Íslandsbanki: Investor Presentation

August-September 2022

islandsbanki.is

This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

Vision and Values

Vision to be
#1 for service

Passion

Professionalism

Collaboration

The Bank

FTEs
702
number of FTEs at Íslandsbanki at period end

12 branches

Listed to Nasdaq Iceland as of June 2021

Market share[1]

31% retail customers

37% SMEs

35% large companies

Sustainability 2Q22

Íslandsbanki receives top ESG score (90/100) from Reitun for the second year in a row

The Bank's score for environmental practices has risen by 12.9% year-on-year

Total avoided greenhouse gas emissions in 2021 ~16,800 tCO2e

Key Figures 2Q22

ROE	11.7%	LCR Group, all currencies	147%
Cost-to-income ratio	42.7%	NSFR Group, all currencies	118%
CET1 ratio[2]	18.2%	Leverage ratio[2]	12.5%
Total capital ratio[2]	21.5%	Total assets	ISK 1,437bn

Ratings and certifications

S&P Global Ratings

BBB/A-2

Stable outlook

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 2Q22

New pension platform released, enables self service for pension customers

Corporates can apply for and modify overdraft in app

App available in Polish

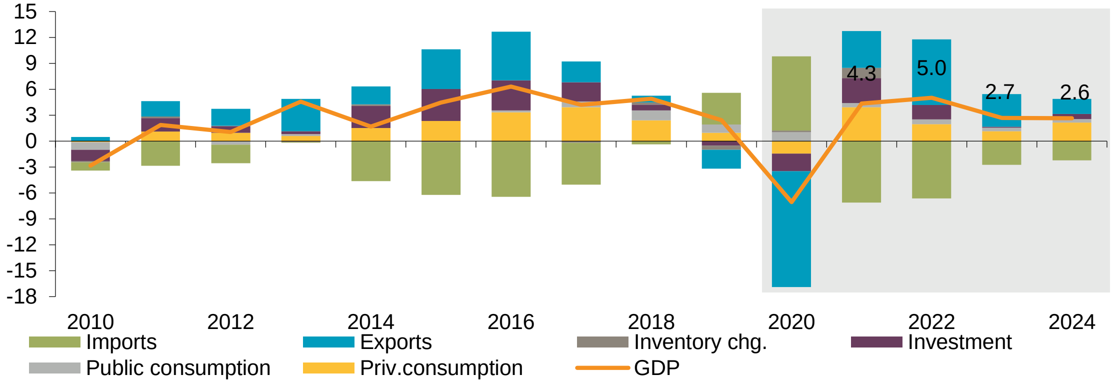
1. Based on Gallup surveys regarding primary bank. 12 months rolling average for retail customers, December 2021 survey for SMEs and 2021 average for large companies.

Export-driven GDP growth following robust growth in demand

Strong foundations facilitate a vigorous recovery as world-wide pandemic impact fades

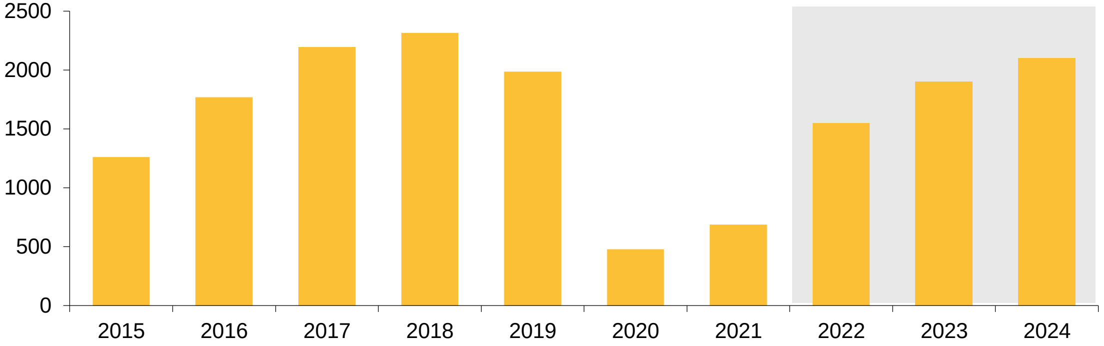
Exports replace domestic demand as the key catalyst of healthy GDP growth…

Real GDP and main subitems, YoY change, %



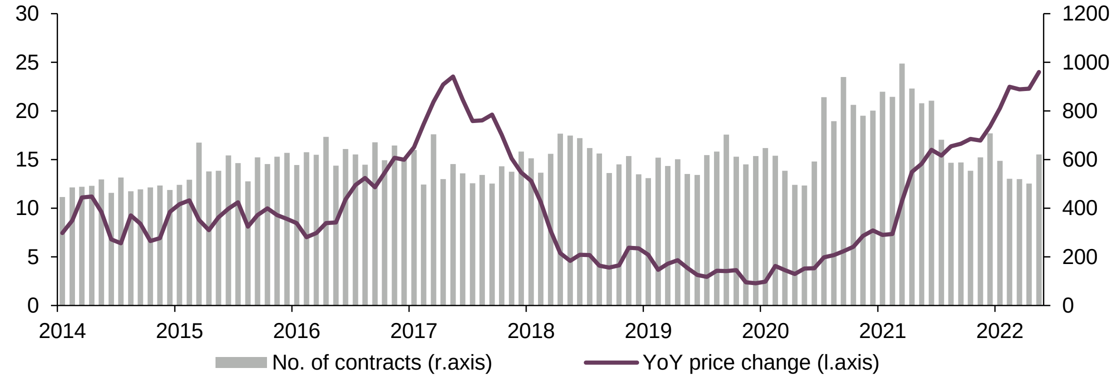
…as tourism sector recovery continues following receding pandemic impact

Number of foreign tourists per year, thousands



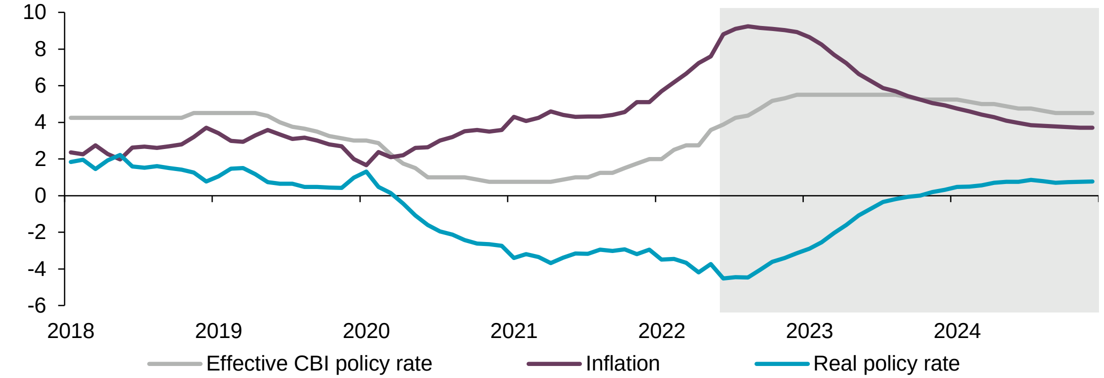
A buoyant housing market has been one of the main drivers of inflation…

Prices and turnover in the capital region residential housing market



…which has prompted considerable monetary tightening by the central bank

Inflation and policy rate, %



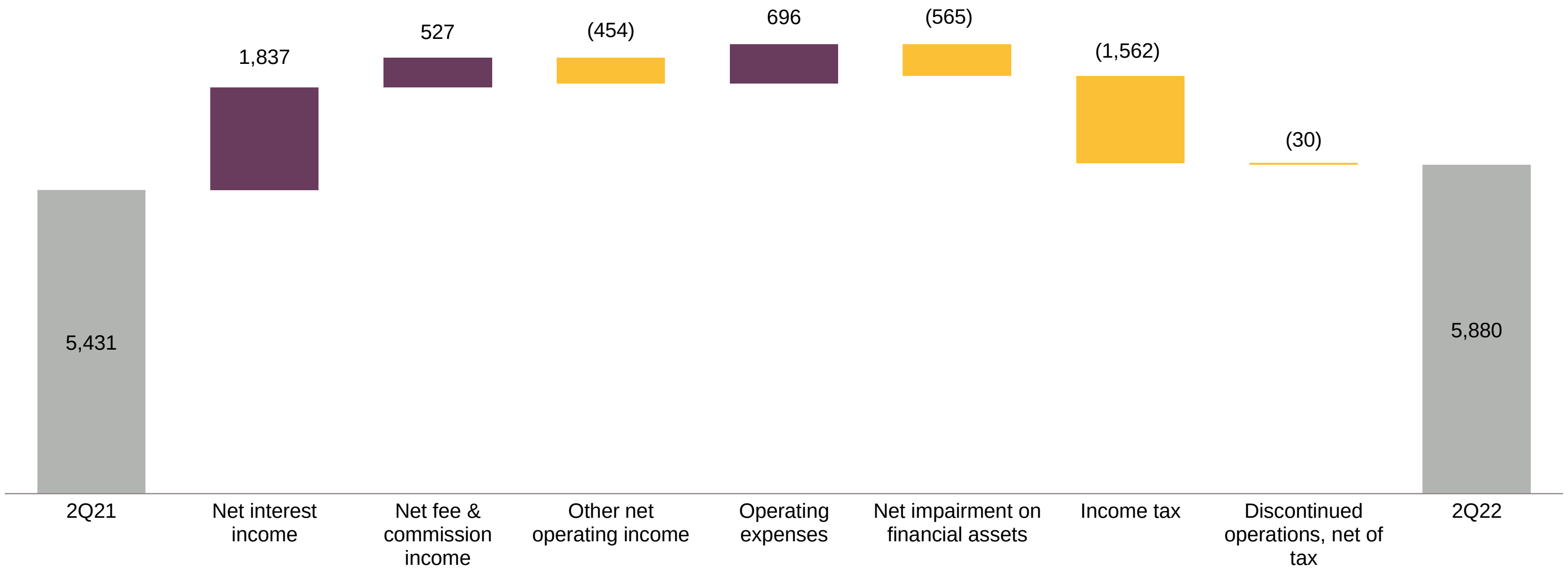
Shaded areas indicate ISB Research forecasts. Source: Statistics Iceland, the Central Bank of Iceland and ISB Research.

Financial overview of the issuer

Increase in core revenues in a good quarter

Control of costs further boost a positive result

Profit for the period – 2Q21 vs 2Q22
ISKm



NII rose strongly in all business segments

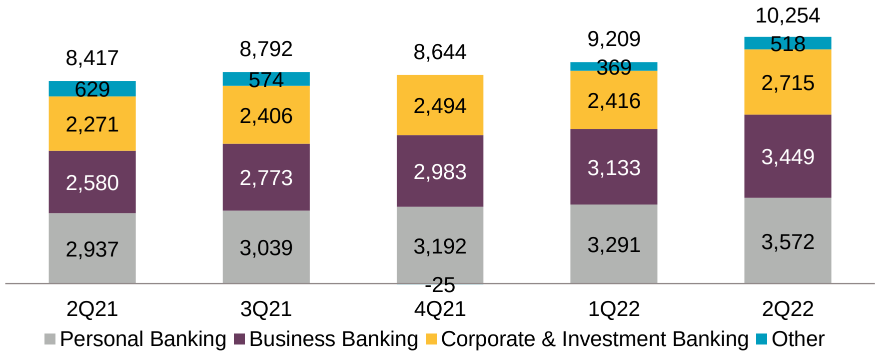
NIM rose to 2.9% due to a higher interest rate environment

Highlights

- NII continued a positive trend supported by higher interest rate environment leading to a rise in deposit margin YoY and positively affecting the Bank's liquidity portfolio
- Additional positive effect came from higher lending and deposit volumes which increased YoY across all business segments
- Lending margin was 1.9% in 2Q22 (2.2% in 2Q21) while deposit margin was 1.8% in 2Q22 (1.1% in 2Q21)

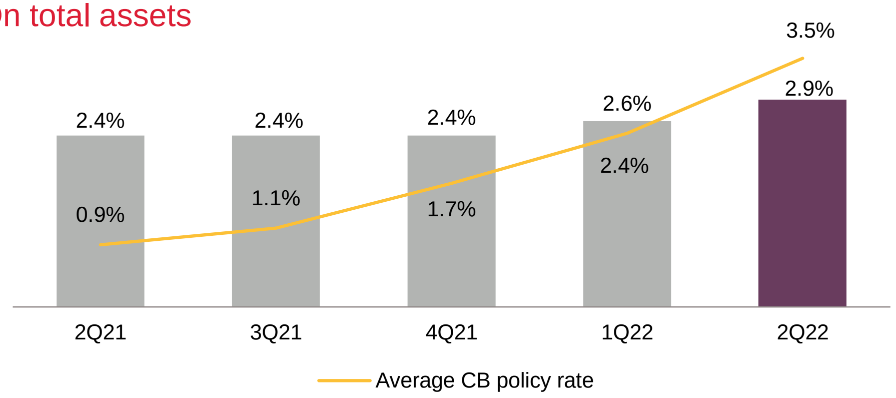
Net interest income

By business segments, ISKm



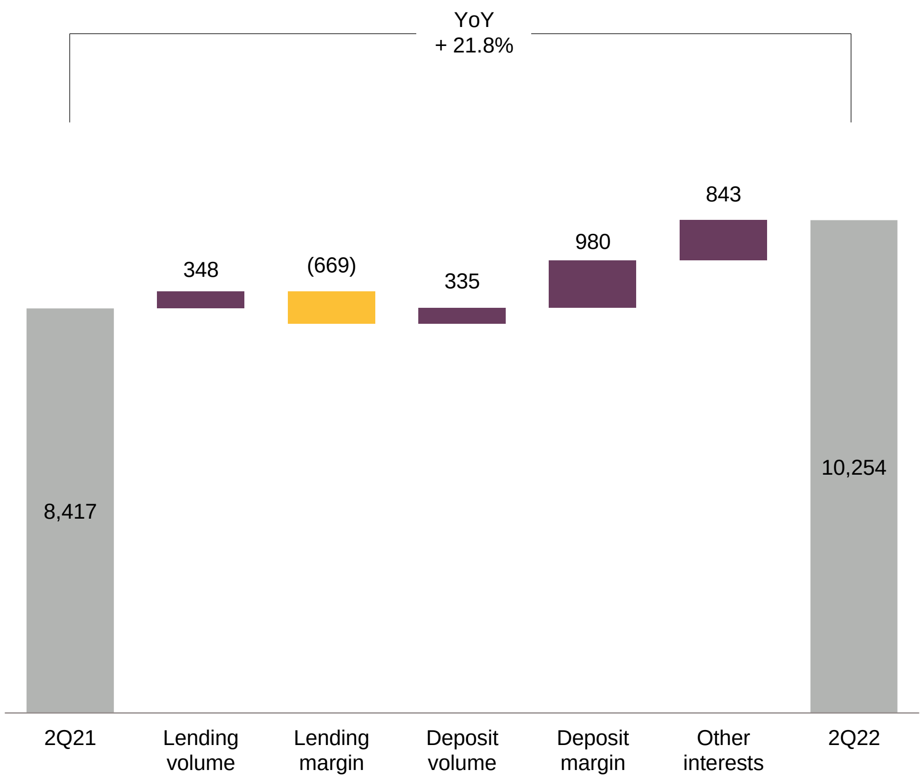
Net interest margin

On total assets



NII – comparison 2Q YoY

ISKm



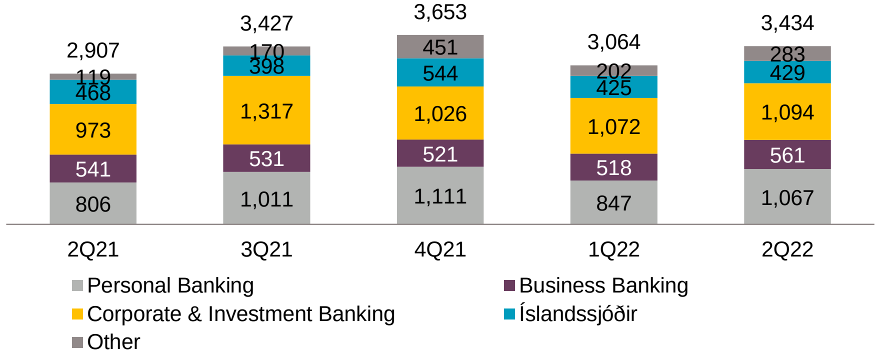
NFCI rose 18.1% YoY

Broad-based fee generation across the business units

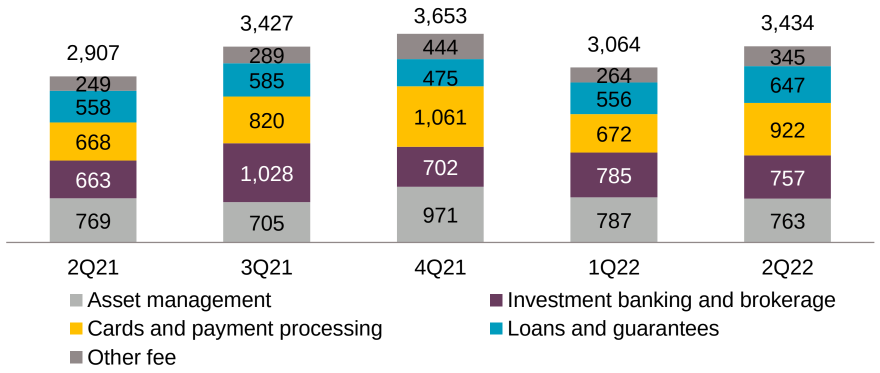
Highlights

- Revenues from investment banking and brokerage increase from currency sales and increased revenues from market making agreements
- Increased card transaction income and interchange income from cards, both domestic and foreign. Card expenses increased at the same time
- NFCI from loans and guarantees rose due to increased fees from guarantees and fees from changes of loan terms

