk of about 42bp, which was broadly in line with expectations for the year and therefore satisfactory in light of the economic slowdown



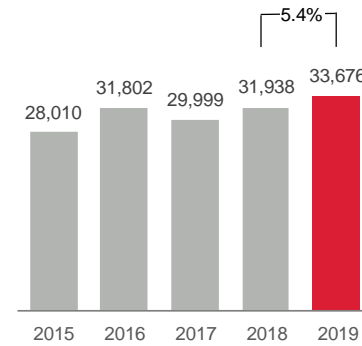
# Operating income

Strong growth in both interest and fee income

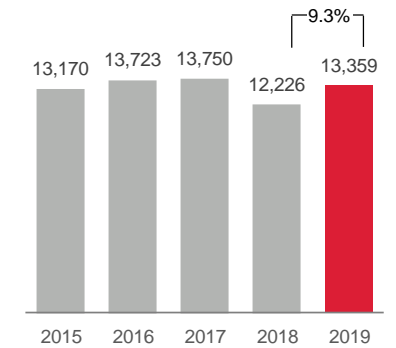
**Total operating income<sup>1</sup>**  
ISKm



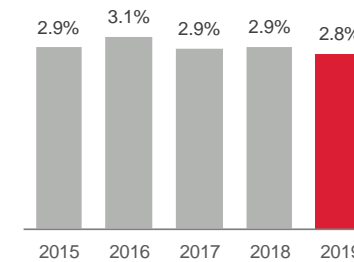
**Net interest income**  
ISKm



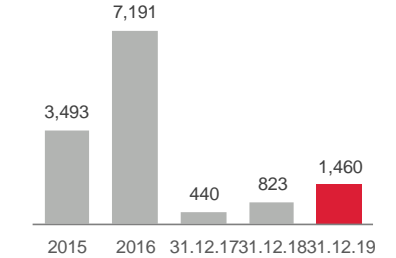
**Net fee and commission income**  
ISKm



**Net interest margin**  
%



**Other net operating income**  
ISKm



1. Excluding one-off income



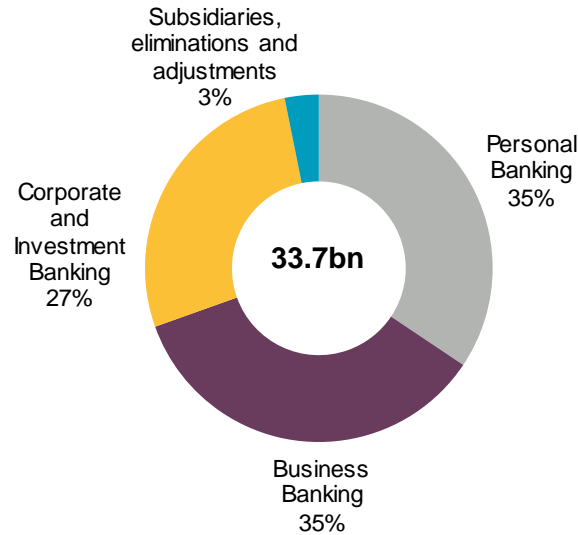
# Solid rise in NII and NFCI income

Well diversified income structure between business units

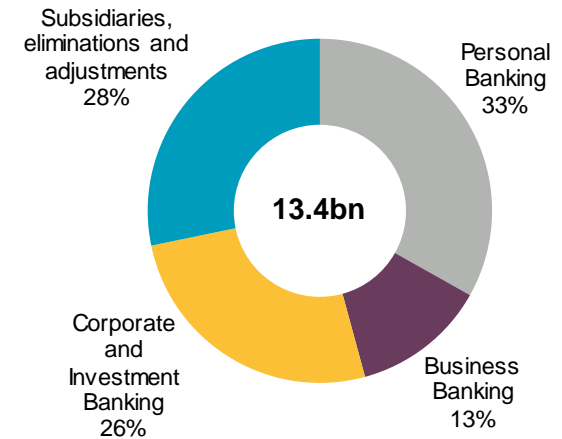
## Highlights

- Net interest income grew by 5.4% between years and the net interest margin was 2.8% compared to 2.9% in 2018
- 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 grew by 9.3% between years
- A modest growth of 2.8% in NFCI in the parent company was supported by strong growth in the three main subsidiaries of the Bank

**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%

## Resilient ROE from regular operations

ISKm	2019	2018	Δ	4Q19	4Q18	Δ
Reported after tax profit	8,454	10,645	(2,191)	1,659	1,404	255
One-off revenue	(1,950)	(2,546)	596	(847)	-	(847)
One-off costs	-	-	-	-	-	-
Bank tax	3,528	3,281	247	814	740	74
Tax impact of adjustments	507	662	(155)	220	-	220
Earnings from regular operations <sup>1</sup>	10,539	12,042	(1,503)	1,846	2,144	(298)
ROE 16% CET1 (regular operations) <sup>2</sup>	6.6%	8.0%		4.6%	5.3%	
ROA from regular operations (after tax)	0.9%	1.1%		0.6%	0.7%	
Net interest margin adj. 16% CET1	2.7%	2.7%		2.7%	2.7%	
Cost / income ratio adj. 16% CET1	64.9%	66.4%		67.2%	70.7%	

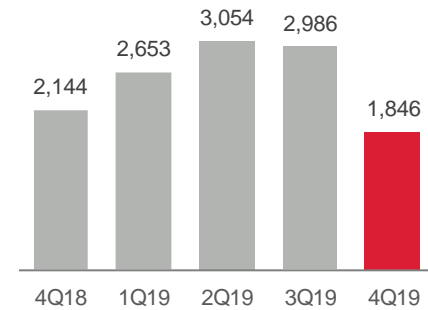
## One off items 2019

- 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
- ISK 847m release of a provision from 2010 related to deposit insurance
- According to a new legislation in December 2019, the Bank tax will be lowered in steps over the coming years from 0.376% to 0.145%. The Bank tax is considered to be one-off cost in 2019, in line with representation in the quarterly accounts. From 2020 onwards, the Bank will however focus on the overall earnings, while showing the impact of the Bank tax in excess of the long term rate

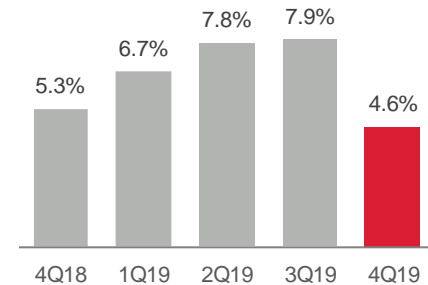
## Highlights

- The Bank set its targets for 2019 based on earnings from regular operations as presented here
- Going forward the Bank will focus more on the overall return on equity, as one-off items are having less of an impact and the Bank is close to its long term capitalization targets, although there are still some possibilities for capital optimization through issuance of AT1 bonds
- Earnings in 4Q2019 were impacted by relatively high impairment charge, redundancy payments and additional IT related write-offs
- Profitability of regular operations reduced between years, mainly due to impairments moving from a positive ISK 1.6bn to negative 3.7bn in 2019

## Earnings from regular operations ISKm



## ROE reg. operations CET1 16% %



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 normalized CET1 of 16%, adjusted for risk free interest on excess capital.

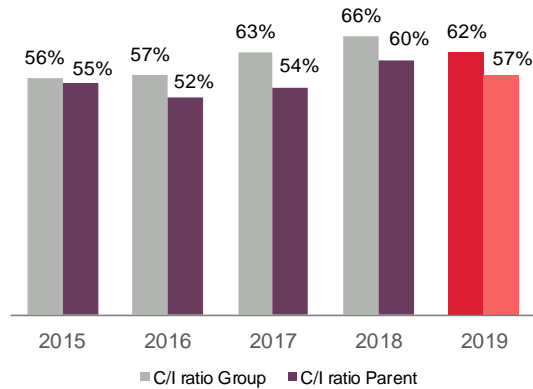




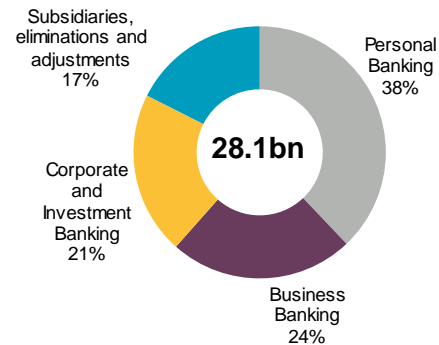
# Administrative expenses

## Decrease in cost to income ratio between years

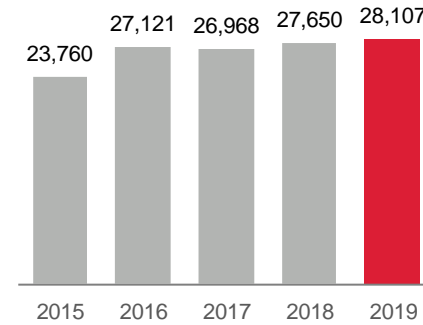
### Efficiency – Cost to income ratio<sup>1</sup>



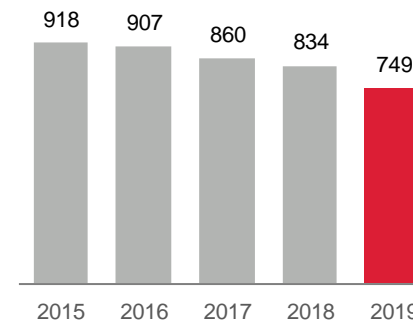
### Administrative expenses Split by division



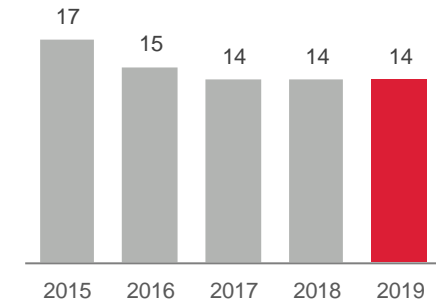
### Administrative expenses ISKm



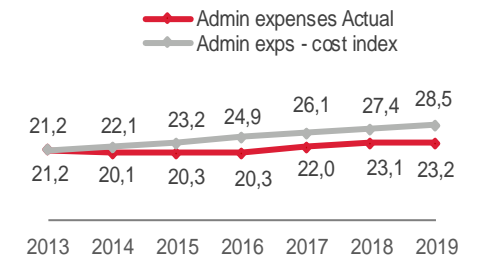
### Period end FTE numbers<sup>2</sup> Parent company



### Branch network



### Annualised admin. exp. vs cost index<sup>3</sup> ISKbn. excl. one-off cost. parent company



1. The cost-to-income ratio excludes bank tax and one-off 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 6.1% up from year-end 2018

Assets, ISKm	31.12.2019	31.12.2018	Δ
Cash and balances with Central Bank	146,638	135,056	11,582
Loans to credit institutions	54,376	41,577	12,799
Bonds and debt instruments	52,870	69,415	(16,545)
Derivatives	5,621	4,550	1,071
Loans to customers	899,632	846,599	53,033
Shares and equity instruments	18,426	13,074	5,352
Investment in associates	746	682	64
Property and equipment	9,168	5,271	3,897
Intangible assets	4,330	5,002	(672)
Other assets	7,683	9,177	(1,494)
<b>Total Assets</b>	<b>1,199,490</b>	<b>1,130,403</b>	<b>69,087</b>

## Highlights

### Liquid assets

- The Bank increased its cash level with the Central Bank by ISK 11.6bn from year-end 2018
- Three line items – cash and balances with the Central Bank, loans to credit institutions and bonds and debt instruments – amount to about ISK 254bn of which ISK 223bn are liquid assets

### Loans to customers

- Net increase in loan portfolio amounted to ISK 53.0bn since year-end 2018, an increase of 6.3%

### Shares and equity instruments

- Increase in shares and equities mainly due to an increase in equity forwards
- 9.6bn are open unhedged exposure to equities

### 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

### Asset encumbrance

- The Bank's asset encumbrance ratio was 18.1% at end of 2019 compared to 18.0% at end of 2018



# Loans to customers grew by 6.3% in 2019

New lending amounted to ISK 226bn in 2019 compared with ISK 239bn in 2018

## Highlights

- In addition to new lending of ISK 226bn, loans amounting to ISK 106bn were refinanced during the year
- Outstanding loans that are refinanced within the Bank are shown both as an increase and a decrease in the net carrying amount
- New lending to individuals was ISK 73bn and new lending to companies was ISK 153bn
- The mortgage portfolio increased by 12.9% while the total loan portfolio of Personal Banking increased by 10.0% (ISK 30bn) which is the largest growth of the business units
- The loan portfolio of Business Banking rose by 5.1% (ISK 11 bn) and Corporate & Inv. Banking by 3.7% (ISK 12bn)

Main sources of changes in net carrying amount  
ISK bn, consolidated



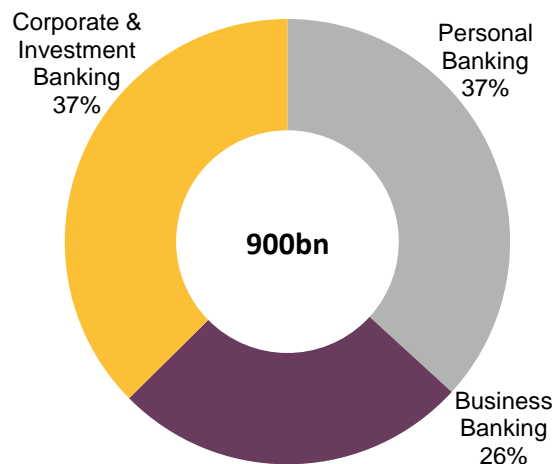


# Diversified loan portfolio

## Exposure to tourism reduced in 2019

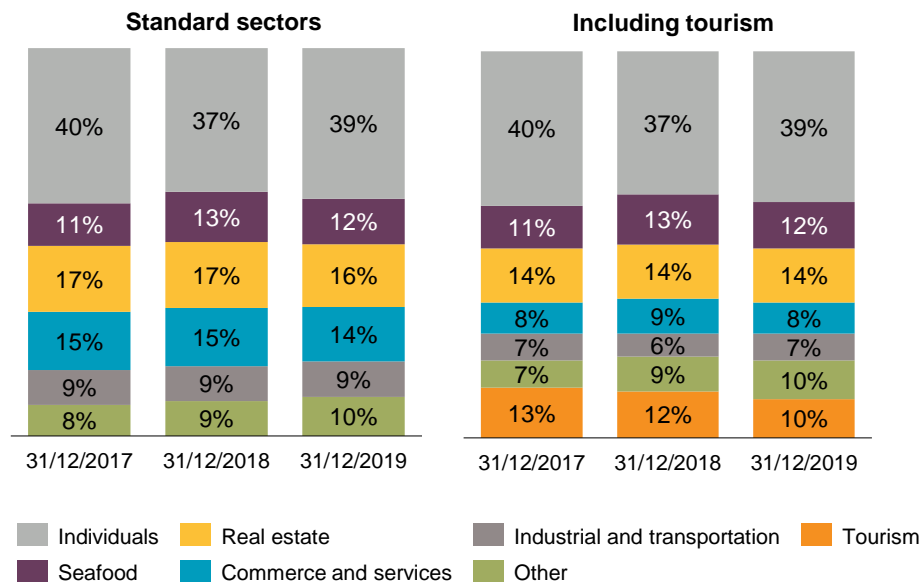
### Loans to customers by business divisions

31.12.2019, consolidated



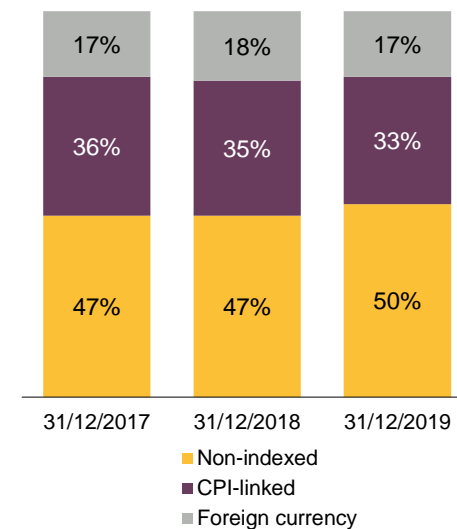
### Loans to customers

By sector, consolidated



### Loans to customers

% of loans by currency type, consolidated



### Highlights

- The loan portfolio is evenly spread out by the three business divisions
- The sector-split is shown both with tourism activities in its relevant sectors and with tourism as a separate quasi-sector
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism
- The ratio of non-indexed loans has increased in 2019
- The Bank had no large exposures at year-end 2019 (exposures exceeding 10% of capital)



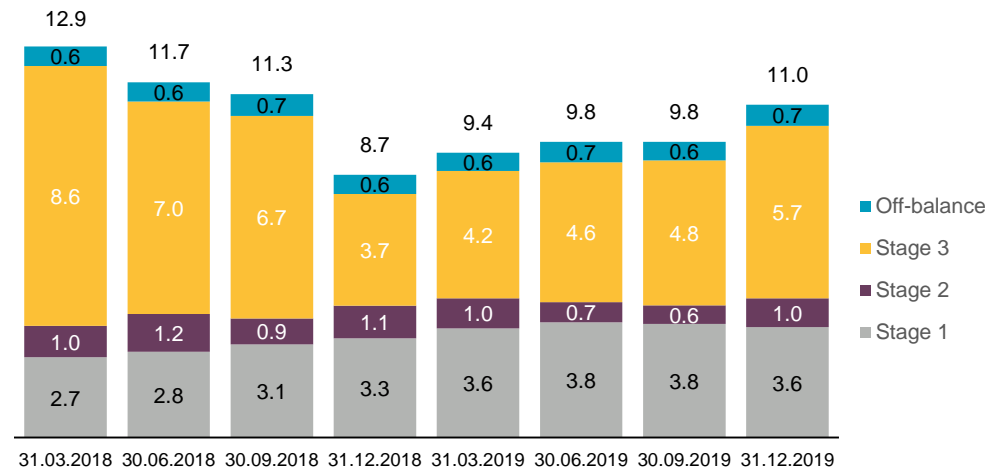
# Sound asset quality

## Modest increase in NPL's in a challenging environment

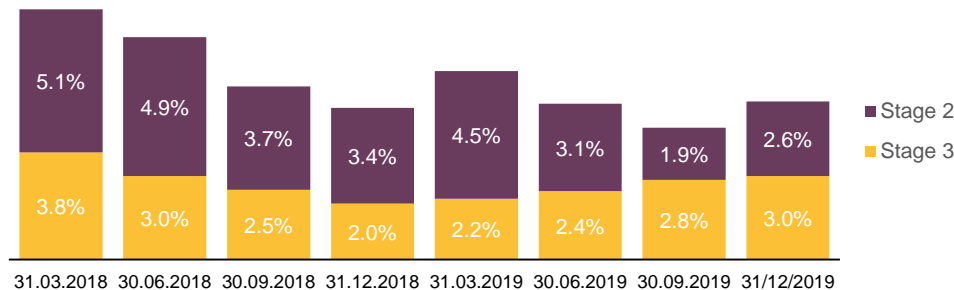
### Highlights

- In 2019, the impairment allowance increased due to less favourable economic environment, additionally in Q4 there was an unfavourable ruling in a long-standing court case
- 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 economic uncertainty will lead to an increase in the impairment allowance
- The gross carrying amount of loans in Stage 2 decreased in 2019, in part due to deterioration of credit quality to Stage 3 that in turn increased from ISK 17bn (2.0%) to 27bn (3.0%)
- 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 2.4% at the end of Q4 2019, compared to 2.9% average for European banks<sup>1</sup>

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

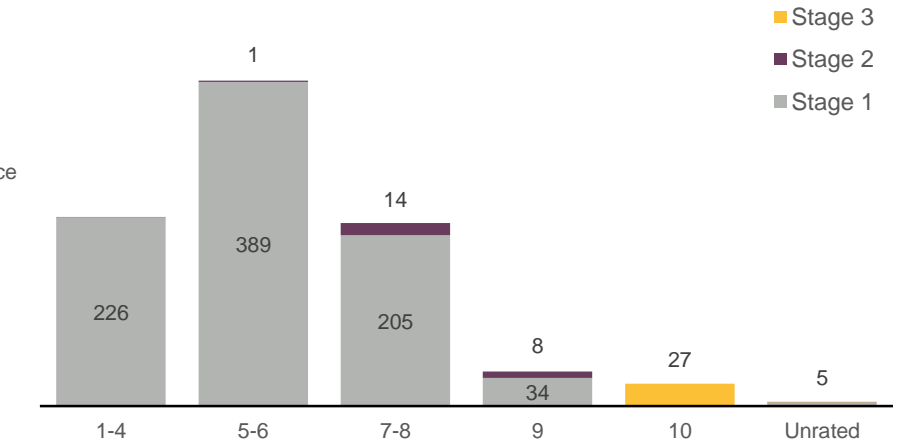


**Loans to customers: Stage 2 and 3**  
Development of gross carrying amount as ratio



1. Source European Banking Authority, data as of Q3 2019.

**Loans to customers: gross carrying amount**  
31.12.2019, risk class and impairment stage, ISK bn



**Loans to customers: credit quality**  
31.12.2019, 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	859	94.4%	3.6	0.4%	855	95.1%
Stage 2	24	2.6%	1.0	4.0%	23	2.5%
Stage 3	27	3.0%	5.7	20.9%	22	2.4%
<b>Total</b>	<b>910</b>	<b>100.0%</b>	<b>10.3</b>	<b>1.1%</b>	<b>900</b>	<b>100.0%</b>



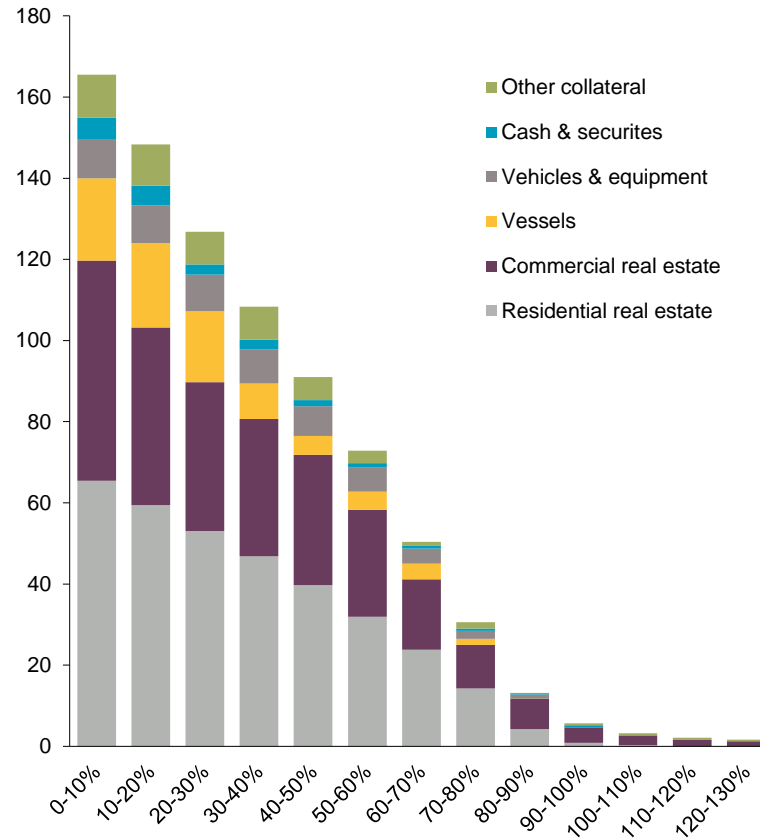
# Loan portfolio well covered

## Loans generally well covered by stable collateral

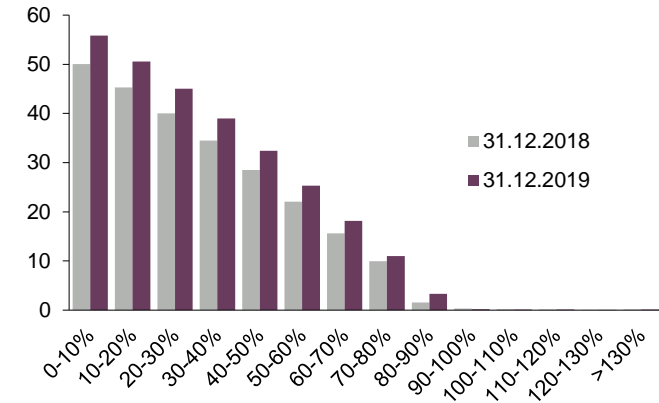
### Highlights

- 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
- The increase in LTV of mortgages is partly due to the fact that additional loans available to first-time buyers are now included in the definition of mortgages
- First-time buyers can get additional loans of ISK 3m, but never higher than 90% LTV
- Mortgages in stage 3 are equally well collateralized as other mortgages to individuals (average LTV 61%)