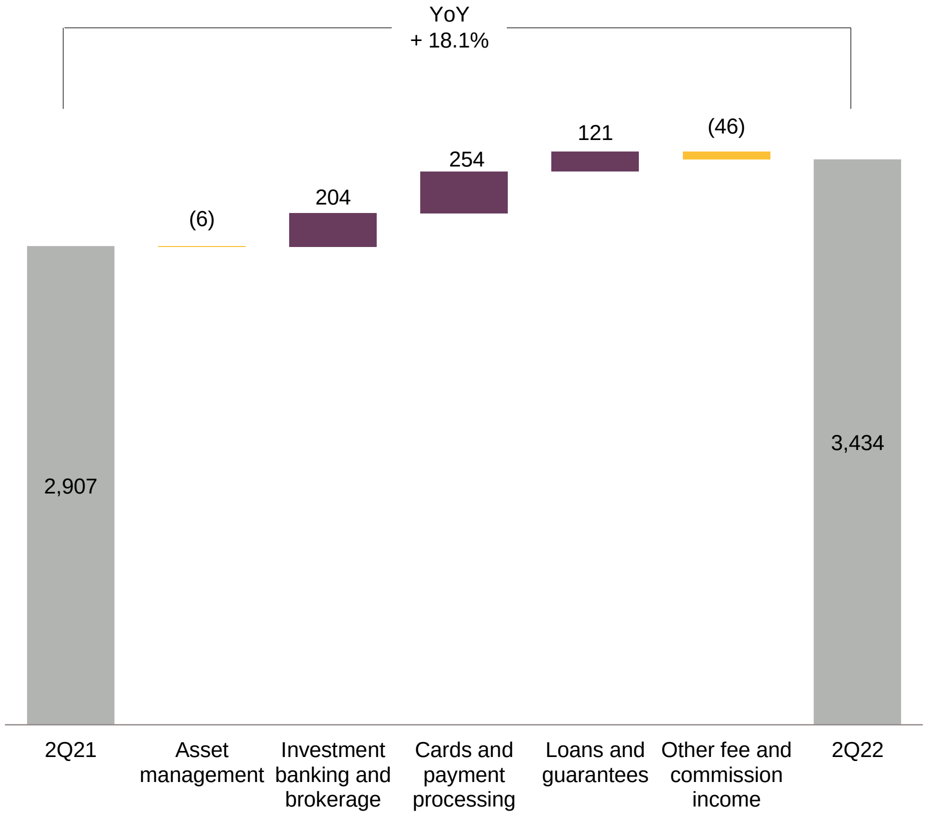
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



NFCI – comparison 2Q YoY
ISKm



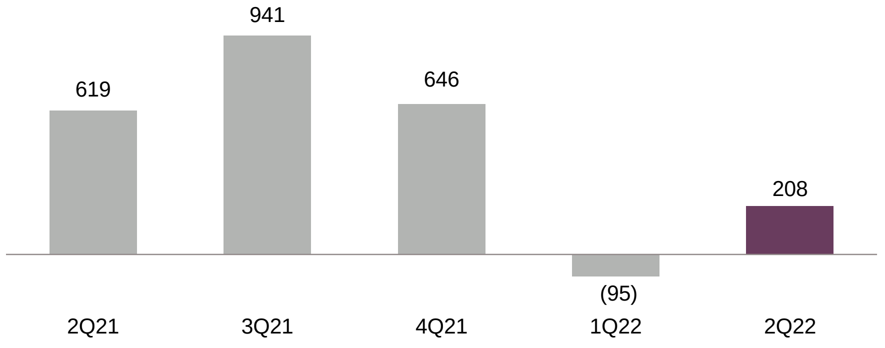
Positive NFI in turbulent markets

Rising benchmark interest rates do however support financial income in other derivatives

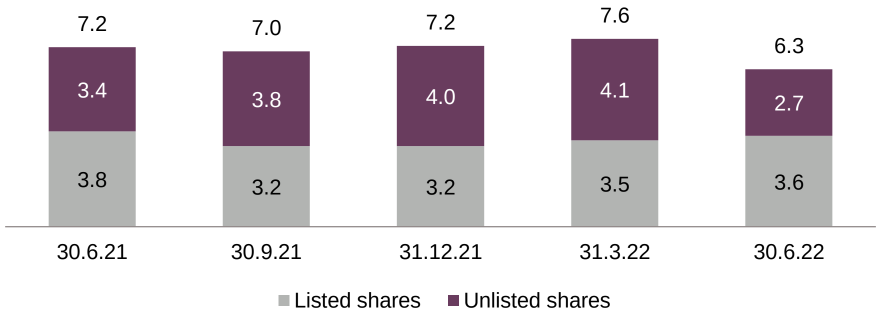
Highlights

- Reduction in shares and equity instruments in 2Q22 is explained by Norðurturninn hf. (owner of the Bank's headquarters) which was classified as shares and equity instrument but is now classified as an associate

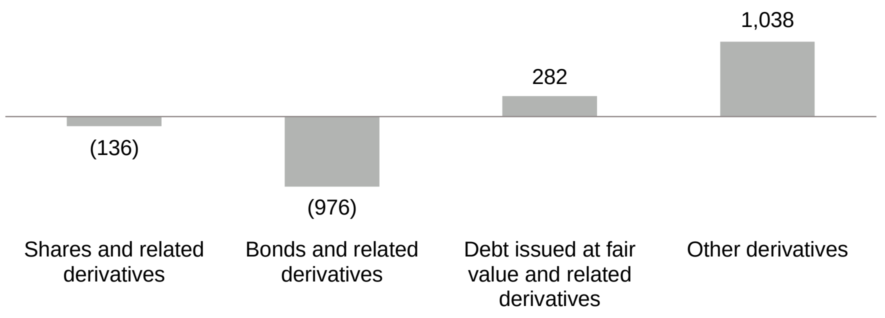
Net financial income
ISKm



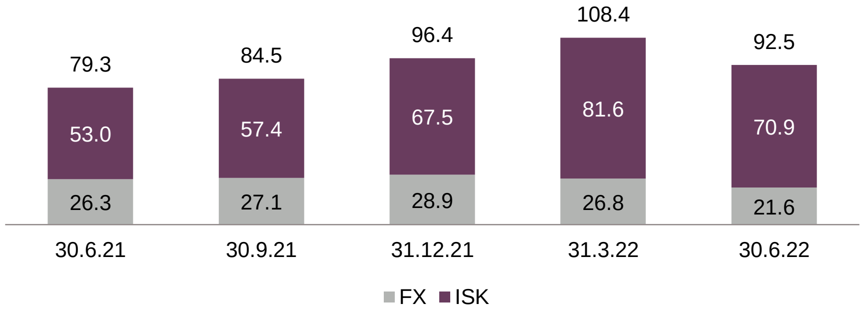
Shares and equity instruments[1]
ISKbn



Net financial income by type in 2Q22
ISKm



Bonds and debt instruments[2]
ISKbn

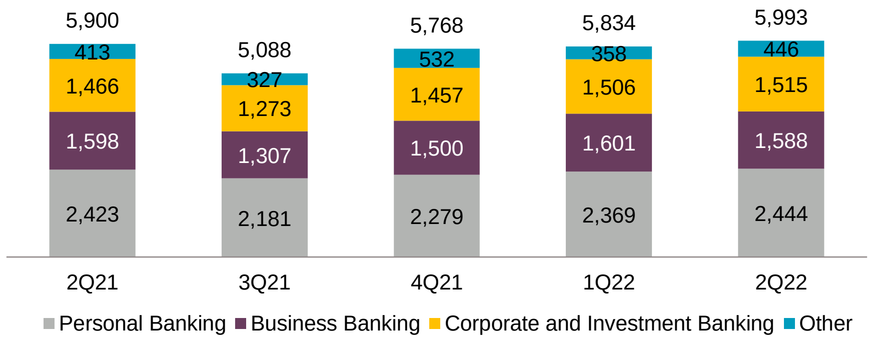


1.Excluding listed shares and equity instruments used for economic hedging. 2. Excluding listed bonds and debt instruments used for economic hedging.

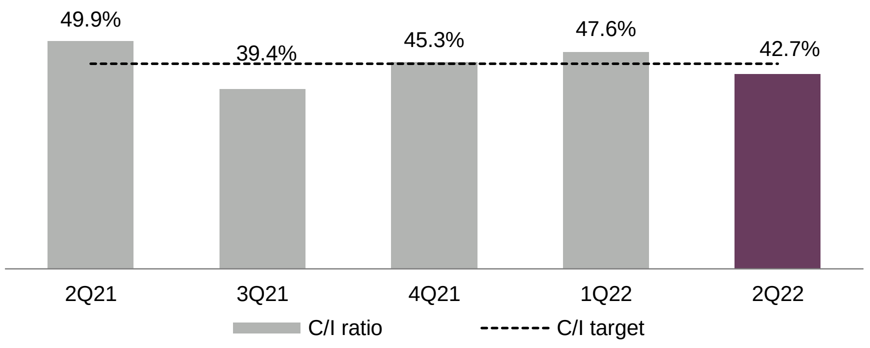
Administrative expenses stable in 2Q22

5.9% reduction in real terms driven by lower salary costs

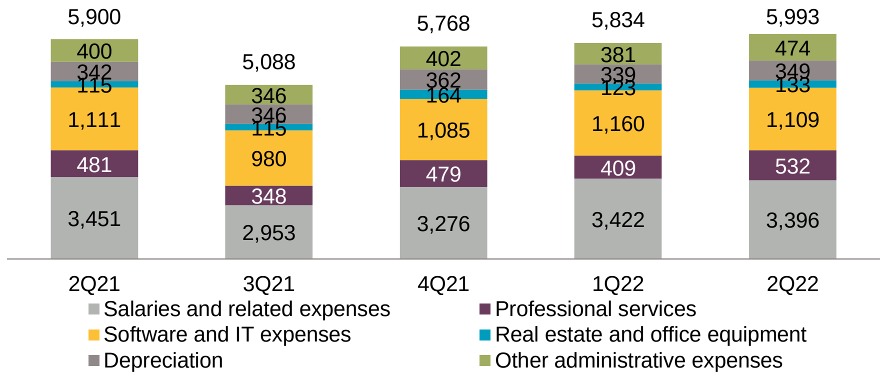
Administrative expenses[1]
ISKm



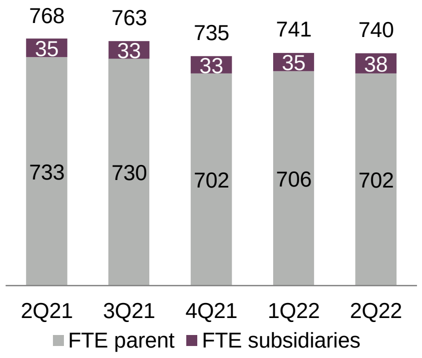
Cost-to-income ratio[2]



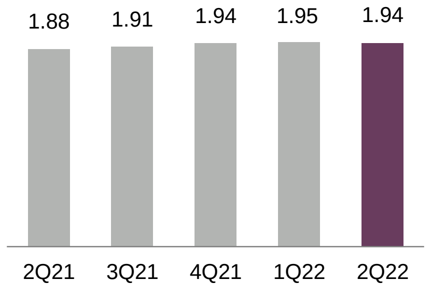
Administrative expenses[1] – by type
ISKm



FTE period end[3]



Total assets / FTE[3]
ISKbn



1. Administrative expenses in 2Q21 are excluding 588m one-off cost related to the Bank's IPO. 2. Calculated as (Administrative expenses + Contribution to the Depositor's and Investors' Guarantee Fund – one off items) / Total operating income – one-off items). 2. Target was updated in 1Q21 from the previous <55% 3. FTE numbers exclude seasonal employees.

Impairment reversals continued in 2Q22

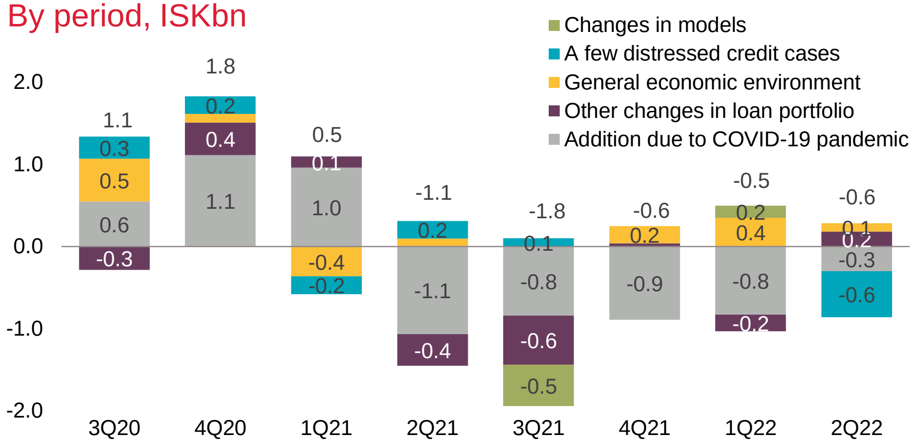
Majority of forborne borrowers have resumed payments

Highlights

- Reserve coverage ratio (RCR) for impairment allowance on Stage 3 was 24% at end of 2Q22
- The RCR fell when a disputed loan that had been fully impaired was paid up following a favourable court ruling
- The definition of forbearance includes a 24-month probation period. Therefore, loans are classified as forborne even after normal payments have resumed
- Loans amounting to ISK 66bn (80% of total) are expected to exit forbearance probation in 2022

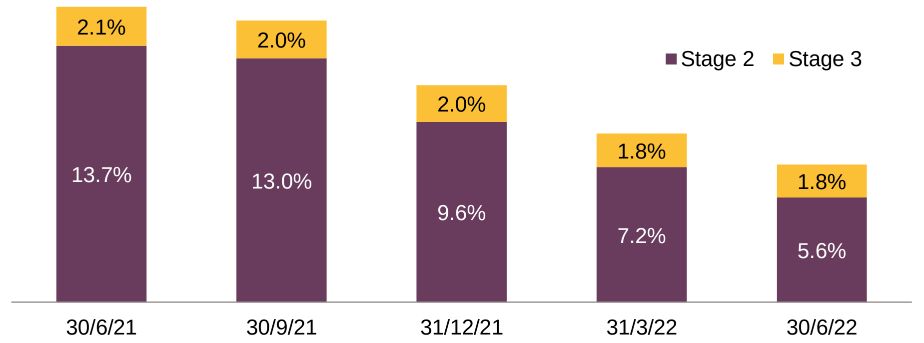
Net impairment on financial assets

By period, ISKbn



Loans to customers: Stage 2 and 3 (NPL)