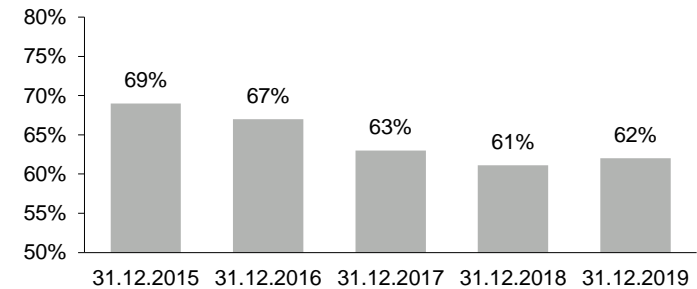
**LTV distribution by underlying asset class**  
ISK bn, by type of underlying asset, as of 31.12.2019



**LTV distribution of mortgages to individuals**  
ISK bn



**Average LTV of mortgages to individuals<sup>1</sup>**  
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.



# Liabilities

## Diversified funding strategy

Liabilities & Equity, ISKm	31.12.2019	31.12.2018	Δ
Deposits from Central Bank and credit institutions	30,925	15,619	15,306
Deposits from customers	618,313	578,959	39,354
Derivative instruments and short positions	6,219	5,521	698
Debt issued and other borrowed funds	306,381	300,976	5,405
Subordinated loans	22,674	16,216	6,458
Tax liabilities	7,853	7,150	703
Other liabilities	27,063	29,649	(2,586)
<b>Total Liabilities</b>	<b>1,019,428</b>	954,090	65,338
<b>Total Equity</b>	<b>180,062</b>	176,313	3,749
<b>Total Liabilities and Equity</b>	<b>1,199,490</b>	1,130,403	69,087

## Highlights

### Deposits

- Customer deposits increased by 6.8% in the period
  - The increase was mainly from domestic financial entities and corporations
  - The customer loans to customer deposit ratio was 145.5% at end of 2019

### 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, 72% of the deposits were in non-indexed ISK, 15% CPI linked and 13% in foreign currencies

#### Deposits concentration stable

- 17% of the Bank's deposits belonged to the 10 largest depositors and 32% belonged to the 100 largest depositors at the end of December 2019, compared to 15% and 37% respectively at year-end 2018

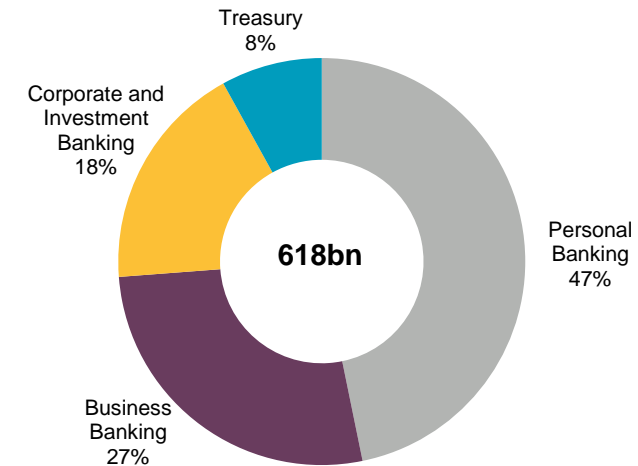
#### Deposits development

- Total increase in deposits is ISK 55bn since year-end 2018. Increase in most customer groups, but with significant increases in domestic financial entities and corporations
- Deposits increased YoY within Corporate and Investment Banking by 12%, Business Banking by 5%, Personal Banking 6% and Treasury by 16%

### Customer and credit institutions deposits by LCR category 31.12.2019 compared with year end-2018, ISK bn, consolidated

Customer type	Less stable		Stable		Term deposits		Total deposits	
		Δ		Δ		Δ		Δ
Retail	228	12	84	3	79	0	391	15
Operational relationship	2	(0)	-	-	-	-	2	(0)
Corporations	74	10	0	(0)	25	2	99	12
Sovereigns, central-banks and public sector entities	7	(1)	0	0	1	0	8	(1)
Pension funds	35	5	-	-	25	(2)	60	3
Domestic financial entities	28	1	-	-	46	22	75	23
Foreign financial entities	8	5	-	-	6	(2)	14	3
<b>Total deposits</b>	<b>383</b>	<b>31</b>	<b>84</b>	<b>3</b>	<b>181</b>	<b>20</b>	<b>649</b>	<b>55</b>

### Breakdown of deposits from customers by divisions 31.12.2019, consolidated





# Borrowings

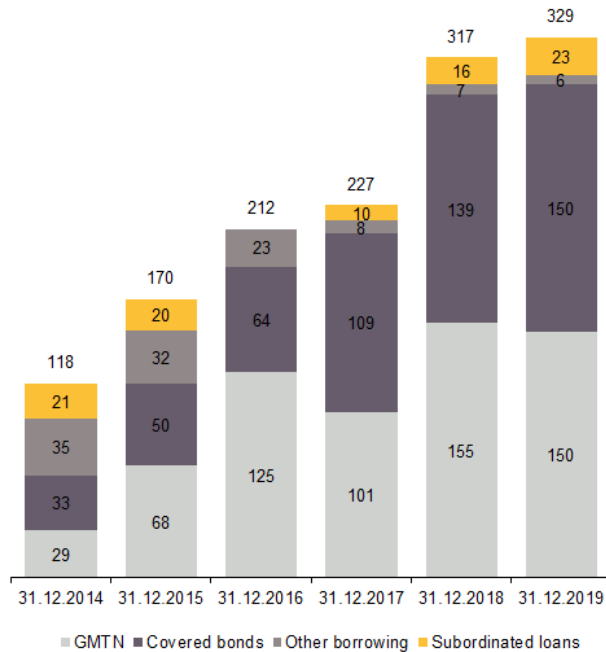
## Successful international and domestic market transactions

### Highlights

- Íslandsbanki is one of the largest issuers of covered bonds in the domestic market
  - ISK 29 bn issued in covered bonds in 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
- In December the Bank also bought back another EUR 144m of the EUR 500m bond maturing in 2020. Thus reducing the 2020 maturity to approximately EUR 56m
- In June the Bank issued SEK 500m 10NC5 Tier 2
  - This was the Banks third Tier 2 issuance
  - With that the Bank reached its Tier 2 target which is an important milestone in optimizing the Bank's long-term capital composition
- The Bank has limited needs to raise funds in FX in 2020

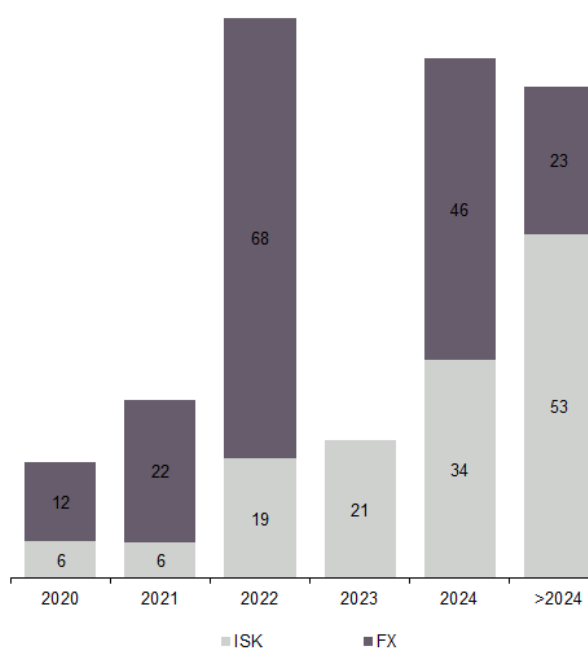
### Borrowing sources

Book value, ISK bn



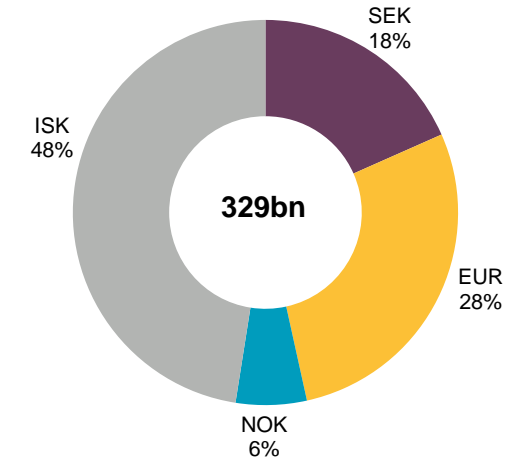
### Maturity profile of long-term debt and repayment of long term debt as percentage of balance sheet<sup>1</sup>

31.12.2019, Nominal value, ISK bn



### Currency split of market borrowing sources

31.12.2019, Nominal value, ISK bn



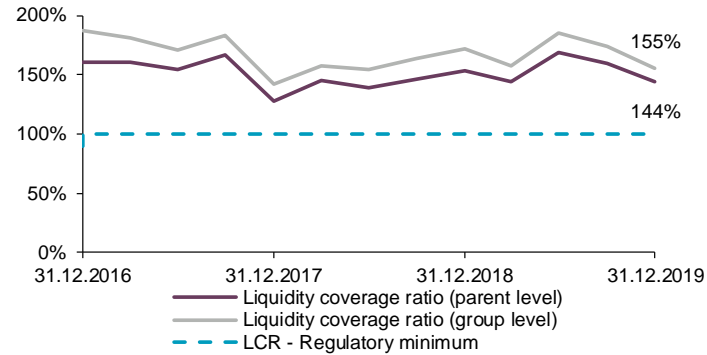
1. Final maturity assumed for callable bonds



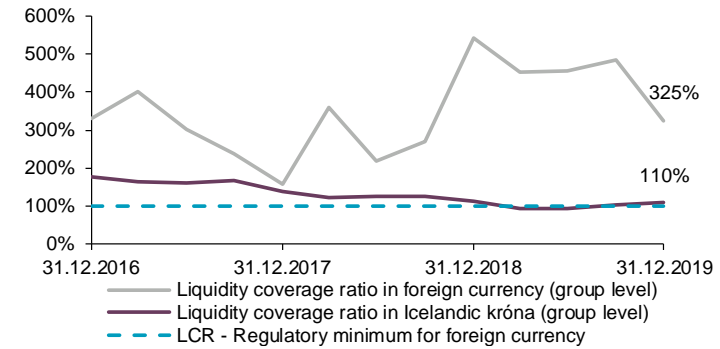
# Sound management of liquidity

Liquid assets of ISK 223bn are prudently managed

## Liquidity coverage ratio (LCR)



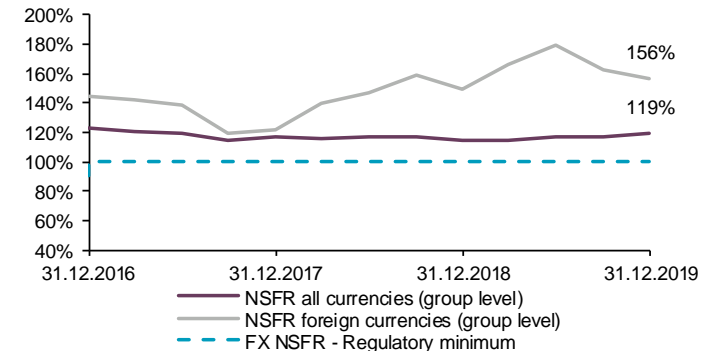
## Liquidity coverage ratio – foreign currencies and Icelandic króna



## Highlights

- All liquidity measures well above internal and 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
- The Central Bank implemented a minimum requirement for the LCR in Icelandic króna. Starting at 30% at the beginning of 2020, then increasing to 40% 2021 and ending at 50% at the start of 2022
- Liquidity and Capital Contingency Plan is tested regularly

## Net stable funding ratio (NSFR)



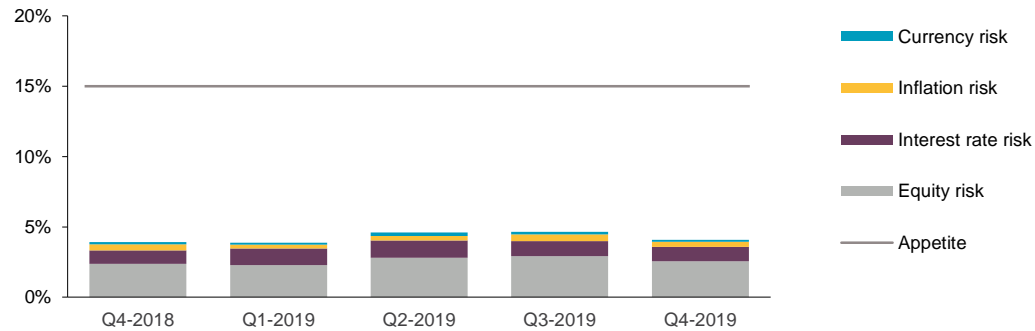


# Market risk well within appetite

The Bank has a modest market risk profile as further reflected in the Pillar 3 Report

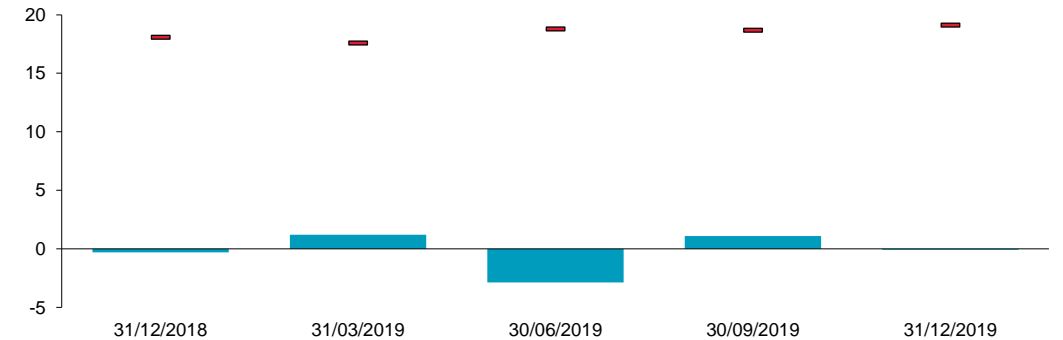
## Market risk exposure and market risk appetite

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



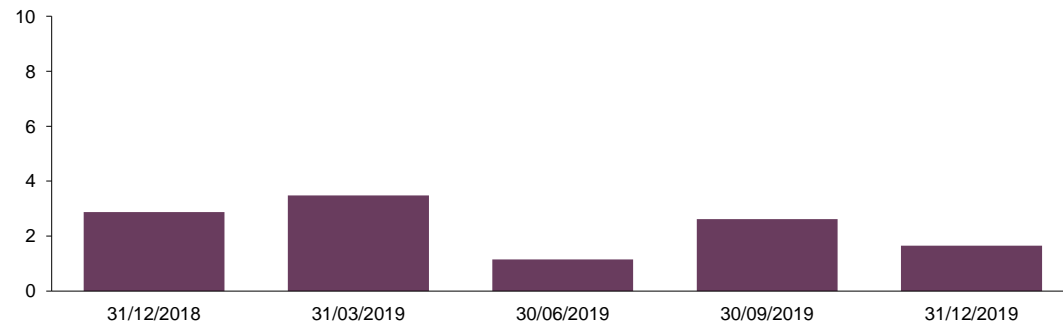
## Development of the currency imbalance compared with regulatory limit

ISK bn, end of quarter, consolidated



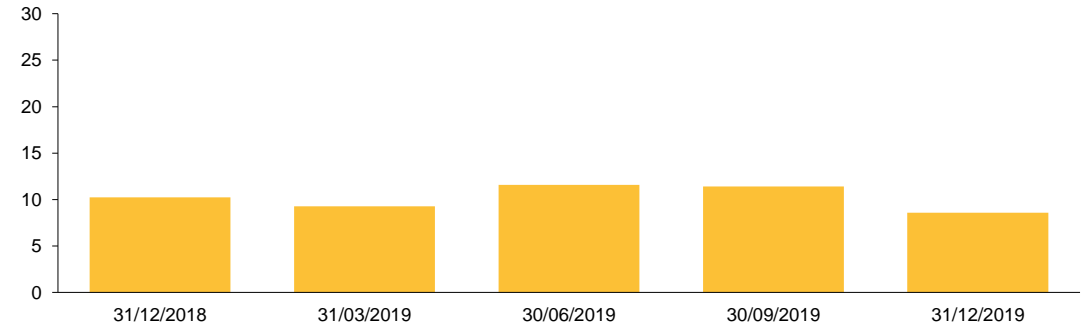
## Development of interest rate risk in the banking book

Weighted average BPV, end of quarter, ISK m, consolidated



## Development of the banking book inflation imbalance

ISK bn, end of quarter, consolidated





# Sound capital position

## The capital ratio exceeds target

### Highlights

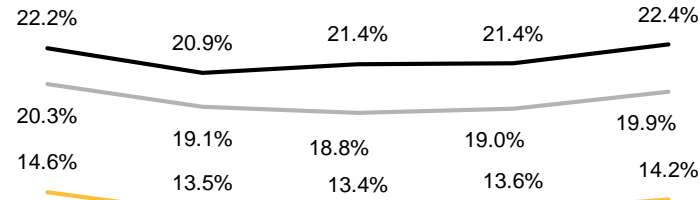
#### Capital ratios

- The CET1 capital was ISK 176bn at year-end 2019 compared to 171bn at year-end 2018
- Retained earnings for the period were offset by a ISK 5.3bn dividend payment in March 2019
- The capital base was ISK 198bn compared to ISK 188bn a year before
- The increase in the capital base is both due to retained earnings and a subordinated bond issuance in June 2019

#### Risk exposure amount (REA)

- The REA increased during the year with the growth in the loan portfolio in the first quarters which then slowed down in the last quarter
- The implementation of IFRS 16, where the right-of-use assets is capitalised contributes to an ISK 4bn increase of REA
- The ratio of REA of total assets remains fairly stable at around 74%

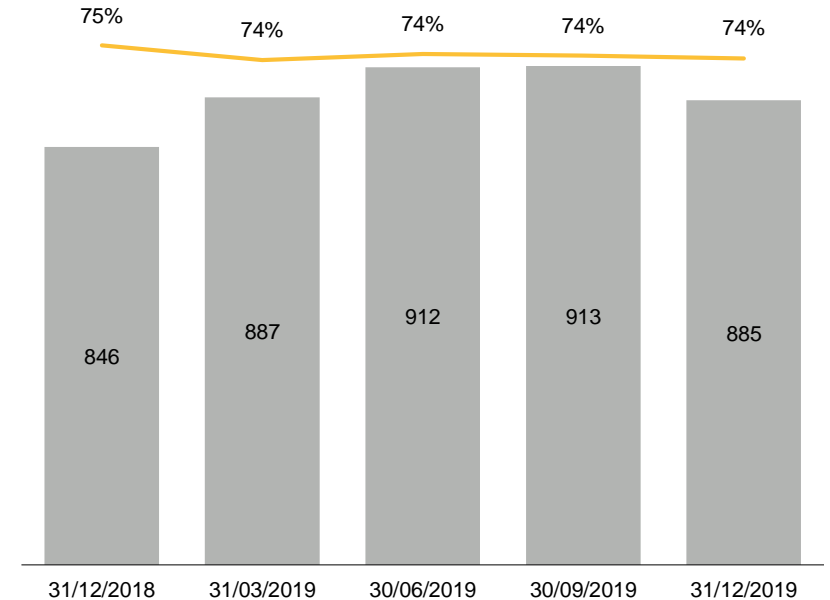
### Capital and leverage ratios



31/12/2018 31/03/2019 30/06/2019 30/09/2019 31/12/2019

— Total capital ratio — CET1 ratio — Leverage ratio

### Risk exposure amount (REA) ISK bn



— REA — REA/Total assets

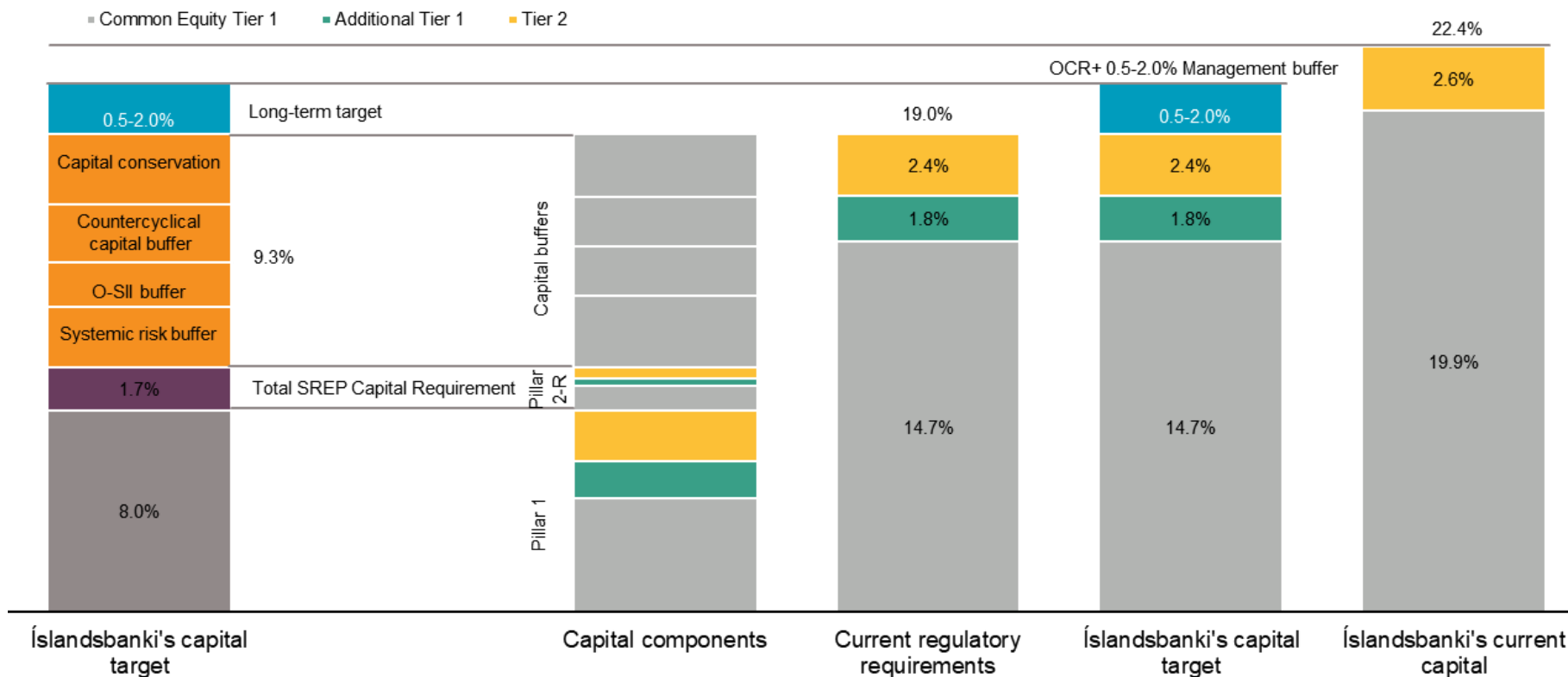


# Íslandsbanki's capital target

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 19% of risk exposure amount (REA)
- This is a decrease of 0.5% in Pillar 2-R between years, mostly due to a more moderate risk profile
- The countercyclical capital buffer increased from 1.25% to 1.75%, effective May 2019 and increased again by 0.25% in February 2020 (included in graph)
- 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 19.5–21.0%, taking into account rise in counter cyclical capital buffer from February 2020
- 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**

	<b>S&amp;P</b>
Long-term	BBB+
Short-term	A-2
Outlook	Negative
Rating action	Jul 19

**Icelandic sovereign**

	<b>S&amp;P</b>	<b>FITCH</b>	<b>MOODY'S</b>
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&amp;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	2019	2018	2017	Guidance
<b>ROE regular operations<sup>1</sup></b>	8-10%	6.6%	✓ 8.0%	✓ 9.9%	<ul style="list-style-type: none"> <li>— Target of 4-6% on top of risk free rate. Risk free-rate is currently 2.5% and 3.67% on average for 2019</li> <li>— As the Bank retains substantive liquid assets, interest rate levels in Iceland can have a substantial impact on ROE</li> <li>— The bank tax, excluded from target returns will lower from current 0.376% to 0.145% in steps over the next four years</li> <li>— The ROE target for 2019 was based on regular operations. Going forward the Bank will set the same return target for overall earnings, however taking into account bank tax in excess of the long term rate</li> </ul>
<b>Cost/ Income ratio<sup>2</sup></b>	<55%	62.4%	66.3%	62.5%	<ul style="list-style-type: none"> <li>— This is a medium to long term target. C/I ratio can be expected to be higher than target in the near term</li> <li>— Headcount and non-headcount related cost control programmes in place</li> <li>— Lower C/I on parent company basis than on a consolidated basis (57.1% at 2019)</li> </ul>
<b>CET1</b>	>16%	✓ 19.9%	✓ 20.3%	✓ 22.6%	<ul style="list-style-type: none"> <li>— Current target for CET1 ratio is 15.2% -16.7% based on SREP requirements and management buffer</li> <li>— The Bank aims to maintain a CET1 ratio of over 16% in the medium to long term</li> </ul>
<b>Total capital ratio</b>	> 19.5 – 21.0%	✓ 22.4%	✓ 22.2%	✓ 24.1%	<ul style="list-style-type: none"> <li>— Based on the regulatory capital requirement with a 50 – 200bp management buffer</li> <li>— Current capital requirement is 19.0% including recently increased countercyclical capital buffer</li> </ul>
<b>Dividend payout ratio</b>	40-50%	✓ 50%	✓ 50%	✓ 100%	<ul style="list-style-type: none"> <li>— The Board of Directors proposes to pay out ISK 4.2 billion in dividend for the 2019 financial year which is in line with the Bank's dividend pay out target</li> </ul>