Development of gross carrying amount as ratio of total loans

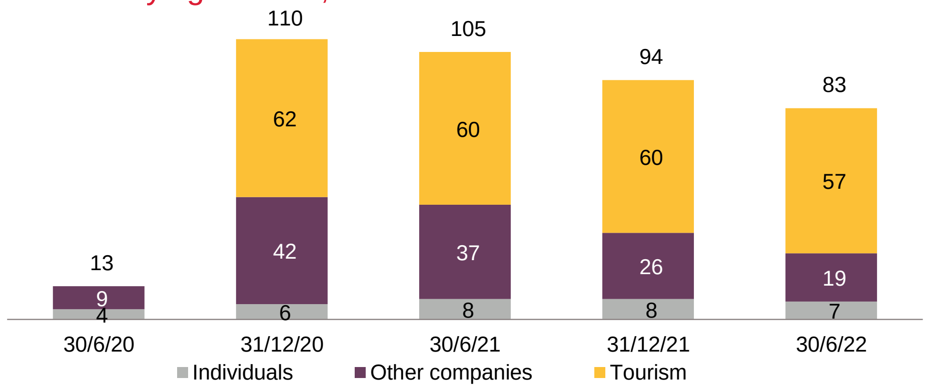


Current and expected cost-of-risk

- Annualised cost of risk was -20bp in 2Q22 compared to -42bp for 2Q21
- Additional impairment allowance currently attributable to the tourism overlay and stage transfer is approx. ISK 0.9bn at end of 2Q22 down from 2.0bn at YE21
- The probability weights of economic scenarios were shifted to 20% (good), 50% (baseline), and 30% (bad) at end of 2Q22. A shift of 5% from baseline to the bad scenario would increase the impairment allowance by ISK 0.3bn while a 5% shift from the baseline to the good would decrease the allowance by ISK 0.15bn
- In 2Q22 a total of approximately ISK 750m of impairment reversals was a result of a favourable court ruling regarding a fully impaired loan

Performing loans with forbearance

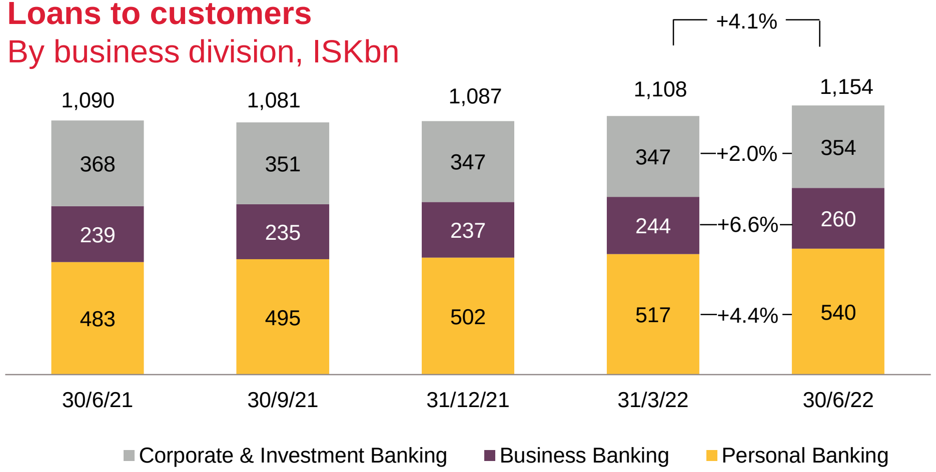
Gross carrying amount, ISKbn



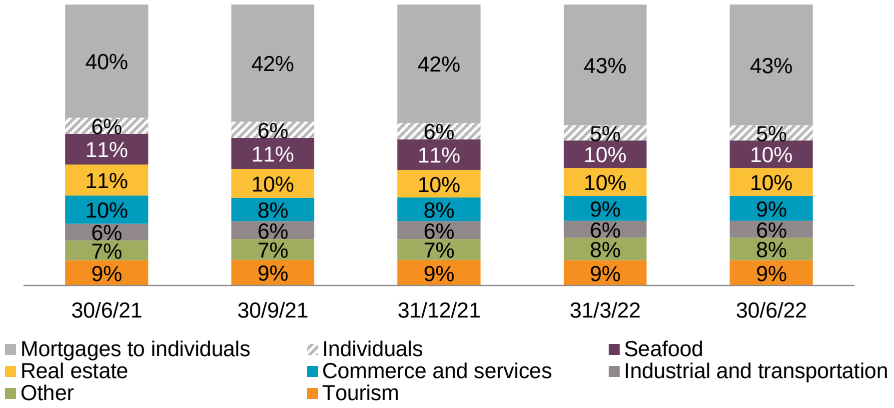
Lending volume growth across all business units

Credit quality remains strong and highly collateralised loan portfolio

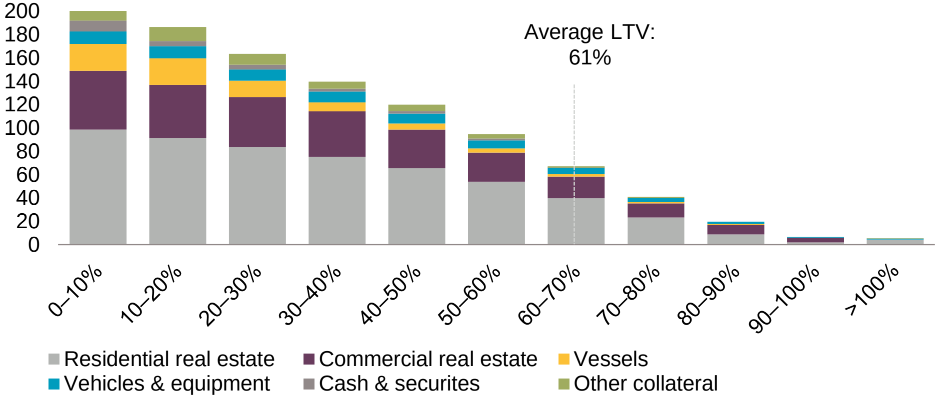
Loans to customers
By business division, ISKbn



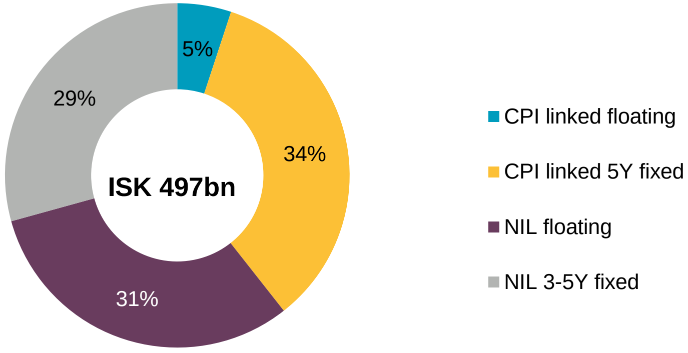
Loans to customers
By sector, with tourism as a separate sector



LTV distribution by underlying asset class
30.6.2022, loan splitting approach, ISKbn



Mortgage portfolio[1]
Gross carrying amount, 30.6.2022



1. NIL stands for non-index linked loans.

Deposits are the largest source of funding

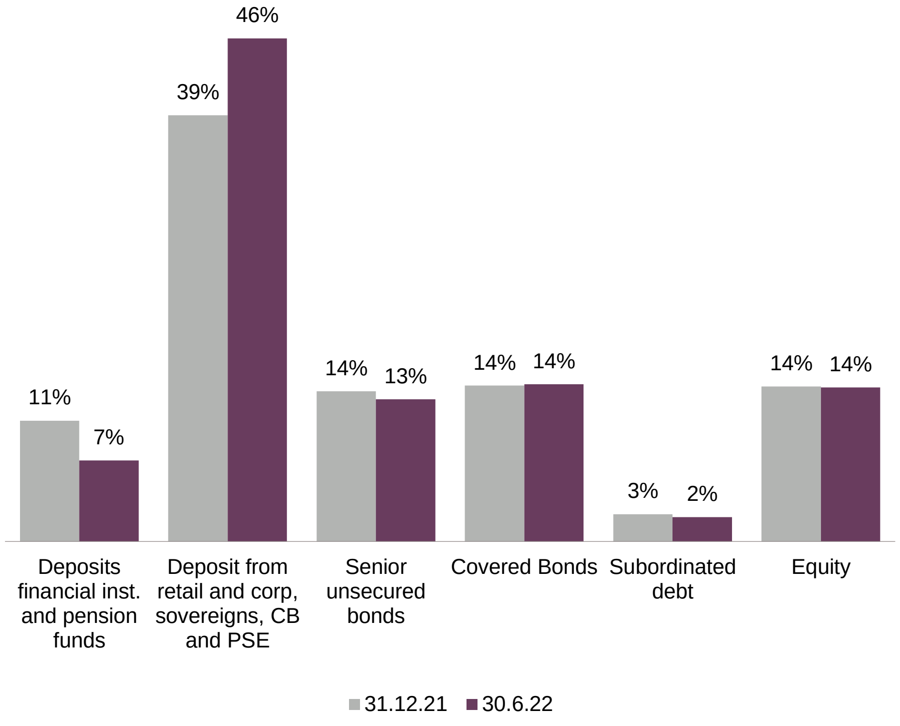
Retail deposits continue to increase

Highlights

- Term deposits are 18% of total deposits
- Deposit concentration is stable. 11% of the Bank’s deposits belonged to the 10 largest depositors and 27% to the 100 largest depositors at 2Q22, compared to 12% and 28% respectively at YE21
- At end of 2Q22 75% of deposits were in non-indexed ISK, 13% CPI-linked and 12% in foreign currencies

Funding sources

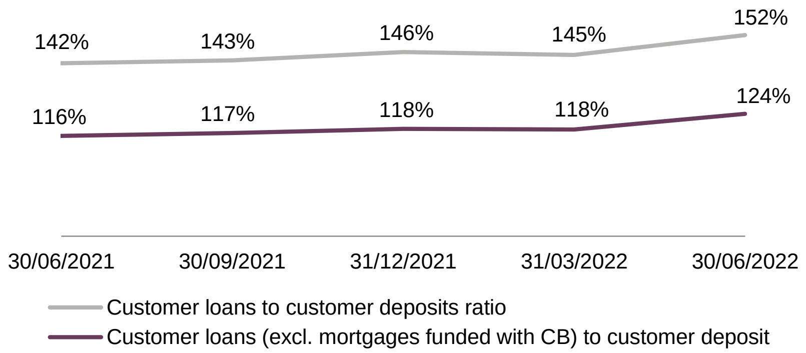
By type, % of total liabilities and equity



Short-term funding | Long-term funding

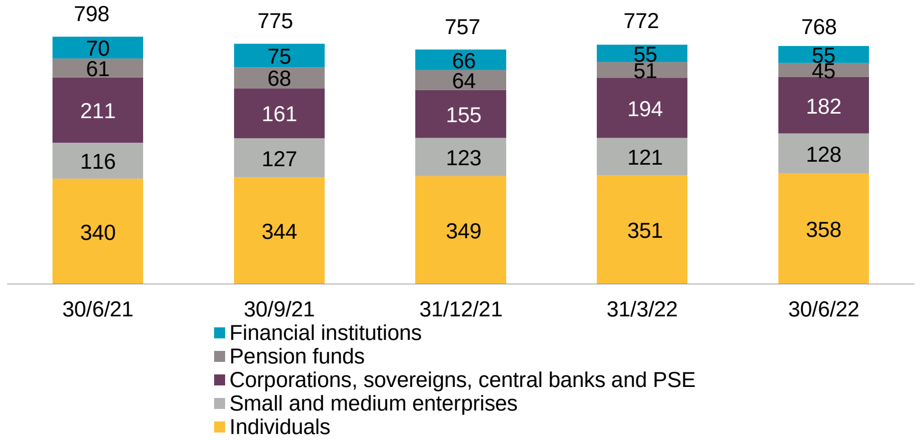
Customer loans to customer deposits ratio

Development, %



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

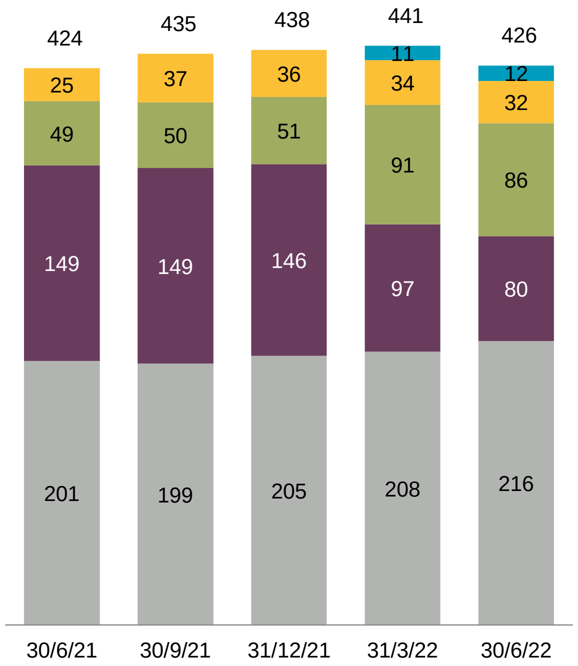
Majority of 2022 maturities already funded through €300m sustainable bond issue in January

Highlights

- S&P Global ratings BBB/A-2 with stable outlook confirmed on 13 July 2022
- In June, the Bank signed a new covered bond programme. Rated A by Standard & Poor's, it will permit issuance in foreign currencies, allowing broader market access and investor diversification
- The Bank has a call option on its SEK 750 Tier 2 of 2027 in November 2022 and a January 2023 call on its EUR 300m senior bond maturing in January 2024
- At end of 2Q22, total LCR ratio was 147%, FX LCR was 240% and total NFSR was 118%
- The Bank's MREL requirement is 21% of total risk exposure amount (TREA) and applies from the date of the announcement, 26 April 2022. The Bank will fulfil the MREL requirement from the outset

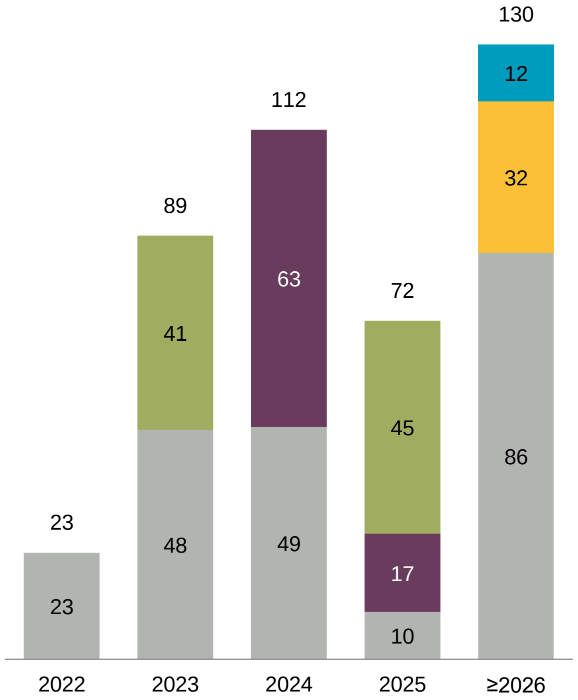
Sources of borrowings

Development, ISKbn



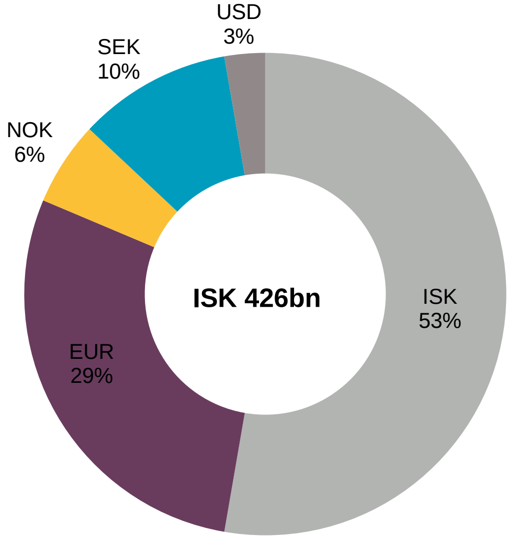
Contractual maturity profile of borrowings