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 Gradual economic recovery ahead

- 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
- Growing economic slack and lower inflation has been met by rate cuts although foreign trade remains in positive territory
- Less economy-wide leverage has increased economic resilience

## 4 Strong credit growth and sound credit quality

- Loans to customers grew by 6.3% during the year
- Stable asset quality with increased impairment allowance due to economic environment
- NPL ratio 2.4% at year end, compared to 2.9% average for European banks using the EBA's NPL definition

## 2 Digital investments deliver higher customer service level

- Substantial IT investments, including a new core payment and deposit system
- Recent roll out of new digital customer solutions in apps and online banking such as new digital mortgage credit assessment
- Customers continue to engage via digital solutions

## 5 Funding success and high liquidity ratios

- Focus on stable deposit growth
- Successful market based funding activities throughout the year
- Strong liquidity position with liquidity ratios above internal targets and regulatory requirements

## 3 Growth in core earnings and cost cutting emphasis

- Income grew by 7.8% during the year and cost to income ratio for the parent company decreased from 62% to 57%
- In order to improve returns the Bank has taken several actions to optimise its operations under a revised strategy
- Digitalisation and IT investments expected to generate more cost savings going forward

## 6 Exceptional capitalisation

- Total capital ratio at 22.4% slightly higher than the Bank's long term target
- The regulator lowered the Bank's pillar 2 requirement in October 2019 by 50bp as a result of an improved risk profile
- Risk exposure amount to total assets at 74% and leverage ratio at 14.2% - capitalisation considered exceptionally high in international comparison



# 5. Annex – Icelandic economy update

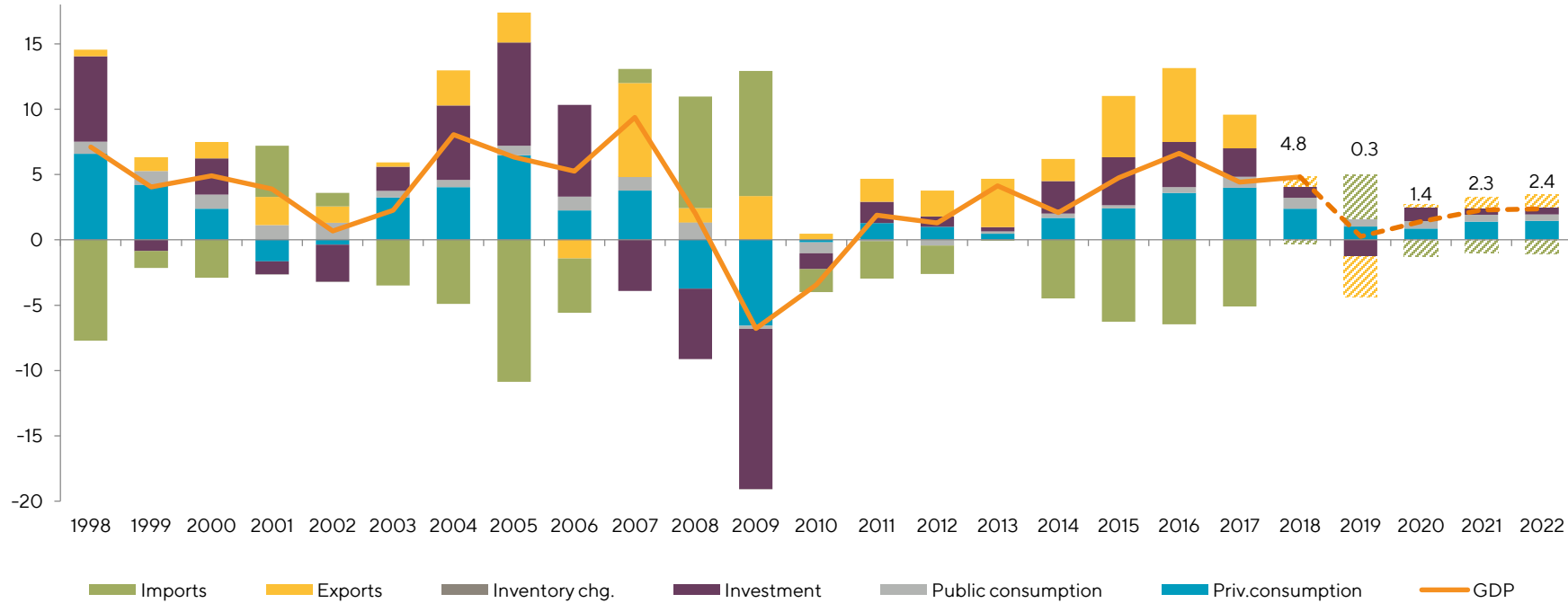


# Icelandic economy on gradual recovery path

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

- After the severe shocks in the late 2000s, a bountiful decade in the Icelandic economy has brought living standards back to pre-crash levels or above them
- A clear turnaround, however, is evident after the setback in tourism at the beginning of the year. YoY GDP growth measured 0.2% in 9M 2019. Domestic demand contracted by 0.9%, however, albeit offset by a favourable contribution from net trade
- Output growth is estimated at 0.3% for 2019 as a whole. A sharp contraction in business investment and services exports counterbalances consumption growth and a strong contraction in imports
- For 2020, ISB Research expects relatively slow growth of about 1.4%, driven by modest growth in domestic demand
- The economy is forecast to gain steam in 2021 and 2022, with growth measuring 2.3% and 2.4%, respectively, as private consumption and exports regain momentum

**GDP and the contribution of major subitems <sup>1</sup>**  
YoY change (%)



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

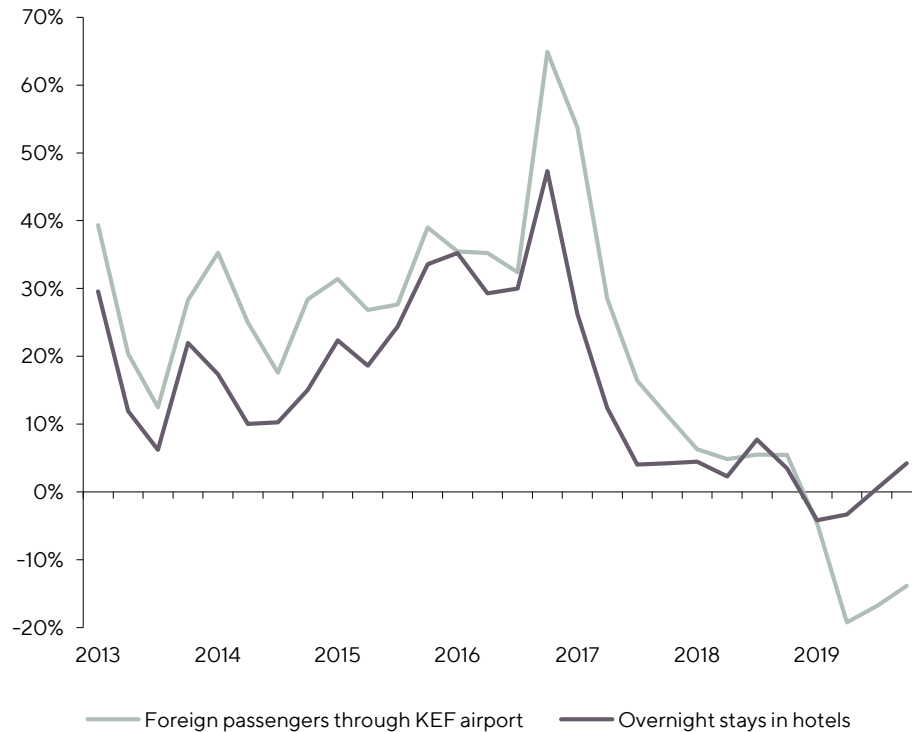


# Tourism sector coming of age

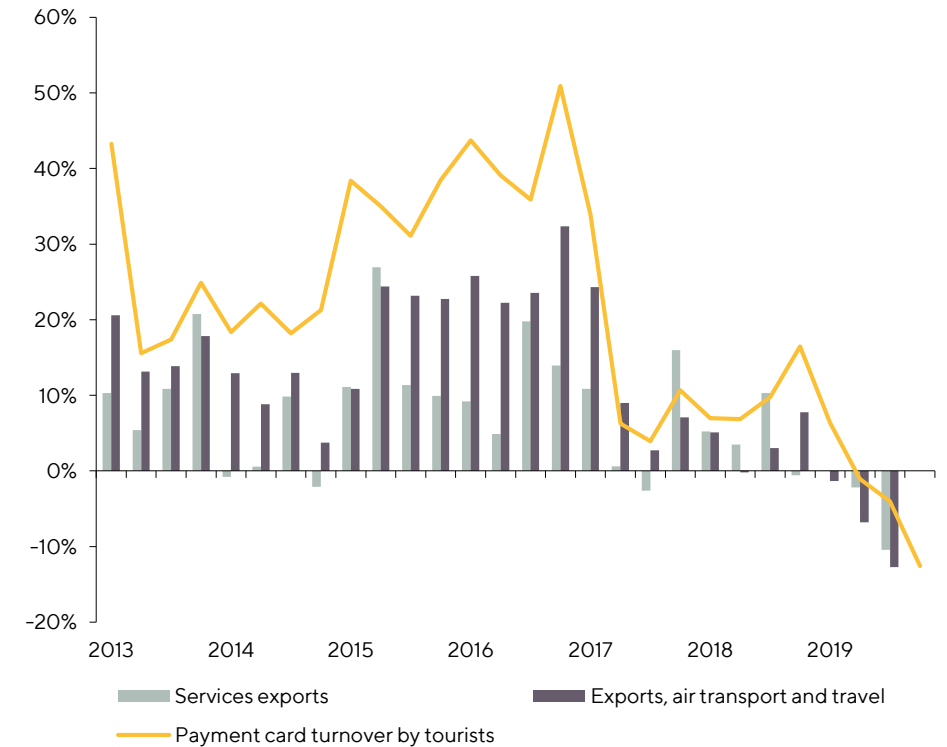
Focus shifting from accommodating rapid growth to maximizing added value

- Despite significant setbacks in 2019, tourism generates the equivalent of nearly four in every ten krónur of foreign exchange revenues
- In 2019 tourist arrivals decreased 14% year-on-year. Still, the year was the third-largest tourism year to date, with nearly 2 million foreign tourists visiting Iceland
- Revenues from foreign tourists totalled ISK 382bn in the first nine months of 2019, a contraction of just over 8% year-on-year in ISK terms
- Tourist numbers look likely to be broadly similar in 2020. The tourism sector has reached a turning point, with streamlining and maximization of value per tourist taking over from rapid growth due to steeply rising visitor numbers
- ISB Research's forecast assumes an increase in tourist arrivals of approximately 3% per year in 2021 and 2022, in line with forecasted developments in global tourism