ISKbn



Currency split of borrowings

30.6.22



Strong capital position and dividend capacity

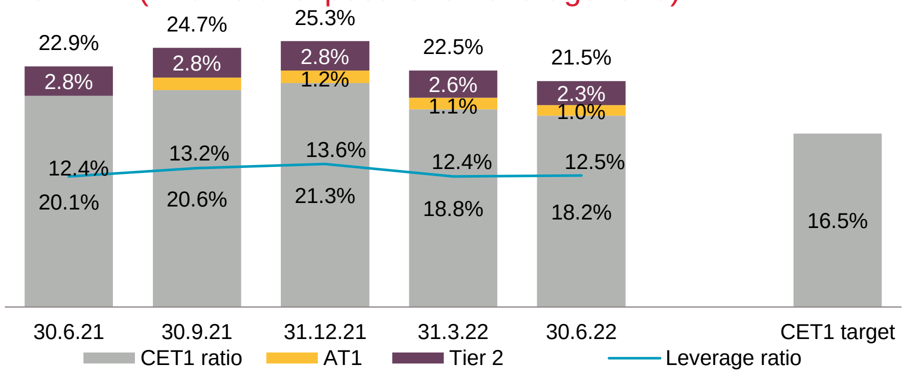
Opportunity exists to optimise capital composition and to continue consistent dividends

Highlights

- Current and long-term expected total capital requirements of 17.9% and 19.0% respectively
- Additional AT1 issuance potential of ISK 6-7bn to optimise capital structure
- Increase in REA in 2Q22 due to strong and profitable loan growth in 2Q22. This leads to drop in CET1 ratio and a reduction in excess capital

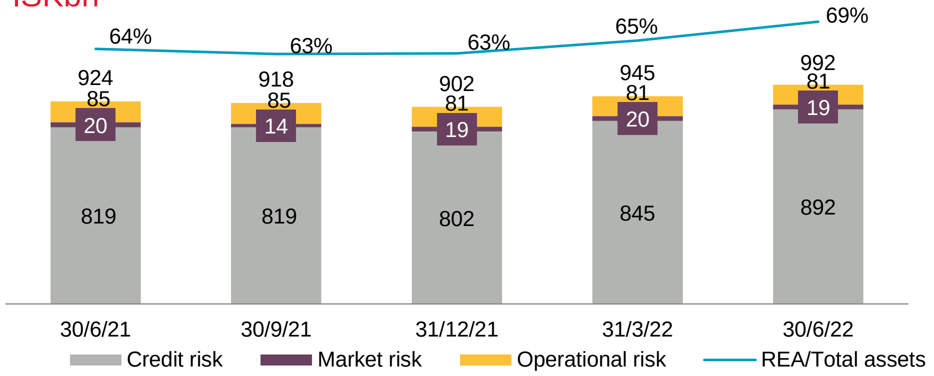
Capital ratios and leverage ratio

% of REA (% of total exposure for leverage ratio)



Risk exposure amount (REA)

ISKbn



Capital distribution plans

- **ISK 30-35bn of excess CET1 capital**
  - Plan to optimise capital structure before year-end 2023
  - Distribution in the form of share buybacks or special dividends, method and timing subject to the market conditions
  - ISK 15bn of capital release planned in the coming months, subject to market conditions

Mortgage origination and underwriting

August-September 2022

Mortgage portfolio – a broad offering

Direct origination and competitive interest rates

Characteristics

- Íslandsbanki originates mortgage loans directly, without collaborating with any brokers
- The pricing strategy is to offer competitive interest rates, ensure good profitability in accordance with the bank’s profitability goals and maintain steady growth in the mortgage market
- Íslandsbanki follows a standard underwriting procedure when it comes to mortgage lending
- In terms of products, the basic loan covers up to 70% of the official real estate value. Borrowers are also offered to take out additional loans up to 80% of the purchase price. Special rules apply for loans in excess of ISK 75m
- For refinancing the loan covers up to 70% of the official real estate value
- Íslandsbanki also offers a special loan of ISK 3m for those who are buying a house for the first time. The loan is in addition to the traditional 80% housing financing of the purchase price, but up to a maximum of 90%

Type of product offerings

1. **Variable non-indexed mortgage**
2. **Variable non-indexed mortgage - additional loan**
3. **Fixed non-indexed mortgage for 3 years**
4. **Fixed non-indexed mortgage for 3 years - additional loan**
5. **Fixed non-indexed mortgage for 5 years**
6. **Fixed non-indexed mortgage for 5 years - additional loan**
7. **Indexed mortgage, with interest rate reset every 5 years**
8. **Indexed mortgage, with interest rate reset every 5 years - additional loan**
9. **Indexed mortgage, with variable interest rates**
10. **Indexed mortgage, with variable interest rates - additional loan**
11. **Variable non-indexed first purchase loan**

Different features for different needs

Borrowers can choose from an array of solutions

Non-indexed loans

- Higher debt burden to begin with
- Inflation does not increase with the loan, which is constantly repaid
- Faster asset formation where the cost of capital is paid every month

Indexed loans

- Lower debt burden to begin with
- Indexation is added to the balance of the loan
- Slower asset formation in the beginning

Equal payments

- Borrower pays the same total amount each month
- Lower debt burden initially
- Much more common (around 95% of the portfolio)

Equal instalments

- Borrower pays the same amount of principal each month
- Higher debt burden initially
- Fixed interest rates

Variable interest rates

- The debt service burden varies according to the current interest rate at any given time
- Suitable if interest rates are falling
- No prepayment fees

Loan term

- Maximum loan period is 40 years for non-indexed loans and 30 years for indexed loans

Fixed rate

- Fixed for 3 or 5 years on non-indexed loans. Interest rate becomes variable once fixed rate period has elapsed
- Fixed for 5 years at a time on indexed loans (then the interest rate is reset every 5 years etc.)
- Generally higher than variable interest rates
- So-called prepayment charge (maximum 1%)

Conservative lending criteria

Applicants must meet a stringent set of requirements

- Individuals intending to buy or refinance a home for own use can apply for a mortgage with Íslandsbanki
- Borrowers can renew their interest rates due to lower LTVs through refinancing, which is common in Iceland
- Íslandsbanki will have first lien position or equal lien on the property in accordance with the loan rules
- Each application is evaluated with regards to the credit rating of the applicant, the credit assessment and the value of the property. Special terms apply to loans that exceed ISK 75m in terms of LTVs and the person’s ability to pay
- Each applicant must successfully complete a credit evaluation, before a loan application can be accepted
- The loan products are divided into base loans (A) and additional loans (B) based on the LTV:
  - Base loan (A): 70% of official real estate value (i. fasteignamat) - (base loans are in the cover pool)
  - Additional loan (B): Up to 80% of property purchase price
- Íslandsbanki offers a special loan up to a maximum of ISK 3m for those who are buying a house for the first time. The loan is in addition to the traditional 80% of the purchase price, but up to a maximum of 90%
- LTI (Loan-to-income): In general, it is ensured that the mortgage payment burden does not exceed 30% of paid income. First-time buyers have an exemption of up to 35%.

Higher interest rates for higher LTVs

Generally the loan part that exceeds the 70% limit is subject to a higher rate

Mortgage product type	Current interest rate	LTV	Loan period (years)
Variable non-indexed mortgage	6.65%	70%	40
Variable non-indexed mortgage rates - additional loan	7.75%	80%[1]	40
Fixed non-indexed mortgage for 3 years	7.65%	70%	40
Fixed non-indexed mortgage for 3 years - additional loan	8.75%	80%[1]	40
Fixed non-indexed mortgage for 5 years	8.05%	70%	40
Fixed non-indexed mortgage for 5 years - additional loan	9.15%	80%[1]	40
Indexed mortgages, with interest rate reset every 5 years	2.30%	70%	30
Indexed mortgages, with interest rate reset every 5 years - additional loan	3.40%	80%[1]	30
Indexed mortgage, with variable interest rates	2.65%	70%	30
Indexed mortgage, with variable interest rates - additional loan	3.75%	80%[1]	30
Variable non-indexed first purchase loan (max ISK 3 million loan)	8.10%	85%	10

Mortgage book breakdown as at 30 June 2022 (ISKbn)	
Variable Non-indexed	149
Fixed Non-indexed	146
Variable Non-indexed first-time buyer loan	5
Total (Non-indexed)	300
Variable Indexed	27
Fixed Indexed	171
Total (Indexed)	198
Mortgage Total	498

1. 80% LTV when buying real estate and 70% of official real estate value when refinancing

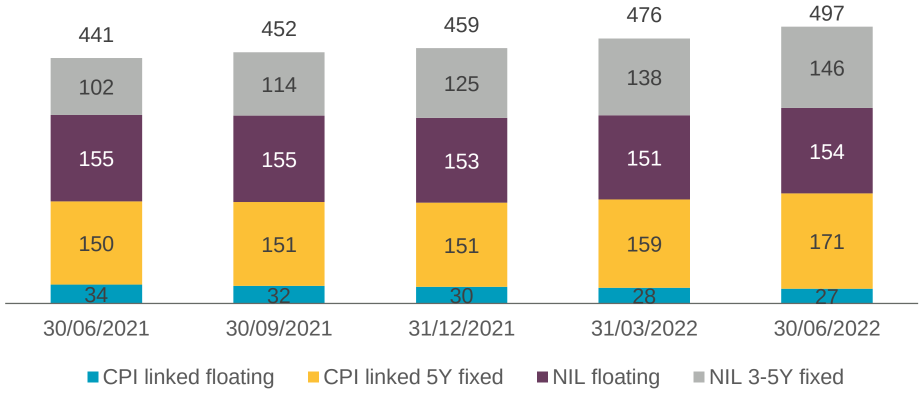
Robust mortgage portfolio

Average LTVs stable and built-in buffers for rate increases

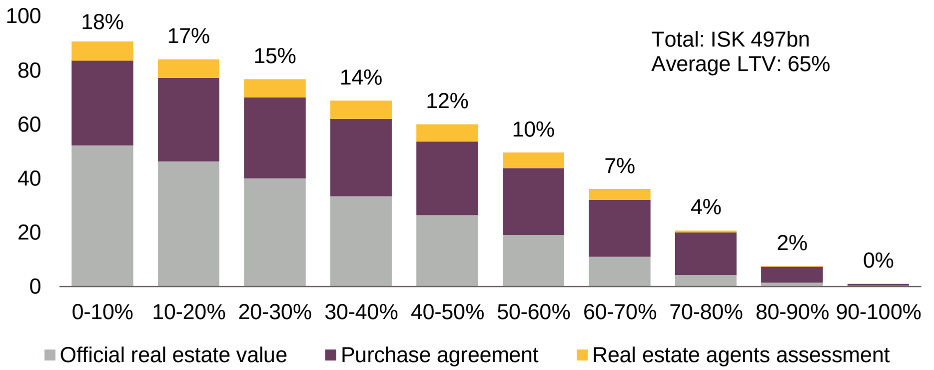
Highlights

- Conservative payment assessment for non-indexed variable rates mortgages in low interest environment makes the Bank's customers well equipped for higher interest rate environment
- LTV is capped at 80% (85% for first time buyers) and debt service-to-income <35% (40% for first-time buyers)
- Sensitivity analysis conducted at year-end showed that if rates would rise by 5% it would not lead to a further capital requirement for the Bank. The Bank's rates have now risen by 2.85% since the analysis and are not expected to exceed the 5% stress test range
- If official real estate value for 2023 was used instead of the official 2022 value, then property value would increase by 26% on average and LTVs would decrease

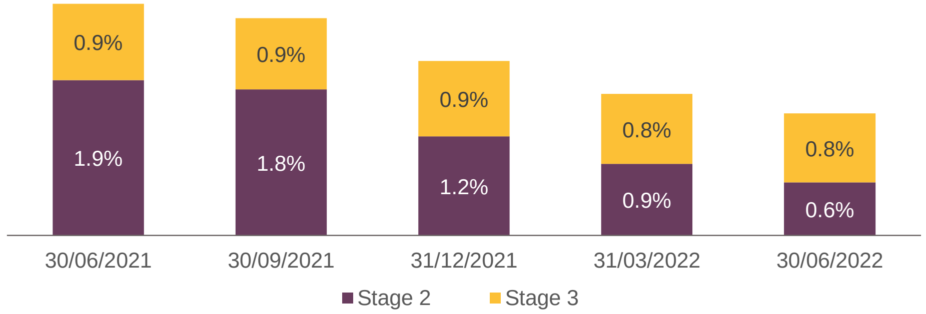
Mortgage portfolio
Gross carrying amount, ISKbn



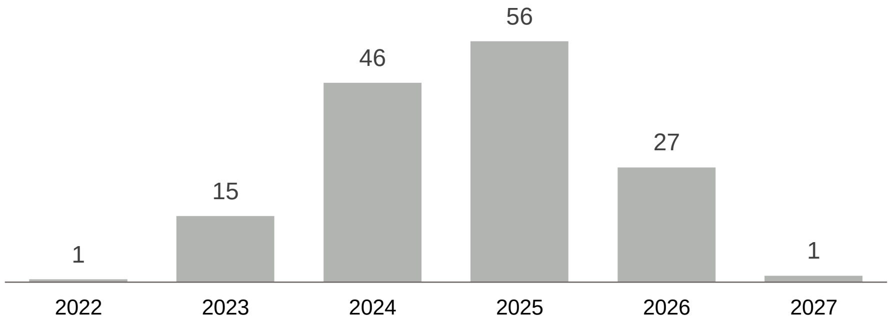
LTV distribution of mortgages to individuals
Gross carrying amount, ISKbn, 30.6.2022



Mortgages portfolio: Stage 2 and 3 (NPL)
Development of gross carrying amount as ratio of mortgages portfolio



Interest rate reset profile for NIL 3-5Y fixed rate mortgages[1]
Gross carrying amount, ISKbn



1. NIL stands for non-index linked loans

Property valuations are regularly updated

LTVs are generally determined based on the official real estate value

Highlights

- Property valuations are updated at least once a year by an external surveyor
- Íslandsbanki uses an official real estate value which is published once a year. In addition, the Bank uses an independent third party valuation model as well in some cases
- The product type depends on the LTV ratio in terms of the borrower's financing needs
- Base loan (A) is up to 70% of official real estate value
- Additional loan (B) is up to 80% of property price
- In terms of refinancing, the maximum loan is 70% of official real estate value (A - Base loan)

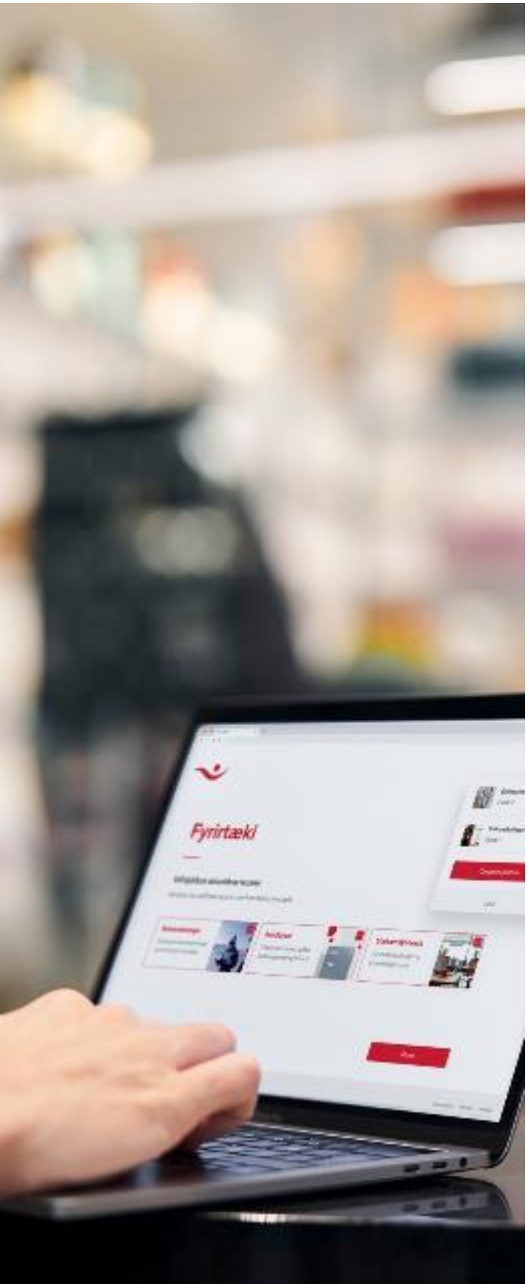
Example

An individual buys an apartment for the first time. The price is ISK 50.000.000 and the official real estate value of the property is ISK 40.000.000. The customer is looking for a maximum loan to buy his first apartment and has a down payment of ISK 7,000,000.

The funding in terms of product types and LTV would be:

- Down payment (savings): ISK 7,000,000
- Base loan (A): ISK 28,000,000 (70% of the official real estate value, ISK 40,000,000)
- Additional loan (B): ISK 12,000,000 (from 70% up to 80% of the property price)
- First-time buyer loan (C): ISK 3,000,000 (in addition to the traditional 80% housing financing of the purchase price)

  Total loan amount: ISK 43,000,000
- LTV: 86%



Application process is streamlined

Response is normally delivered within 1 to 5 days

The application process for a mortgage is fully digital, with 99% of applications being made digitally

Information required: All necessary data is retrieved digitally through a third party, such as credit rating and debt statement from Credit Info, and information on salary income at the tax authority, when performing an automatic credit assessment. The credit assessment is the first step in the process before the client chooses a loan form, an amount, etc.

Risk profile considerations: The ability to pay can affect the form of the loan choice. The product offering to customers in some cases varies by risk profile; for instance, lower income individuals cannot take out non-indexed loans because the debt burden is too high or in excess of 30% of their disposable income

Timeline: It normally takes 1-5 days to finalize a credit decision on behalf of the Bank

Rejection rate and type: The rejection rate has been in the range of 1-5% of all loan applications in recent years. Examples of rejections can be insufficient completion of a property in construction stage, inadequate credit rating, missing cost estimates for improvements or deficiencies in the property, the borrower not being domiciled in the property, etc.

Loans past due are monitored closely

Foreclosure procedures are not expected to take more than 18 months

Highlights

- Íslandsbanki takes out a list once a month of all debts that are in arrears over 30 days. The Bank keeps a close eye on a daily basis on all arrears that have reached 55 days past-due; on a monthly basis, customers who do not have other debts in legal collection receive a text message or an e-mail
- The legal publication is read daily and if debt is secured by collateral, notifications of forced sales are received, in order to spot early warning signals
- On default, the first letter is sent out on the 7th day since default. The second letter (intermediate collection letter) is issued on the 17th day since default and finally, the third letter, the Final Warning, is issued on the 31st day since default
- Mortgage loans past-due for 90 days or more are removed from the cover pool

Foreclosure procedure

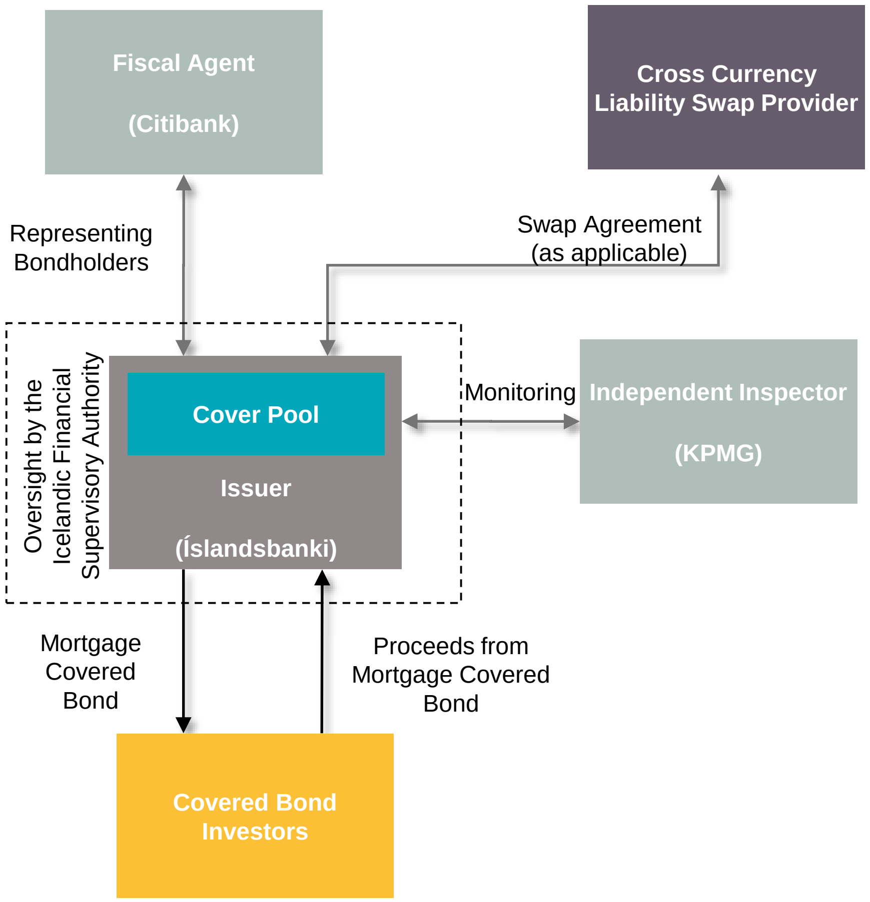
- If the debt is secured, letter number two is a payment challenge 15 days after the collection letter. A forced sale request is sent out 15 days after a demand for payment is published by a policy witness or when a confiscation of property is available. The sheriff issues a time when the first forced sale takes place (can be up to two months after request). Approximately 4 weeks after the first forced sale, the start of the auction takes place and about 4 weeks after that, the final sale of the property itself takes place. The process can take 6-12 months. If the debt is not paid in full at auction, a request for enforcement is then made and an unsuccessful foreclosure is requested, and the debt is then written off and sent to the claims shift at Mótus (third party collateral)
- From the time the case comes in for collection at 55-60 days in arrears, the process can take from 10 months up to 18 months if there is no response from the debtor

Covered bond programme and cover pool

Íslandsbanki's covered bond programme

Assets are ring-fenced on the issuer's balance sheet

Transaction Structure



Key features

- Íslandsbanki's covered bond programme reflects the Icelandic ring fencing on balance sheet structure: the assets inlcuded in the cover pool are segregated from Íslandsbanki's remaining assets by way of registration in a cover assets register, with no need to transfer the cover pool to a separate entity
- The covered bondholders benefit from dual recourse to both Íslandsbanki on an unsecured basis and to the cover pool of assets
- The programme currently commits to an overcollateralisation (OC) of 25%, which will gradually decrease to 5% by 2030 – the Icelandic covered bond framework protects the OC for the benefit of the bondholders in the event of issuer insolvency
- The cover pool is bankruptcy remote and exclusively available to meet outstanding claims under the covered bonds. It is composed exclusively of Icelandic residential mortgages. Substitute assets are allowed up to a limit of 20%
- The programme features a liquidity reserve covering 180 days of net outflows
- On 1 June 2022, S&P assigned a 'A' rating to the programme

Hedging structure

- Íslandsbanki established a collateral reserve account upon issuing its first EUR-denominated covered bond
- Assets and/or cash are pledged to the collateral reserve account according to the amounts and thresholds in S&P's rating methodology
- Covered bondholders have full recourse on the collateral reserve account
- The programme allows Íslandsbanki the flexibility to enter into swap agreements with external counterparties. Such swap agreements shall provide hedging from currency risk arising from mismatches between the covered mortgage loans included in the cover pool, denominated in ISK, and the amounts payable to the covered bondholders
- The amounts standing to the credit of the collateral reserve account may be used by Íslandsbanki to enter into a cross currency liability swap

Íslandsbanki’s covered bond programme – cont’d

Monitoring / Representation of Bondholders / Oversight

- The Independent Inspector is appointed by the issuer and approved by the Icelandic Financial Supervisory Authority, or *Fjármálaeftirlitið* (FME) to monitor the cover pool and the cover asset register. It also ensures compliance with matching and market risk limits in accordance with the Icelandic covered bond legislation. The Independent Inspector must submit a report of its inspection to the FME every six months and must notify the FME as soon as they learn about any event deemed to be significant to the supervisory authority
- The Fiscal Agent acts as a point of contact between the issuer and the covered bondholders. Any notices to be given to or by covered bondholders, for example, need to be submitted through the Fiscal Agent
- The FME oversees both covered bond issuer and application of the legal framework

Issuer bankruptcy does not entitle covered bondholders to accelerate the programme

- The programme does not feature issuer events of default, the occurrence of which would entitle covered bondholders to accelerate the covered bonds
- Pursuant to the Icelandic covered bond law, if an issuer enters into resolution proceedings issued covered bonds cannot be accelerated
- Following an issuer insolvency, any payments by borrowers of the mortgages included in the cover pool will also be added to the register and used to make payments under the covered bonds

Soft bullet maturity extension mechanism

- Upon failure of the issuer to pay the Final Redemption Amount of a series of covered bonds on their scheduled maturity date, payment of principal is automatically deferred to the Extended Final Maturity Date, provided that such an extension is contemplated in the final terms
- Such non payment does not result in the acceleration of the covered bonds
- The issuer can make a partial payment of the relevant Final Redemption Amount on any interest payment date following the maturity extension and up to the Extended Final Maturity Date
- Interest will continue to be payable on any unpaid amount on each interest payment date falling after the maturity date up to the Extended Final Maturity Date
- On the Extended Maturity Date, failure to pay the Final Redemption Amount will constitute a default

Account bank

- If the issuer ceases to be an Eligible Institution (i.e. it is downgraded below BBB-), it shall establish one or more of the following bank accounts in its name with an Eligible Institution: transaction account, liquidity reserve account and collateral reserve accounts denominated in ISK and any other currency for which there are covered bonds outstanding at the time
- The cash flows originated under the mortgage loans through borrower payments will be transferred to the transaction account
- In the event that any Eligible Institution ceases to be qualified as such, the issuer will be obliged to transfer the relevant issuer account to a credit institution with the appropriate minimum ratings

Matching rules are there to protect the investor

The Icelandic Covered Bond Act requires issuers to satisfy a set of requirements, known as matching rules, to ensure that the covered bond programme is able to mitigate asset-liability mismatches

Breach of matching rules requirements

- A breach of the matching requirements prior to the winding up of the issuer in circumstances where no additional assets are available to the issuer or the issuer lacks the ability to acquire additional assets could cause the FME to revoke the license to issue covered bonds
- If the matching requirements are breached following the winding up of the issuer, the winding up committee would not be permitted to add more assets to the cover pool

Nominal Value Test

- The total current value of the cover pool which is to serve as collateral for the covered bonds must always exceed the aggregate outstanding amount of covered bonds
- Loans that are more than 90 days past due are not taken into account for the calculation of the nominal value test
- Deposit set-off risk will be mitigated by Íslandsbanki through the deduction of such amounts from the nominal value of the cover pool for the purposes of calculating the Nominal Value Test, therefore increasing the required OC necessary to meet the test and providing additional protection to covered bondholders

Index matching

- The Bank conducts monthly tests to ensure interest matching between the inflation-linked assets in the cover pool and the outstanding inflation-linked covered bonds. The Independent Inspector has visibility over these tests and the matching of the aforementioned generally

Liquidity coverage

- Instalments and other cash flows accruing on the cover assets in the cover pool and from derivative agreements must be such that at any given time the issuer can meet all its financial obligations towards covered bondholders and counterparties to derivative agreements
- Íslandsbanki contractually commits to funding a liquidity reserve with the amount required to be paid on all outstanding covered bonds in respect of interest and third party expenses for the following 6 months
- Cash flows from mortgages in default (90 days or more) are ignored in the calculation and not included in the cover pool register

Asset Coverage Test

- On each monthly calculation date the issuer must ensure that the total value of the cover pool, including cash, the collateral reserve account and the liquidity reserve ledgers is greater than: (i) the total outstanding amount of all series of covered bonds (ii) any other payment obligations to be paid from the cover pool (iii) the deposit-set off amount

Net Present Value Test (interest rate sensitivity)

- On a net present value (NPV) basis, cover assets, including derivatives, must always exceed the corresponding value of interest and principal of the outstanding covered bonds, taking into account the effects of stress-test scenarios on interest and currency risk set by the FME
- The issuer and the covered bond programme must be able to withstand changes to the risk free interest rate with respect to the net cover pool value and ensure that the cover pool matching rules are still met under a best and worst case stress testing scenario
- Interest rate risk: the FME defines the stress test for interest rate risk as a sudden and sustained parallel shift in the reference curve by 100bps up and down
- Currency risk: likewise, the FME defines the currency risk stress test as a 10% sudden and sustained change in the relevant foreign exchange rate between the currency of covered bonds and the currency of cover assets

Cover Pool – main features

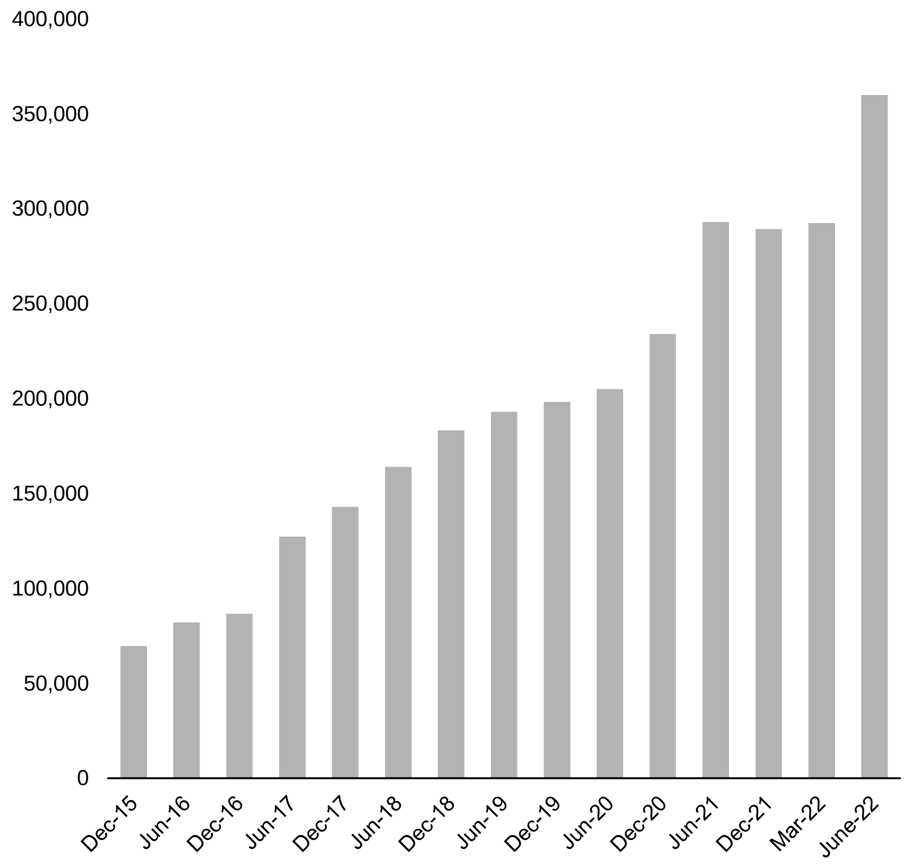
Cover pool made of entirely residential mortgage loans