### Foreign visitors and overnight hotel stays YoY change



### Services exports and foreign card turnover YoY change



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

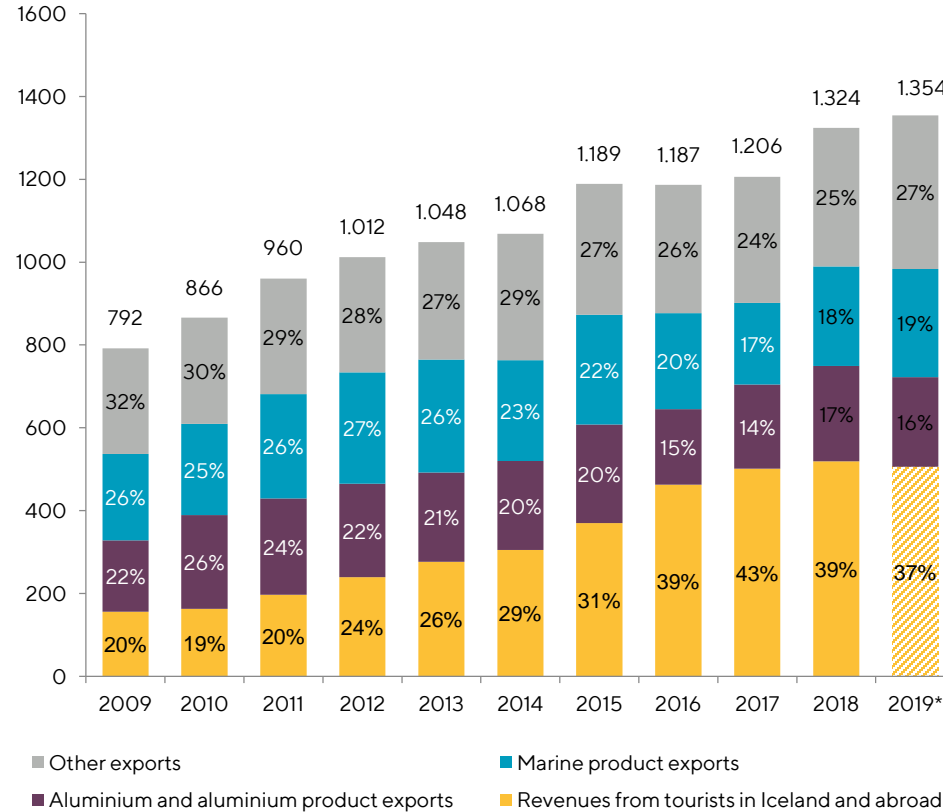


# Continued current account surplus expected

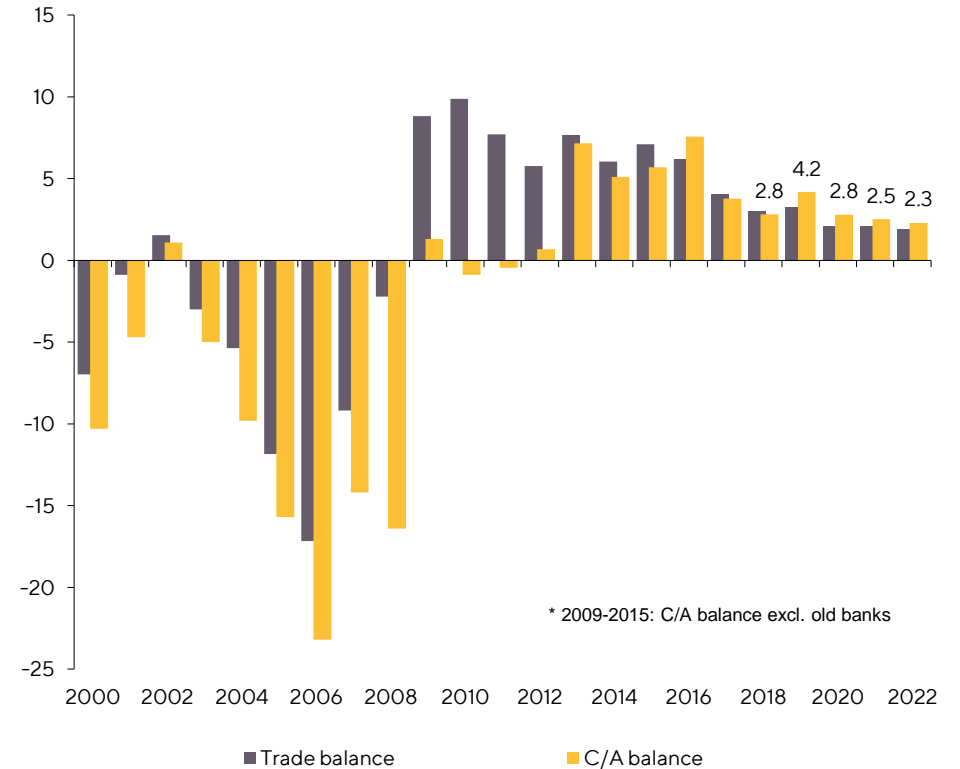
## Strong net external position increases resilience

- The surplus on goods and services trade was sizeable in 2019, in spite of reduced tourist numbers and the failure of the capelin catch
- The goods account deficit in 2019 was the smallest since 2015, largely due to a sharp contraction in imports
- The outlook in 2020 is for very weak export growth and considerably stronger growth in imports, particularly goods imports
- Exports appear set to pick up next year, fuelled by moderate growth in the tourism and fishing industries
- After a long period of near-constant current account deficit, the past decade has seen a radical shift, with an uninterrupted current account surplus since 2012 despite spates of unrest in the domestic economy
- A current account surplus of 2.8% of GDP is forecast for this year, followed by 2.5% surplus in 2020 and 2.3% in 2021
- Iceland's net international investment position will remain positive, with external assets exceeding external liabilities by nearly 1/4 of GDP as of end-September 2019

### Export revenues ISK bn



### Current account balance % of GDP



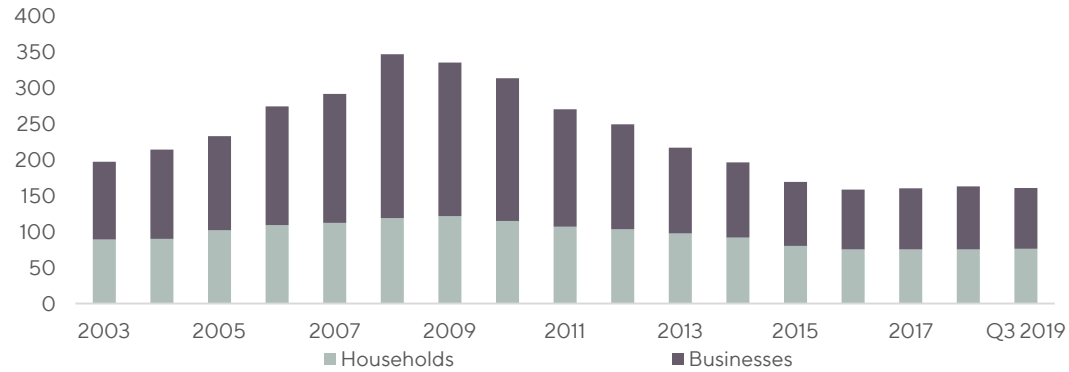
1. Shaded areas and dotted lines indicate ISB Research/ forecasts  
Source: Central bank of Iceland, Statistics Iceland and ISB Research



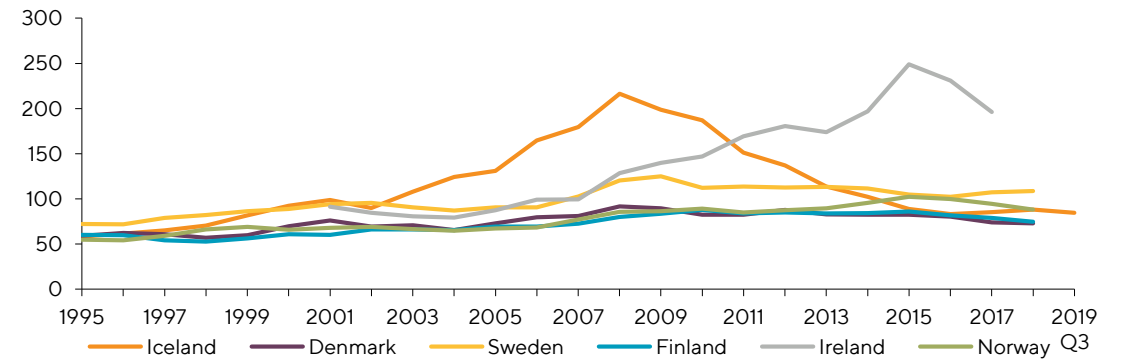
# Domestic balance sheets strong overall

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

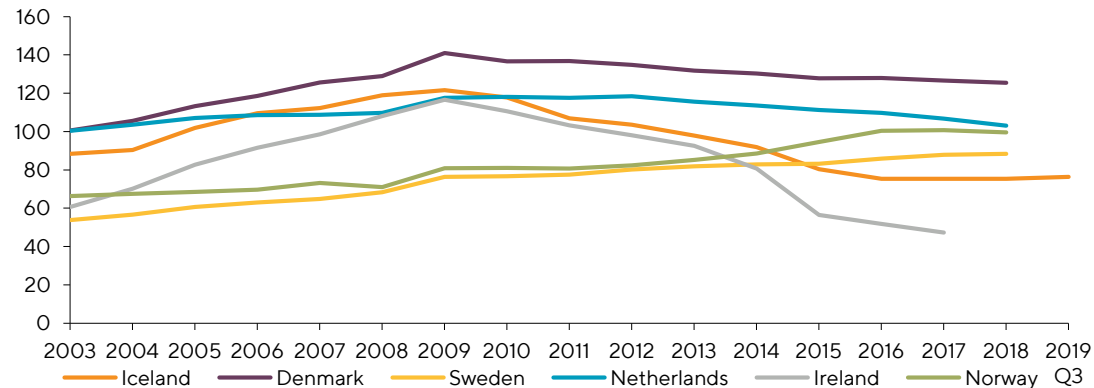
## Private sector debt % of GDP



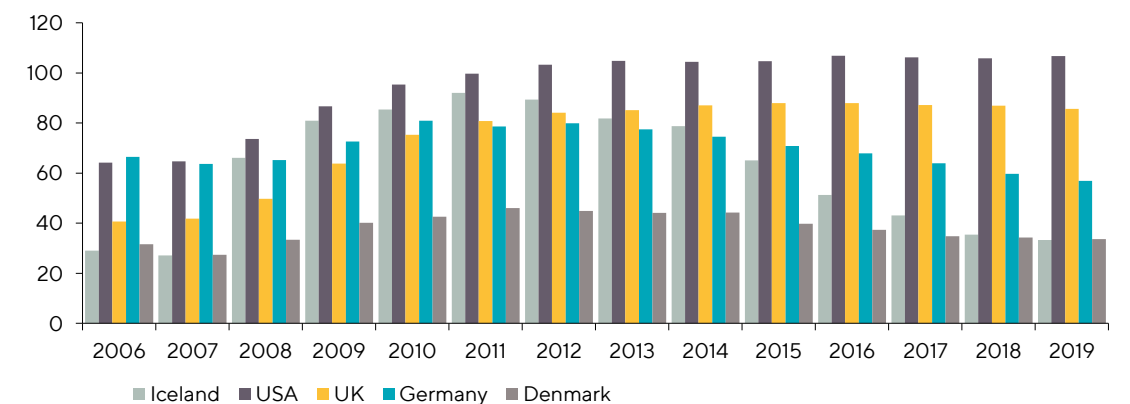
## Corporate debt % of GDP



## Household debt % of GDP



## General government gross debt % of GDP



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



# Businesses have prepared for headwinds

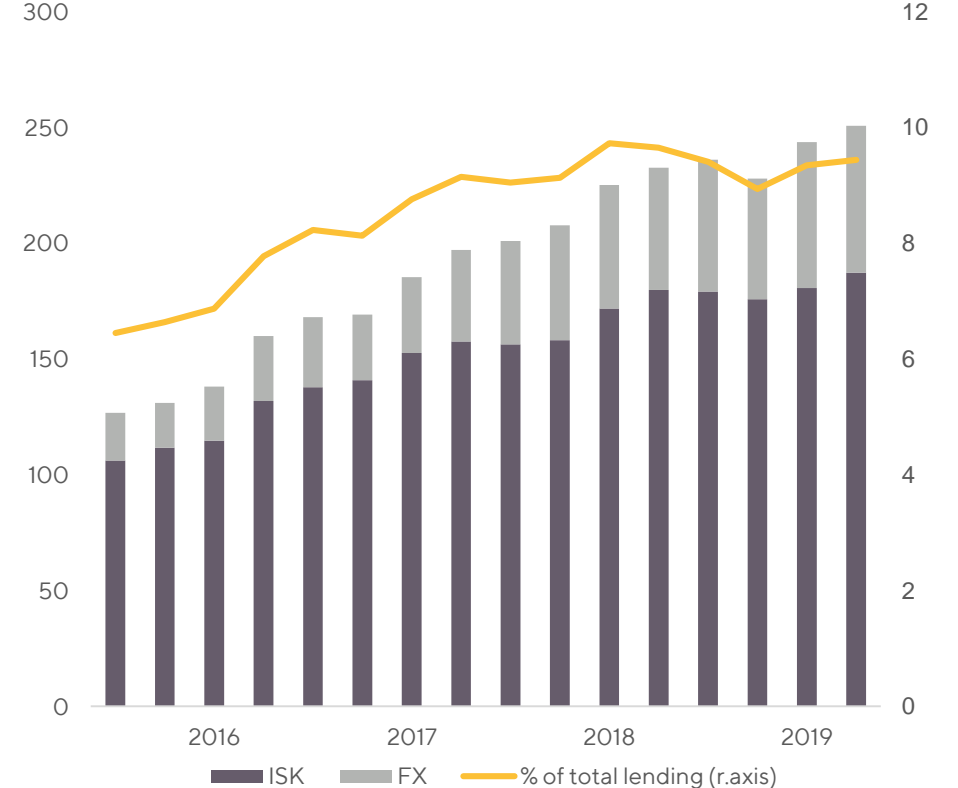
## Lending growth to tourist sector broadly in line with general lending growth