Composition of the cover pool

- The cover pool currently consists of mortgage loans secured against residential properties located in Iceland – going forward, the intention is for this composition to be maintained
- All the properties included in the cover pool are owner-occupied
- Pursuant to the Icelandic Covered Bond Act, residential mortgage loans form part of the cover pool only up to a maximum LTV of 80%
- The Icelandic Covered Bond Act defines that the market value of the properties to be used for calculating the LTVs needs to be based on the selling price of comparable properties in recent transactions or, where such market value is not available, on a specific valuation carried out in accordance with generally accepted principles
- The Icelandic Covered Bond Act provides that no mortgage loan may be registered in the cover pool if they have been in arrears for 90 days or more
- The cover pool includes a mix of inflation-linked and non inflation-linked mortgage loans
- Loans granted to employees of Íslandsbanki are also included

Cover pool has expanded over years

ISKm



Cover Pool – main features – cont'd

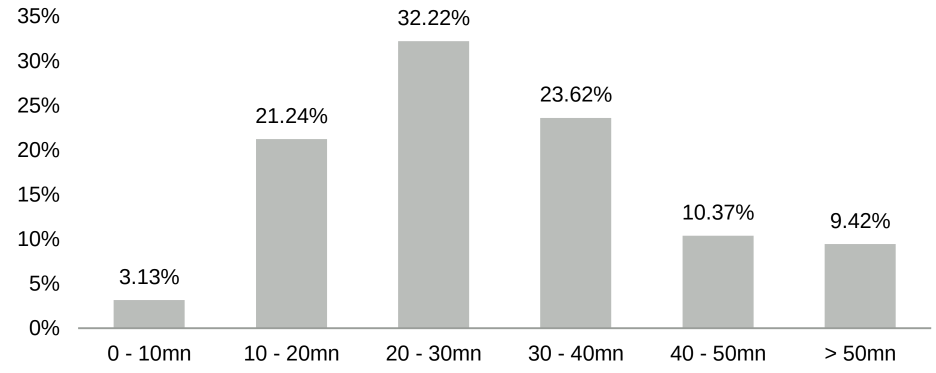
Nearly ISK 300bn of collateral backing the loans

Cover pool composition as at 30 June 2022

Cut-off Date	30/06/2022
Current Balance (ISKm)	360,064
Cover Pool Balance (ISKm)	360,064
Number of Loans	15,567
Number of Borrowers	13,855
WA Current LTV	56.13%
WA Seasoning (Years)	2.38
WA Remaining Term (Years)	33.06
Fixed rate (%)	66.86%
Variable rate (%)	33.13%
WA Interest Rate (%)	3.80%

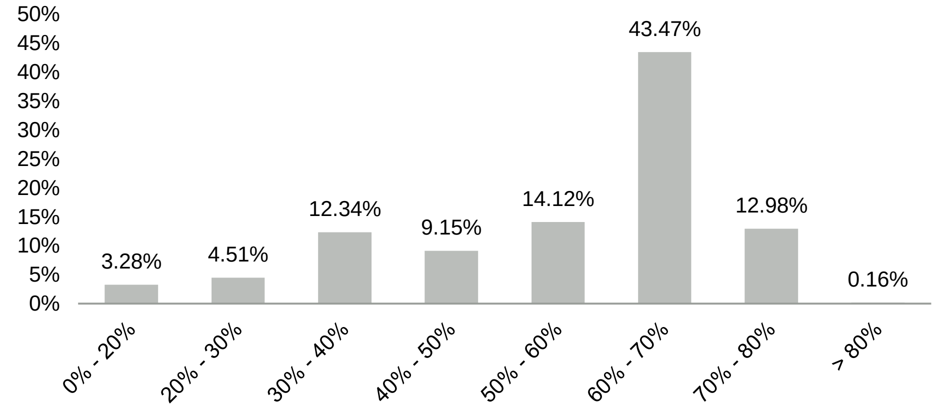
Current balance range

ISKm, 30 June 2022



LTV range

(% of current principal balance), 30 June 2022

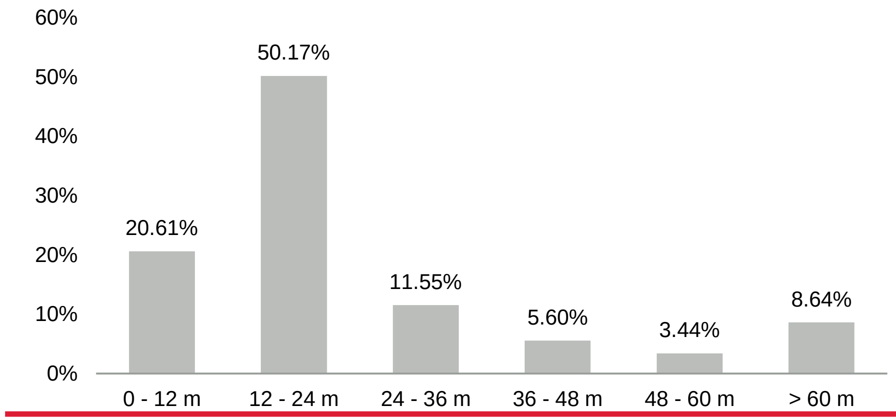


Cover Pool – main features – cont'd

Loan features are aligned with market standards

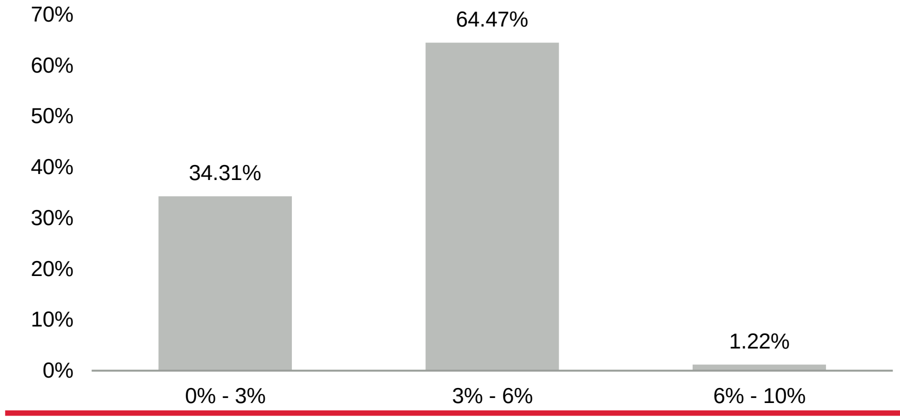
Seasoning profile, months

(% of current principal balance), 30 June 2022



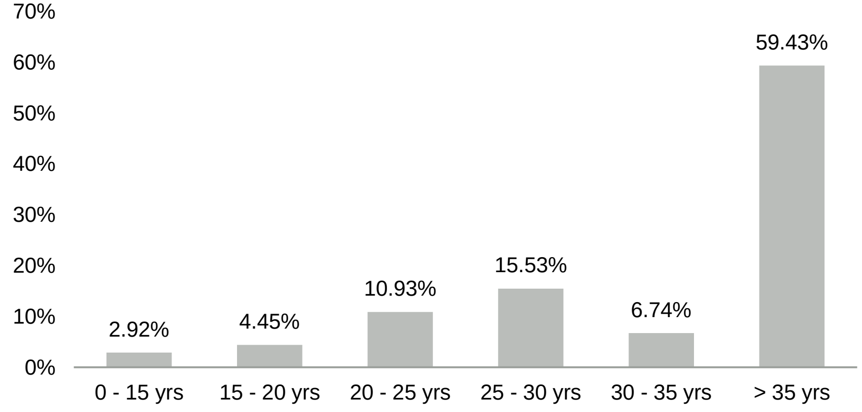
Interest rate range

(% of current principal balance), 30 June 2022



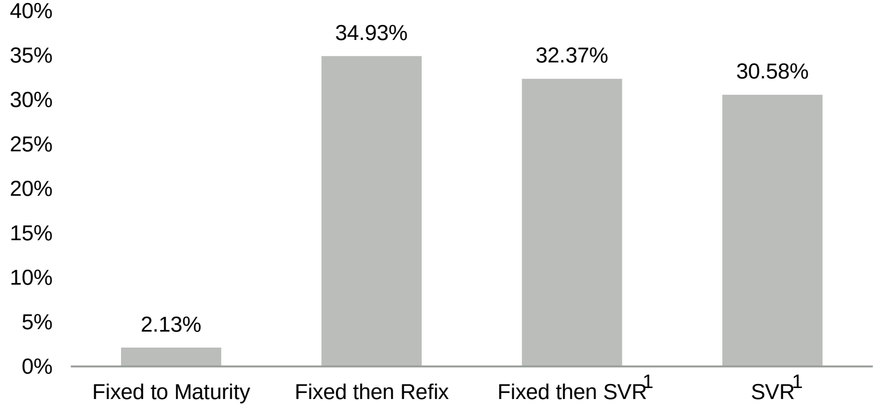
Remaining maturity term, years

(% of current principal balance), 30 June 2022



Current interest rate type

(% of current principal balance), 30 June 2022



1. SVR stands for Standard Variable Rate

Appendix I – About Íslandsbanki and additional financial information

Financial overview

Key figures & ratios

		2Q22	1Q22	4Q21	3Q21	2Q21
PROFITABILITY	Profit for the period, ISKm	**5,880**	5,187	7,092	7,587	5,431
	Return on equity	**11.7%**	10.2%	14.2%	15.7%	11.6%
	Net interest margin (of total assets)	**2.9%**	2.6%	2.4%	2.4%	2.4%
	Cost-to-income ratio[1]	**42.7%**	47.6%	45.3%	39.4%	49.9%
	Cost of risk[2]	**(0.20%)**	(0.17%)	(0.23%)	(0.64%)	(0.42%)
		30.6.22	**31.3.22**	**31.12.21**	**30.9.21**	**30.6.21**
BALANCE SHEET	Loans to customers, ISKm	**1,153,677**	1,107,893	1,086,327	1,081,418	1,089,723
	Total assets, ISKm	**1,437,253**	1,446,355	1,428,821	1,456,372	1,446,860
	Risk exposure amount, ISKm	**992,883**	945,321	901,646	917,764	924,375
	Deposits from customers, ISKm	**756,862**	761,471	744,036	754,442	765,614
	Customer loans to customer deposits ratio	**152%**	145%	146%	143%	142%
	Non-performing loans (NPL) ratio[3]	**1.8%**	1.8%	2.0%	2.0%	2.1%
LIQUIDITY	Net stable funding ratio (NSFR), for all currencies	**118%**	123%	122%	121%	122%
	Liquidity coverage ratio (LCR), for all currencies	**147%**	195%	156%	225%	187%
CAPITAL	Total equity, ISKm	**203,662**	197,201	203,710	197,381	190,355
	CET 1 ratio[4]	**18.2%**	18.8%	21.3%	20.6%	20.1%
	Tier 1 ratio[4]	**19.2%**	19.9%	22.5%	21.8%	20.1%
	Total capital ratio[4]	**21.5%**	22.5%	25.3%	24.7%	22.9%
	Leverage ratio[4]	**12.5%**	12.4%	13.6%	13.2%	12.4%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 2. Negative cost of risk means that there is a net release of impairments. 3. Stage 3, loans to customers, gross carrying amount. 4. Including 3Q21 profit for 30.9.21 and 1Q22 profit for 31.3.22.

Income growth of 16% YoY driven by NII and NFCI

Robust profitability in 2Q22 built on a solid platform

Income statement, ISKm	2Q22	2Q21	Δ%	1H22	1H21	Δ%	2021
Net interest income	**10,254**	8,417	22%	**19,463**	16,607	17%	34,043
Net fee and commission income	**3,434**	2,907	18%	**6,498**	5,769	13%	12,849
Net financial income (expense)	**208**	619	(66%)	**113**	912	(88%)	2,499
Net foreign exchange gain	**75**	95	(21%)	**241**	225	7%	479
Other operating income	**59**	82	(28%)	**324**	204	59%	302
Total operating income	**14,030**	12,120	16%	**26,639**	23,717	12%	50,172
Salaries and related expenses	**(3,396)**	(3,594)	(6%)	**(6,818)**	(7,168)	(5%)	(13,397)
Other operating expenses	**(2,597)**	(2,894)	(10%)	**(5,009)**	(5,172)	(3%)	(9,799)
Administrative expenses	**(5,993)**	(6,488)	(8%)	**(11,827)**	(12,340)	(4%)	(23,196)
Contribution to the Depositor's and Investors' Guarantee Fund	0	(162)	(100%)	**(165)**	(344)	(52%)	(688)
Bank tax	(412)	(451)	(9%)	**(842)**	(861)	(2%)	(1,683)
Total operating expenses	**(6,405)**	(7,101)	(10%)	**(12,834)**	(13,545)	(5%)	(25,567)
Net impairment on financial assets	**575**	1,140	(50%)	**1,058**	622	70%	3,018
Profit before tax	**8,200**	6,159	33%	**14,863**	10,794	38%	27,623
Income tax expense	**(2,331)**	(769)	203%	**(3,794)**	(1,805)	110%	(5,119)
Profit for the period from continuing operations	**5,869**	5,390	9%	**11,069**	8,989	23%	22,504
Discontinued operations held for sale, net of income tax	**11**	41	(73%)	**(2)**	57	(104%)	1,221
Profit for the period	**5,880**	5,431	8%	**11,067**	9,046	22%	23,725

Key ratios							
Net Interest Margin (NIM)	**2.9%**	2.4%		**2.7%**	2.4%		2.4%
Cost-to-income ratio (C/I)	**42.7%**	49.9%		**45.0%**	50.6%		46.2%
Return on Equity (ROE)	**11.7%**	11.6%		**10.9%**	9.7%		12.3%
Cost of risk (COR)	**(0.20%)**	(0.42%)		**(0.19%)**	0.12%		(0.28%)

Balance sheet reflects a balanced loan and funding profile

Conservative mix of assets and stable funding

Assets

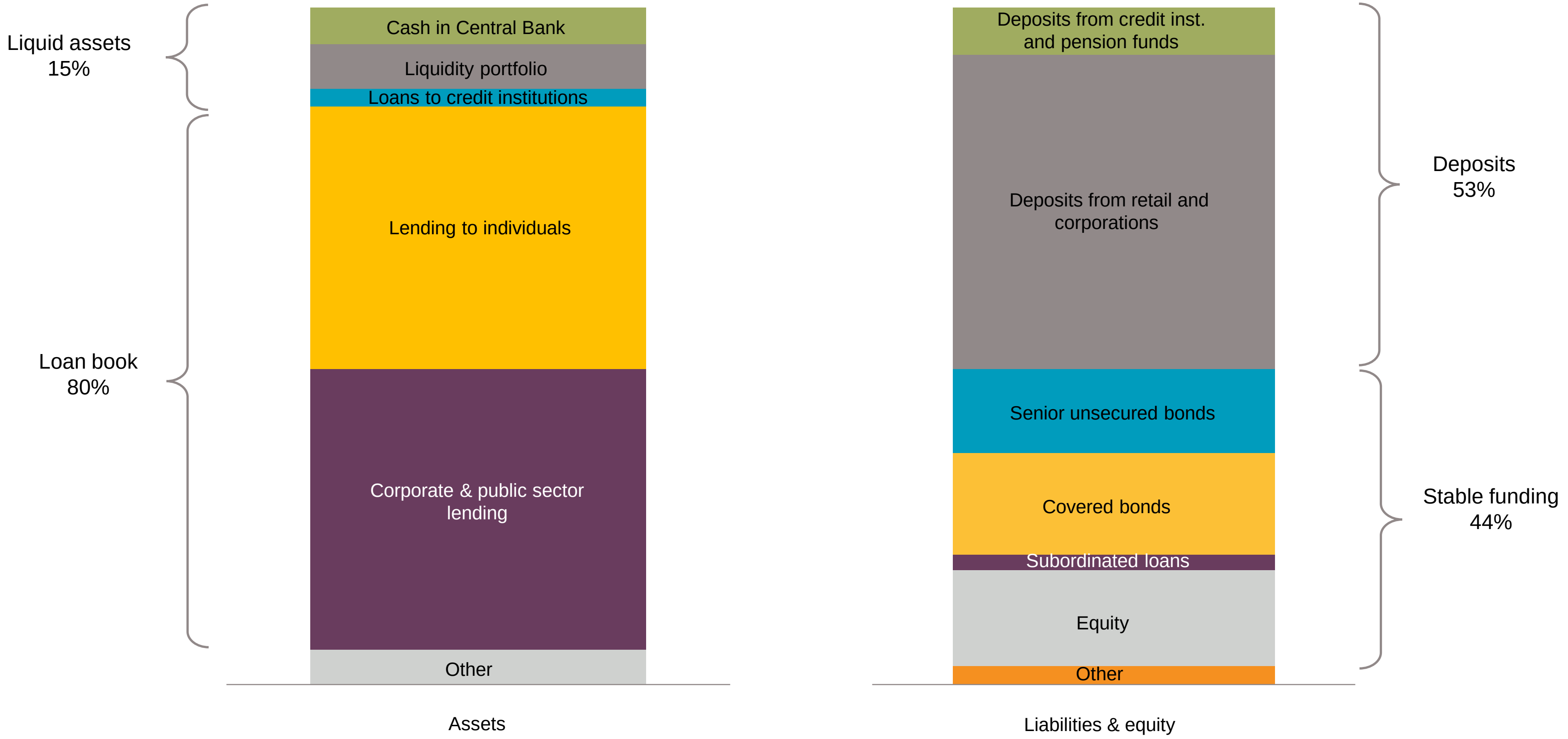
- Vast majority of assets consist of lending to both retail and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporates are the single largest funding source
- Bonds and debt instruments have become a more prominent part of the funding mix thanks to continuous focus on attracting new pockets of demand, including foreign currency and ESG issuance