- Investment lost pace in 2019, after a five-year period of uninterrupted growth. In total, investment probably shrunk by 5.6% YoY
- The outlook is for a rebound in 2020, with total investment growth measuring just over 5%, due mainly to 6% growth in business investment after a two-year contraction
- An upturn in public investment is also expected this year as the authorities engage in counter-cyclical infrastructure investment
- 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
- Investment level is assumed 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

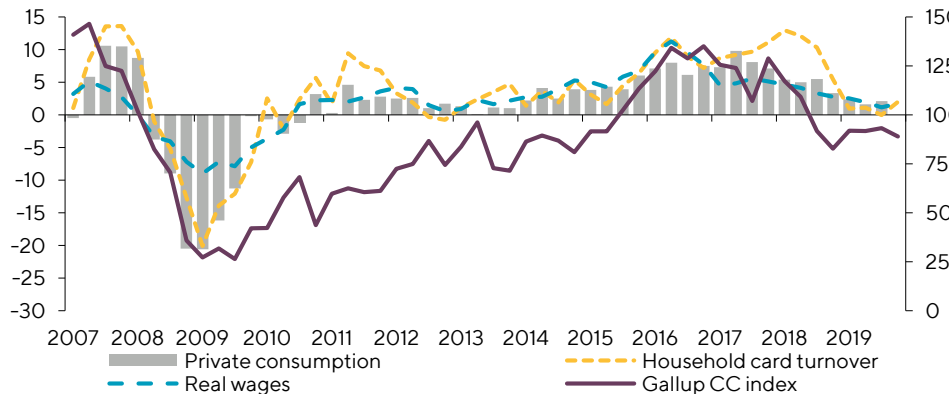
- Private consumption has been strong in recent years, bolstered by rapidly rising real wages, low unemployment, robust population growth, and a general sense of optimism. Unlike the previous upswing, household debt has remained modest and saving considerable
- Private consumption growth has eased in the recent term. It bottomed out at 1.6% in Q2/2019 but then picked up in the second half of the year
- After a period of tight conditions, tension in the labour market has eased. In 2019, unemployment rose by a percentage point and wage rises were the most modest since 2010
- Unemployment is expected to peak this year at 4.4% and then fall to 3.0% by 2022. Real wage growth is assumed to measure about 2.0% per year through 2022
- A period of slower private consumption growth seems to lie ahead, although households' strong position will help greatly in this regard. ISB Research expects the growth rate to measure 1.7% in 2021 and rise to 2.8% by the end of the forecast horizon

### Unemployment and wage growth



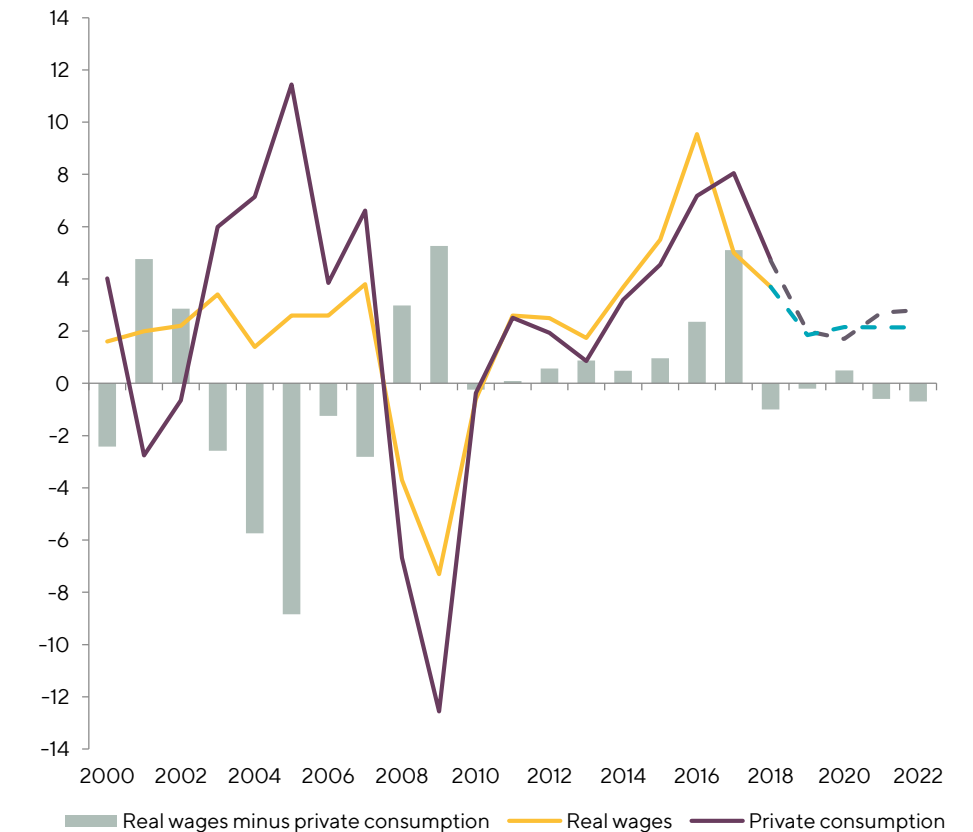
### Private consumption and related indicators

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



### Real wages and private consumption

YoY change (%)



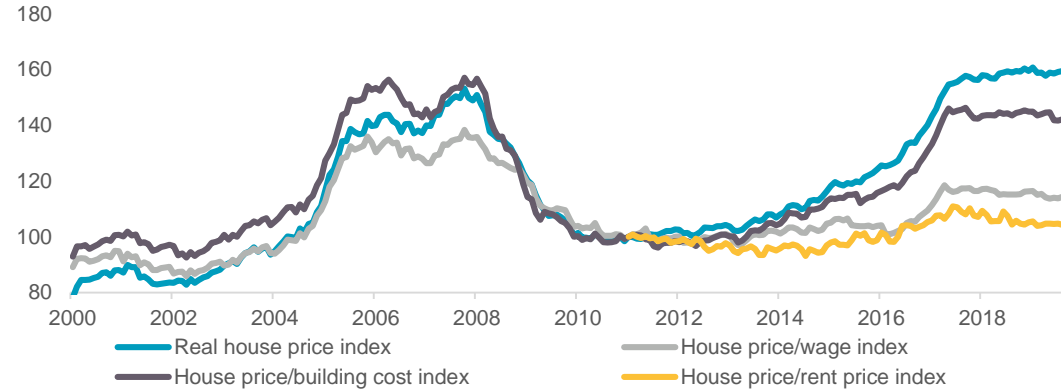
1. Shaded areas and dotted lines indicate ISB Research forecasts  
Source: Statistic Iceland and ISB Research



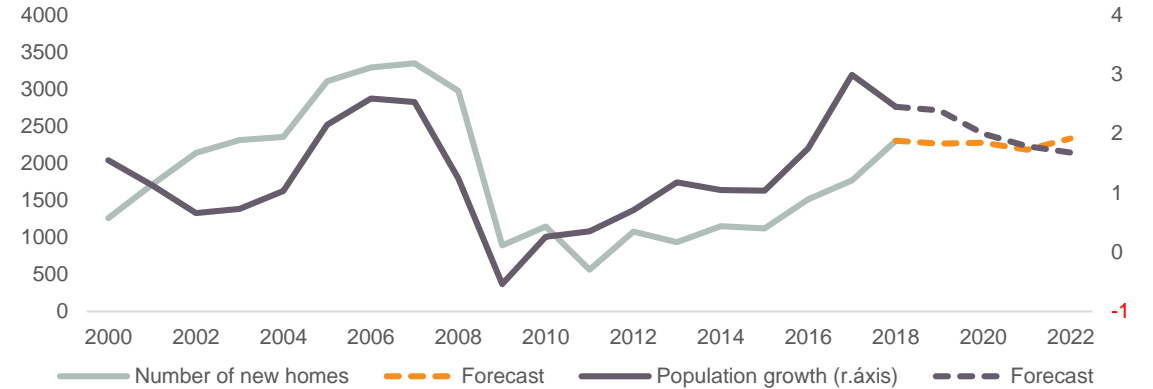
# Real estate market approaching balance

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

## Residential capital region house prices and determinants



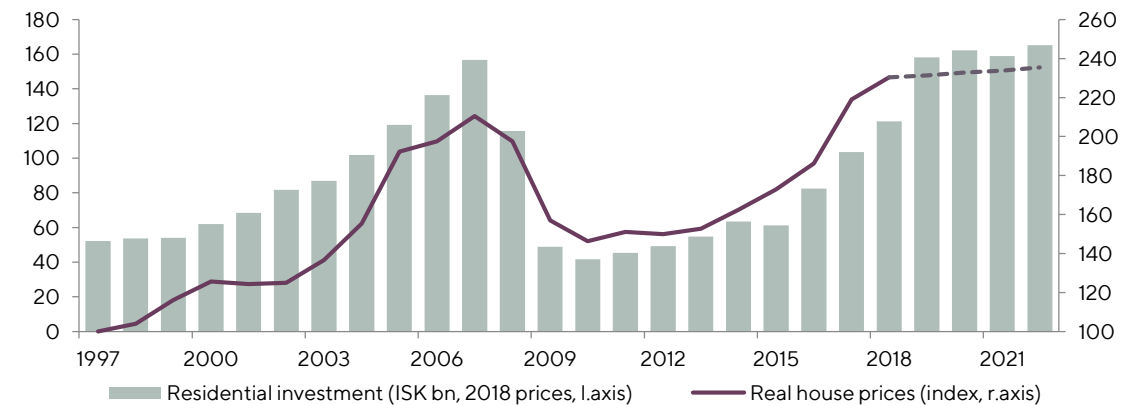
## New apartments and population increase in the capital region<sup>1</sup>