Simplified balance sheet structure

30.6.2022, ISK 1,437bn



Growth in loans to customers continues

Steady mortgage growth supported by a strong capital base

Assets, ISKm	30.6.22	31.3.22	Δ	Δ%	31.12.21	Δ	Δ%
Cash and balances with Central Bank	**77,884**	77,799	85	0%	113,667	(35,783)	(31%)
Loans to credit institutions	**37,226**	73,220	(35,994)	(49%)	43,988	(6,762)	(15%)
Bonds and debt instruments	**108,477**	130,700	(22,223)	(17%)	132,289	(23,812)	(18%)
Derivatives	**6,193**	4,245	1,948	46%	2,445	3,748	153%
Loans to customers	**1,153,677**	1,107,893	45,784	4%	1,086,327	67,350	6%
Shares and equity instruments	**25,789**	28,655	(2,866)	(10%)	31,677	(5,888)	(19%)
Investment in associates	**3,836**	767	3,069	400%	939	2,897	309%
Property and equipment	**6,846**	6,911	(65)	(1%)	7,010	(164)	(2%)
Intangible assets	**3,304**	3,327	(23)	(1%)	3,351	(47)	(1%)
Other assets	**12,126**	11,170	956	9%	5,784	6,342	110%
Non-current assets and disposal groups held for sale	**1,895**	1,668	227	14%	1,344	551	41%
Total Assets	**1,437,253**	1,446,355	-9,102	(1%)	1,428,821	8,432	1%
Key ratios							
Risk Exposure Amount (REA)	**992,883**	945,321	47,562	5%	901,646	91,237	10%
Non-performing loans (NPL) ratio[1]	**1.8%**	1.8%			2.0%		

1. Stage 3, loans to customers, gross carrying amount.

Diversified funding base

Deposits are the largest source of funding

Liabilities & Equity, ISKm	30.6.22	31.3.22	Δ	Δ%	31.12.21	Δ	Δ%
Deposits from Central Bank and credit institutions	**11,437**	10,949	488	4%	13,384	(1,947)	(15%)
Deposits from customers	**756,862**	761,471	(4,609)	(1%)	744,036	12,826	2%
Derivative instruments and short positions	**11,410**	11,013	397	4%	9,467	1,943	21%
Debt issued and other borrowed funds	**393,754**	406,845	(13,091)	(3%)	402,226	(8,472)	(2%)
Subordinated loans	**32,181**	34,139	(1,958)	(6%)	35,762	(3,581)	(10%)
Tax liabilities	**8,498**	6,980	1,518	22%	6,432	2,066	32%
Other liabilities	**18,498**	16,802	1,696	10%	12,848	5,650	44%
Non-current liabilities and disposal groups held for sale	**951**	955	(4)	(0%)	956	(5)	(1%)
Total Liabilities	**1,233,591**	1,249,154	(15,563)	(1%)	1,225,111	8,480	1%
Total Equity	**203,662**	197,201	6,461	3%	203,710	(48)	(0%)
Total Liabilities and Equity	**1,437,253**	1,446,355	(9,102)	(1%)	1,428,821	8,432	1%

Key ratios

Customer loans to customer deposits ratio	**152%**	145%	146%
REA/total assets	**69.1%**	65.4%	63.1%
Net stable funding ratio (NSFR)	**118%**	123%	122%
Liquidity coverage ratio (LCR)	**147%**	195%	156%
Total capital ratio[1]	**21.5%**	22.5%	25.3%
Tier 1 capital ratio[1]	**19.2%**	19.9%	22.5%
Leverage ratio[1]	**12.5%**	12.4%	13.6%

1. Including first quarter profit for 31.3.22.

Appendix II – Icelandic economy update

Export-driven GDP growth following robust growth in demand

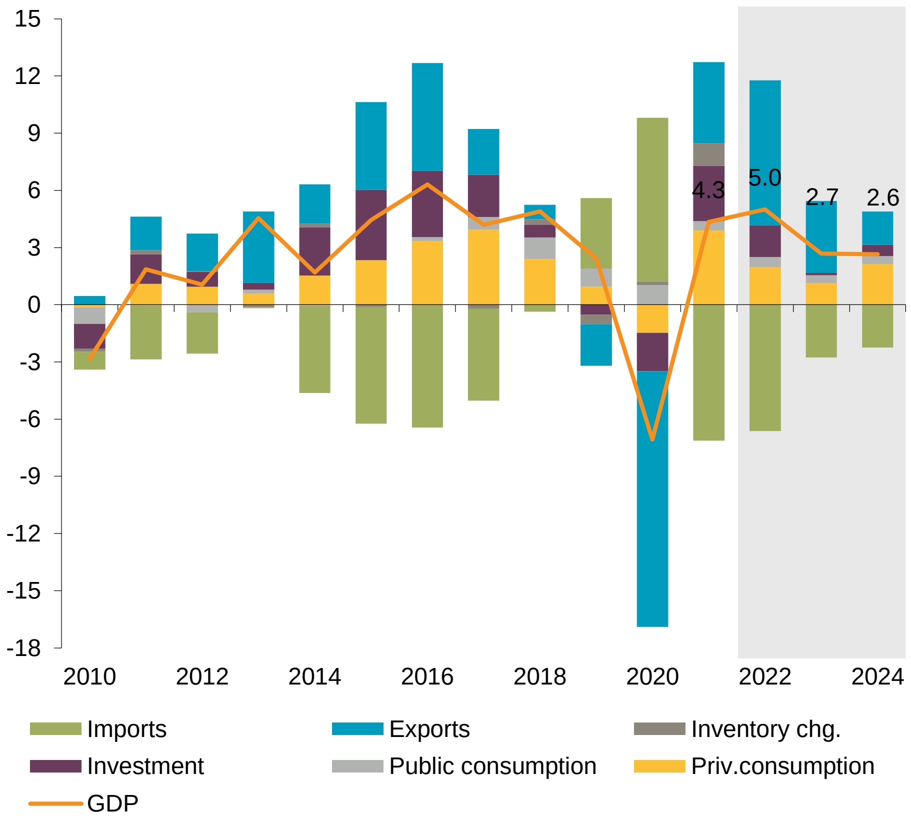
GDP growth rapid in 2022 but slower in coming years

Highlights

- After a 7.1% contraction in 2020, the Icelandic economy recovered strongly in 2021, with GDP growth measuring 4.3%
- Growth was driven mainly by domestic demand. Exports also picked up strongly, albeit outpaced by import growth
- ISB Research (forecast published in May-2022) expects GDP growth at 5.0% in 2022, the fastest growth rate since 2016
- Exports take over from domestic demand as the main catalyst of growth, with a rapid recovery of tourism and an increase in other exports. Growing consumption and investment also fuel GDP growth in 2022
- For 2023, GDP growth is forecast to measure 2.7%, with exports once again the main driver, although growth in exports as well as domestic demand will ease year-on-year
- For 2024, GDP growth is projected at 2.6% as export growth eases further and tighter economic policy and supply constraints slow the pace of growth
- If either or both the Ukraine war and the COVID-19 endgame put severe pressure on the global economy in the coming term, it could weaken the Icelandic economy further ahead

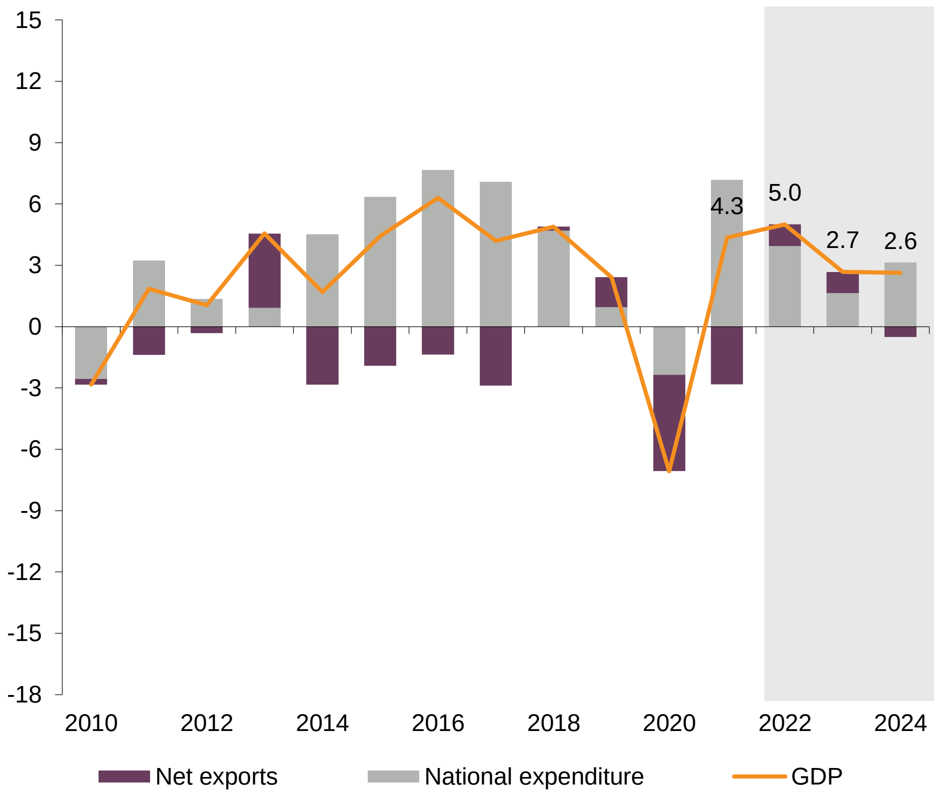
GDP and contribution of its subcomponents

Volume change from prior year (%)



GDP, domestic demand, and external trade

Volume change from prior year (%)



Sources: Statistics Iceland, ÍSB Research.

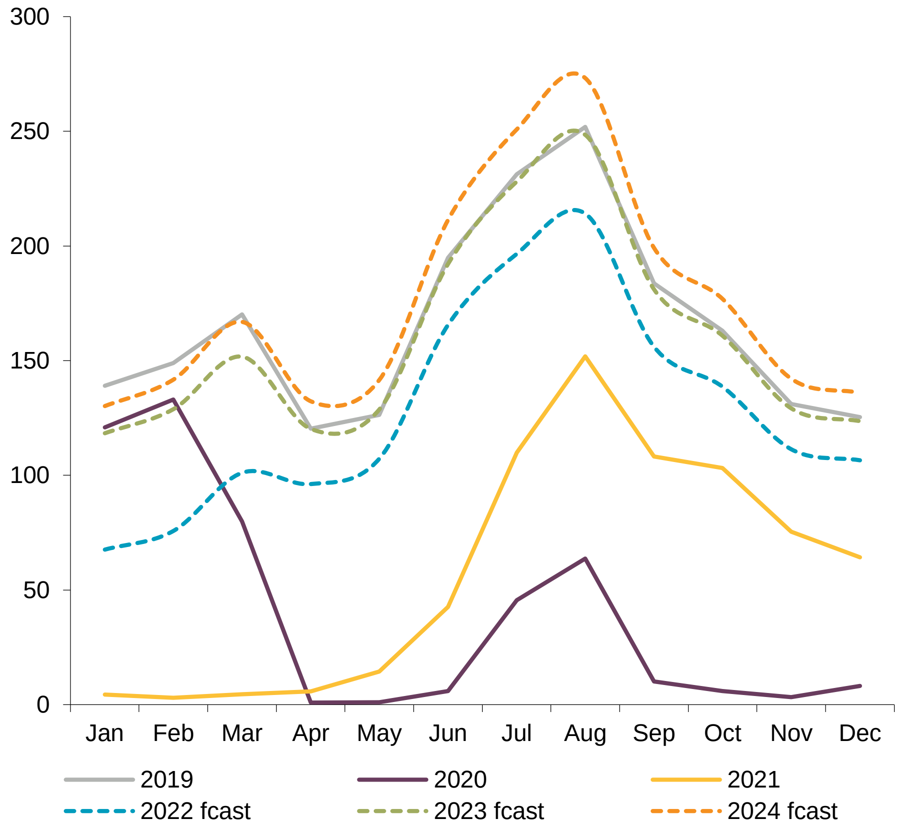
Tourism recovering swiftly from a two-year drought

We forecast that 1.5-1.6 million tourists will visit Iceland in 2022

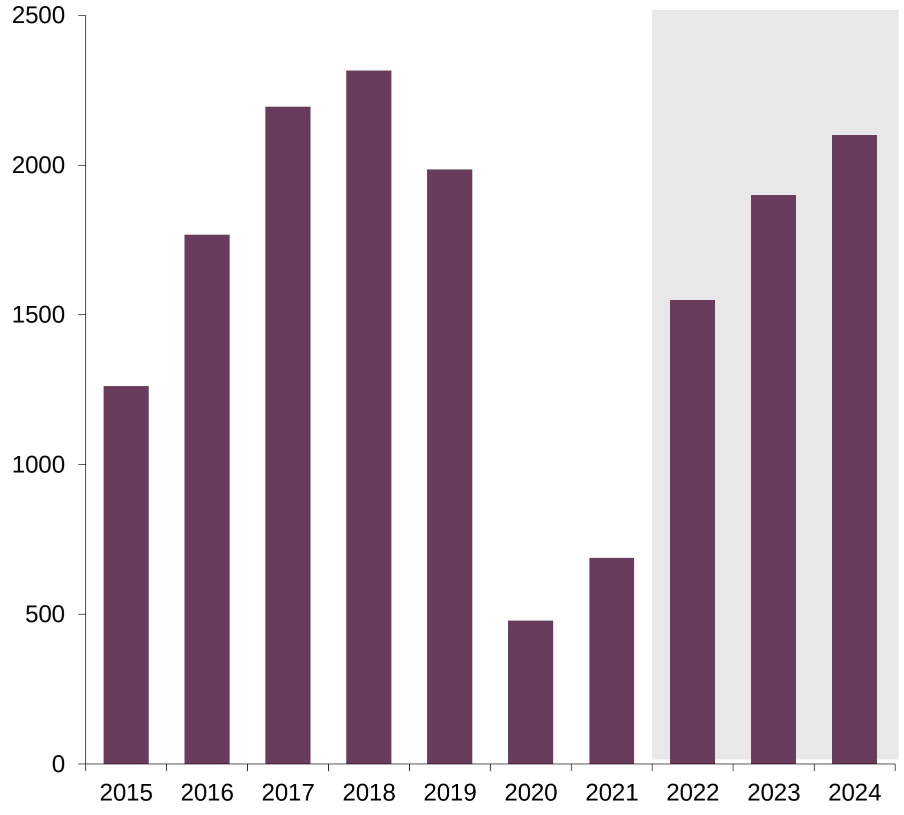
Highlights

- After a turbulent two-year period the tourist sector appears poised for a swift recovery
- 636,000 tourists visited Iceland in 1H of 2022, the largest total for this period since 2019
- Tourism operators are upbeat about the summer and autumn. This year's tourist numbers could come to 80-90% of the 2019 total
- ISB Research expects 1.5-1.6 million tourists this year, about the same number as in the mid-2010s
- Tourist numbers are assumed to rise to 1.9 million in 2023 and 2.1 million in 2024
- The slowdown in growth further ahead is due in part to a higher real exchange rate and the prospect of weaker growth in global demand
- Even though visitors were far fewer in 2021 than before the pandemic, stayed longer and spent more on average in Iceland than they did previously
- Average revenues per tourist will likely continue to be somewhat higher than in the past decade

Number of foreign tourists, by month
thousands



Number of foreign tourists, by year
thousands



Sources: Icelandic Tourist Board, ÍSB Research.