## Commercial real estate real price index



## House prices and residential investment



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

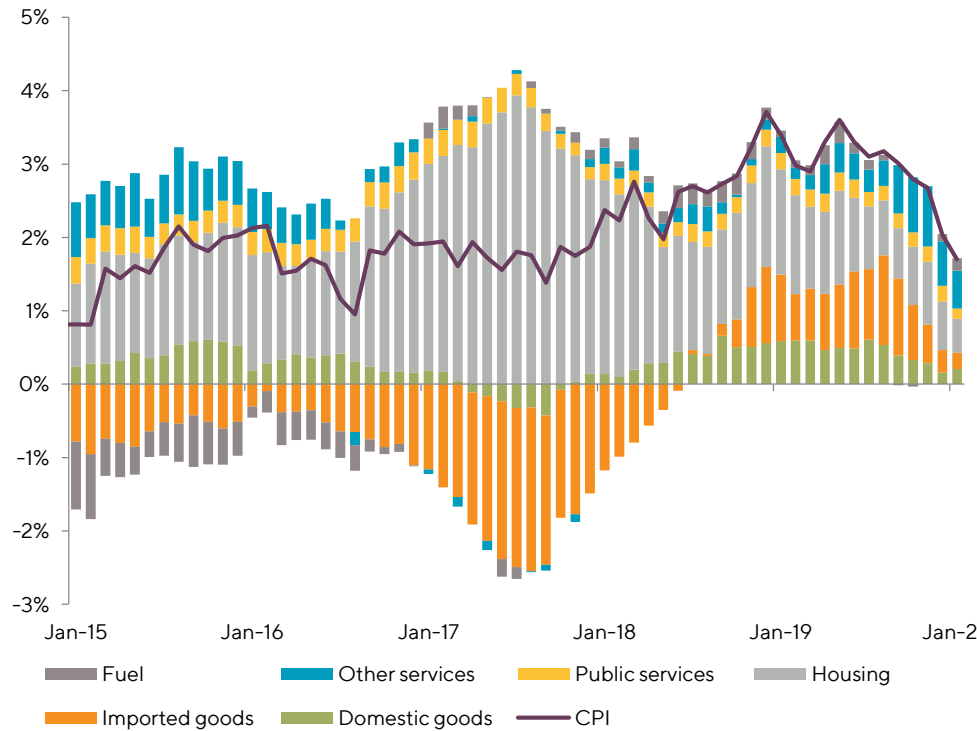


# Inflation under wraps and policy rate to remain low in 2020

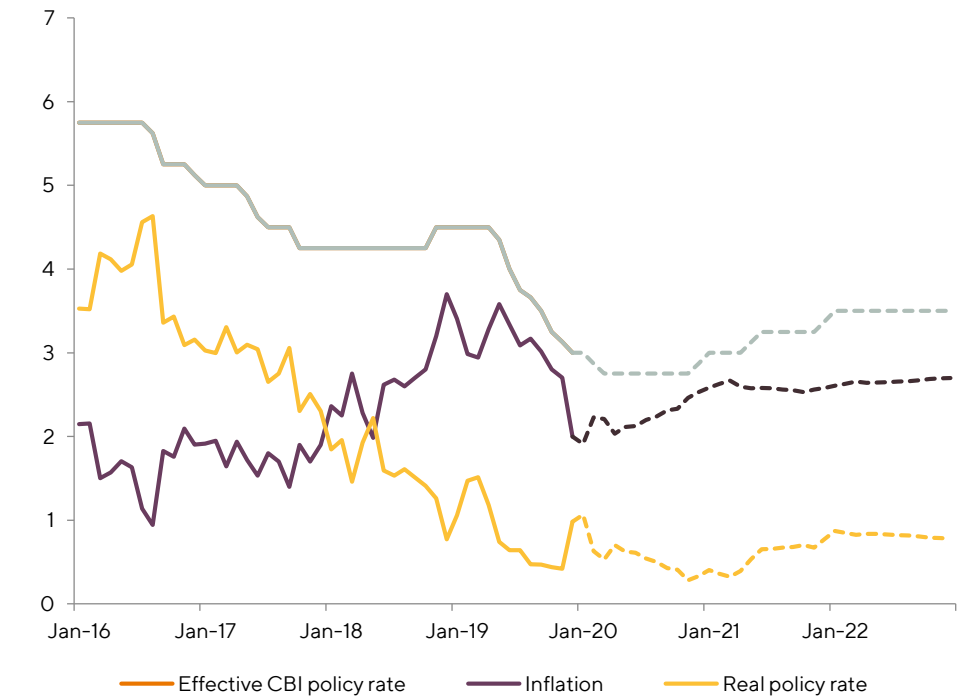
## Policy rate becoming more accommodative as economy cools

- After a short-lived spike following the ISK depreciation in autumn 2018, inflation fell markedly in 2019. By the end of 2019, it measured 2.0%, its lowest in two years
- The outlook is for modest inflation during the forecast horizon. ISB Research expects inflation to remain below the CBI's target this year, averaging 2.2%, before rising to an average of 2.6% in 2021 and 2.7% in 2022
- 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
- In 2019, the CBI's policy rate was lowered by a total of 1.5 percentage points as the inflation outlook improved and the economy cooled. The real policy rate fell much less, however
- Following a rate cut in H1, the policy rate is expected to remain steady at 2.75% through 2020 and then begin rising again in 2021 as the economic outlook improves

### 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

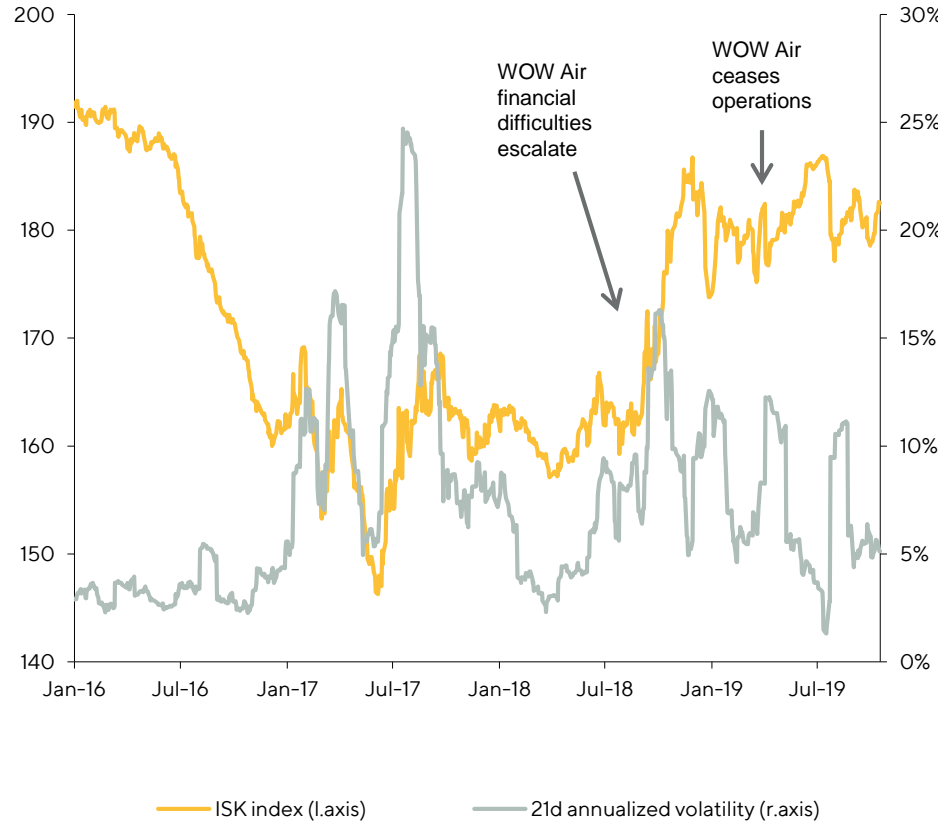


# ISK relatively well balanced

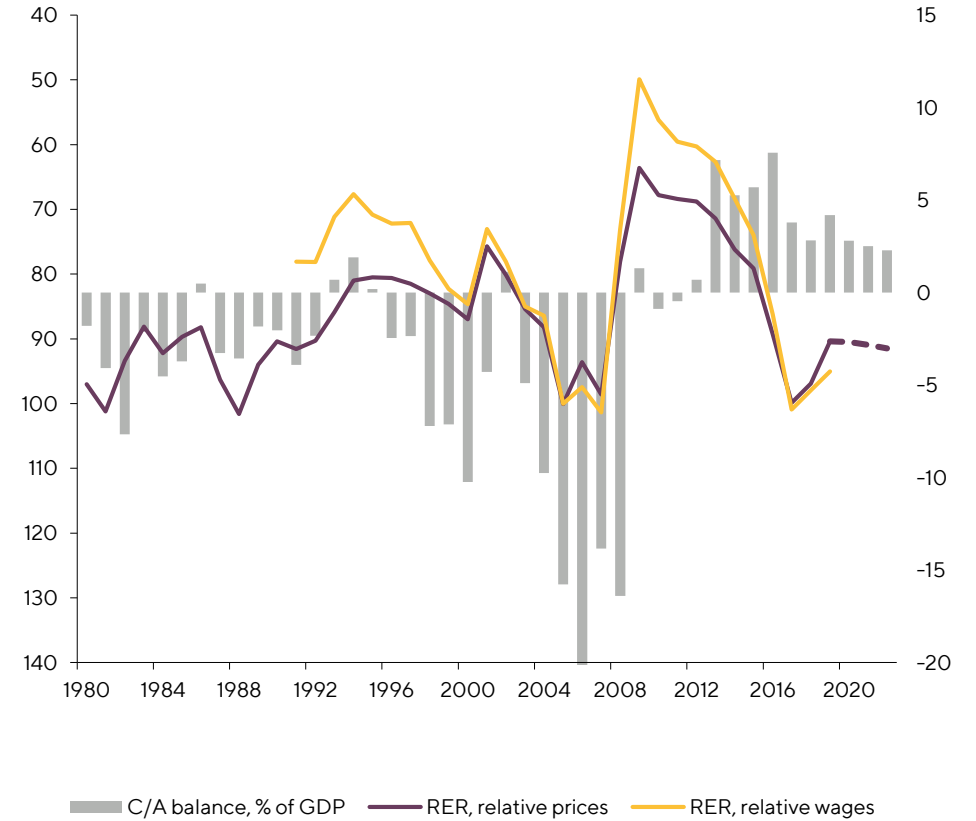
Real exchange rate likely to remain close to current levels in the near term

- After depreciating by 9% in H2/2018, the ISK was more stable by various measures in 2019 than in any single year since it was floated at the turn of the century
- From the beginning of 2019 through end-January 2020, the ISK has fluctuated within a band of roughly 6% centered on an index value of 180 in terms of the Central Bank's (CBI) trade-weighted exchange rate index (TWI)
- The real exchange rate is most likely currently within the range that is consistent with an internally and externally balanced economy
- Uncertainty about near-term exchange rate developments seems to be broadly symmetric. It is probable that the ISK exchange rate will remain around the level seen in the past year, provided that there are no dramatic and unexpected changes in major underlying factors

## ISK exchange rate, daily values and volatility



## Real exchange rate indices and current account balance



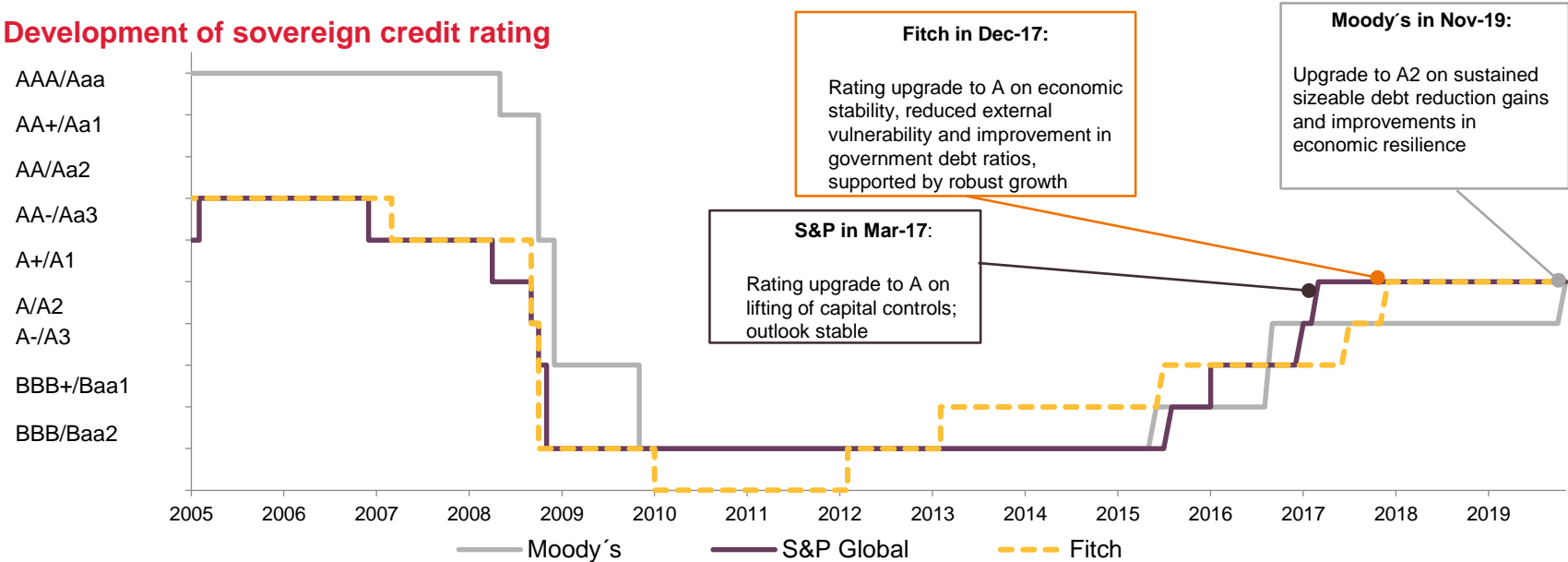
1. Dotted lines indicate ISB Research forecasts  
 Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research



# 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 November 2019

- The rating agency points out that Iceland's government debt has fallen substantially since 2011, more so than in any other rated sovereign in the post-crisis era
- Refinements to the fiscal framework, including the Organic Budget Law, will further help to preserve these fiscal improvements

### 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



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