Current account balance set to improve in the near term

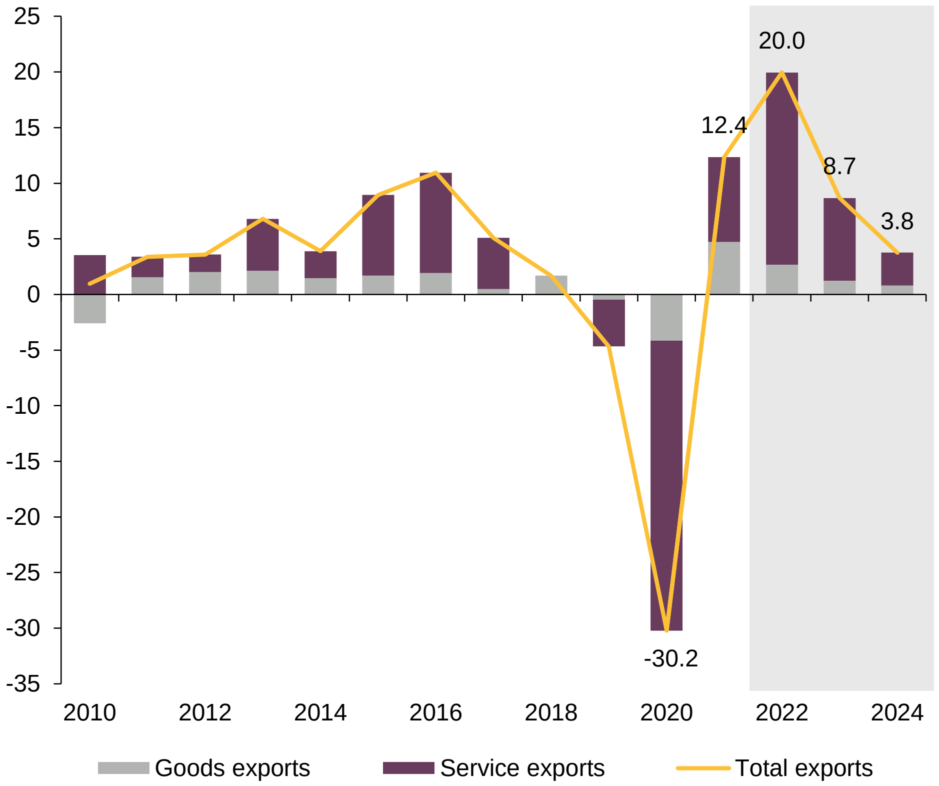
Increased share of exports in GDP growth spurs a recovery of external trade in coming quarters

Highlights

- The rapid recovery of tourism explains a large share of the forecasted 20% export growth in 2022 and just almost 9% growth in 2023
- Furthermore, the outlook is for stronger exports of farmed fish, capelin, aluminium and other industrial goods, and increasingly, intellectual property usage
- The export growth in the abovementioned goods is partly offset by a contraction in exports of groundfish, particularly cod
- For 2021 Iceland recorded a current account deficit of ISK 90.2bn, or 2.8% of GDP. It was the first full-year deficit since 2011
- For 2022, though, the outlook is for the current account to be in balance
- For 2022-2023, a return to current account surplus is expected as export growth outpaces import growth and terms of trade improve somewhat
- Iceland's net external assets currently total just over 4/10 of GDP. This could improve even further during the forecast horizon

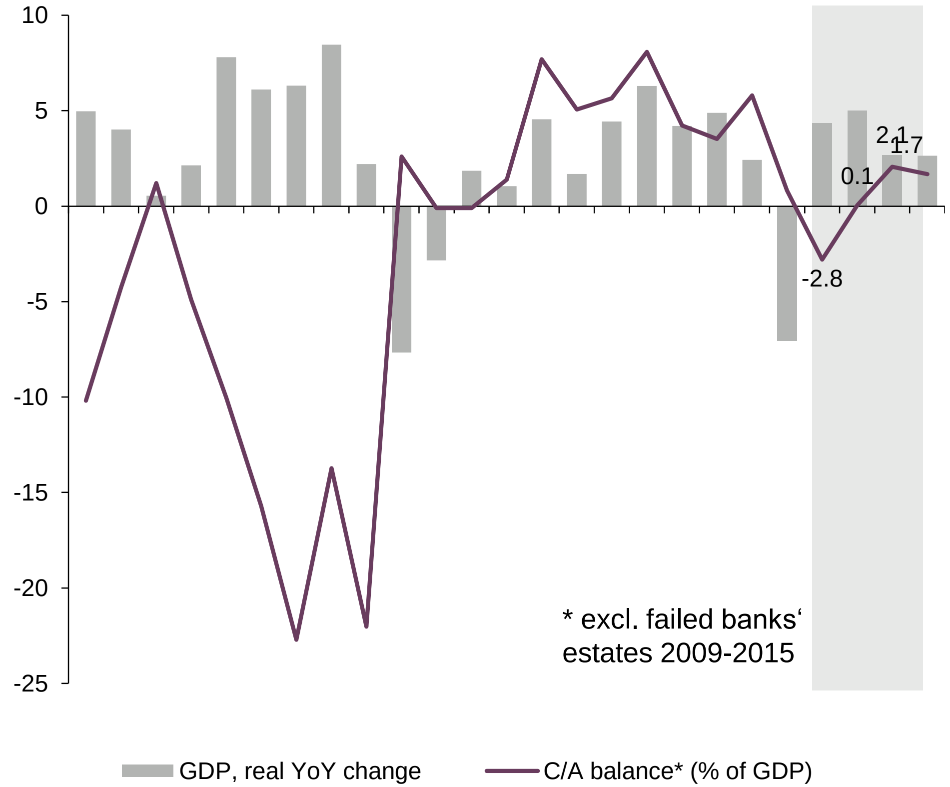
Exports and contribution from subcomponents

% change



Current account balance and GDP growth

% of GDP and % change YoY

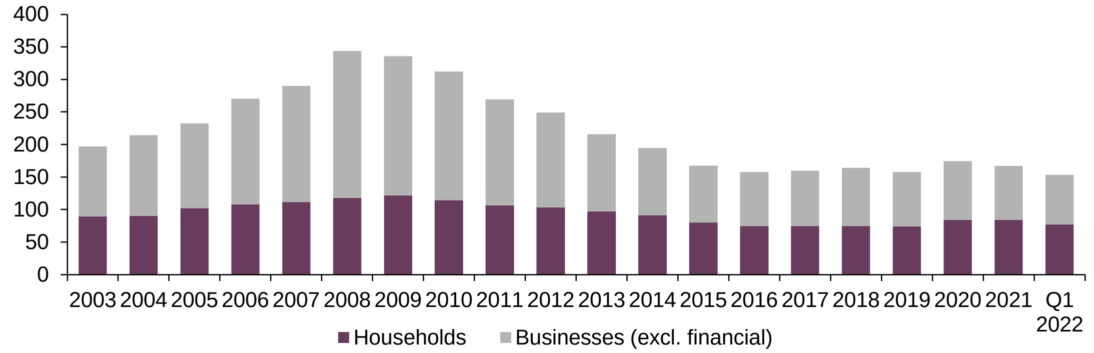


Sources: Statistics Icelandic, Central Bank of Iceland, ÍSB Research.

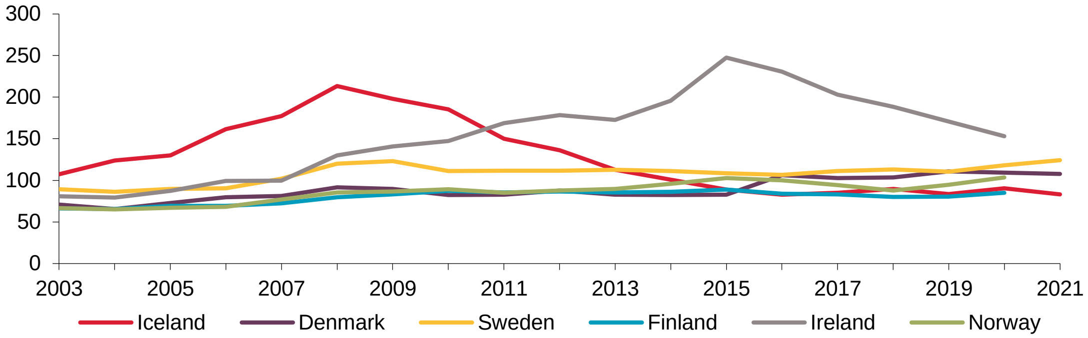
Domestic balance sheets still healthy

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

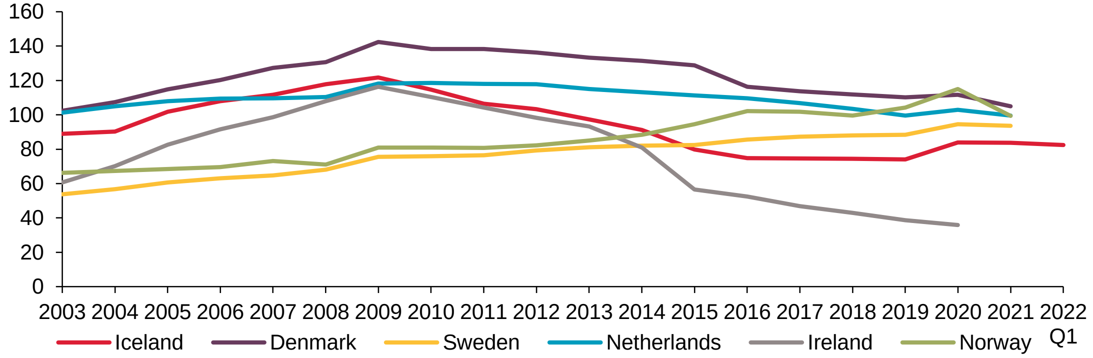
Private sector debt
% of GDP



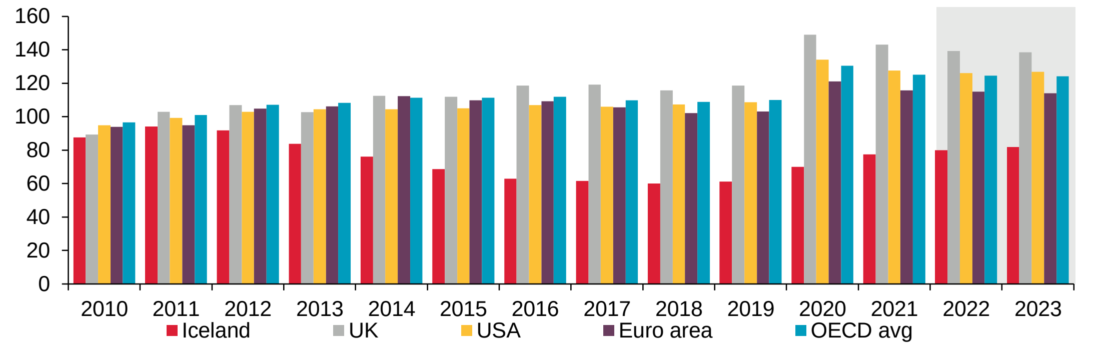
Corporate debt
% of GDP



Household debt
% of GDP



General government gross financial liabilities
% of GDP



Shaded areas indicate OECD forecasts.
Source: Central Bank of Iceland, Statistics Iceland, OECD and ISB Research.

Investment growth loses pace after a growth spurt

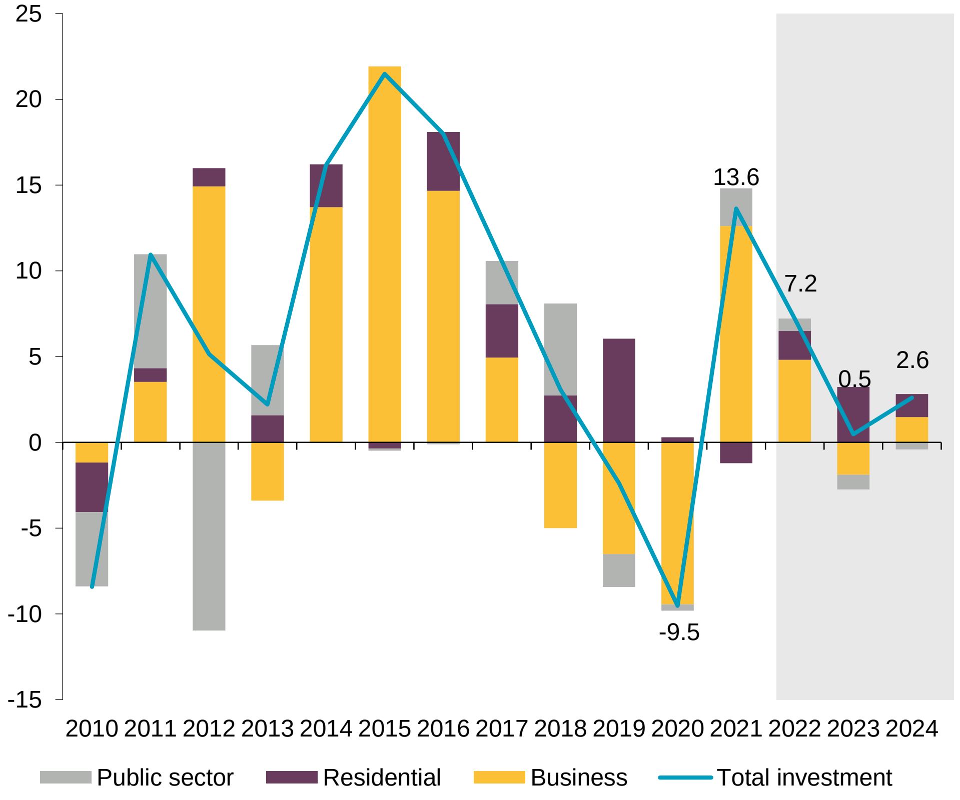
Residential investment to take over from business investment as the driver of growth

Highlights

- After a two-year contraction, investment spiked in 2021, with growth measuring just under 14%, its fastest pace in five years
- Business investment growth was extremely strong, and public investment also grew handsomely, while residential investment shrank by over 4%
- The outlook is for relatively robust growth in business investment in 2022. Residential investment will also pick up again and public sector investment looks sett to increase moderately
- In 2023, residential investment will likely be the sole driver of growth, as business investment looks set to contract because of rising interest rates and bleaker expectations about firms' operating environment
- 2024 will probably see moderate growth in private sector investment coupled with a contraction in public investment
- ISB Research forecasts that total investment will grow by over 7% in 2022, less than 1% in 2023, and nearly 3% in 2024
- The investment-to-GDP ratio will therefore taper off gradually, although investment will be relatively strong in historical context

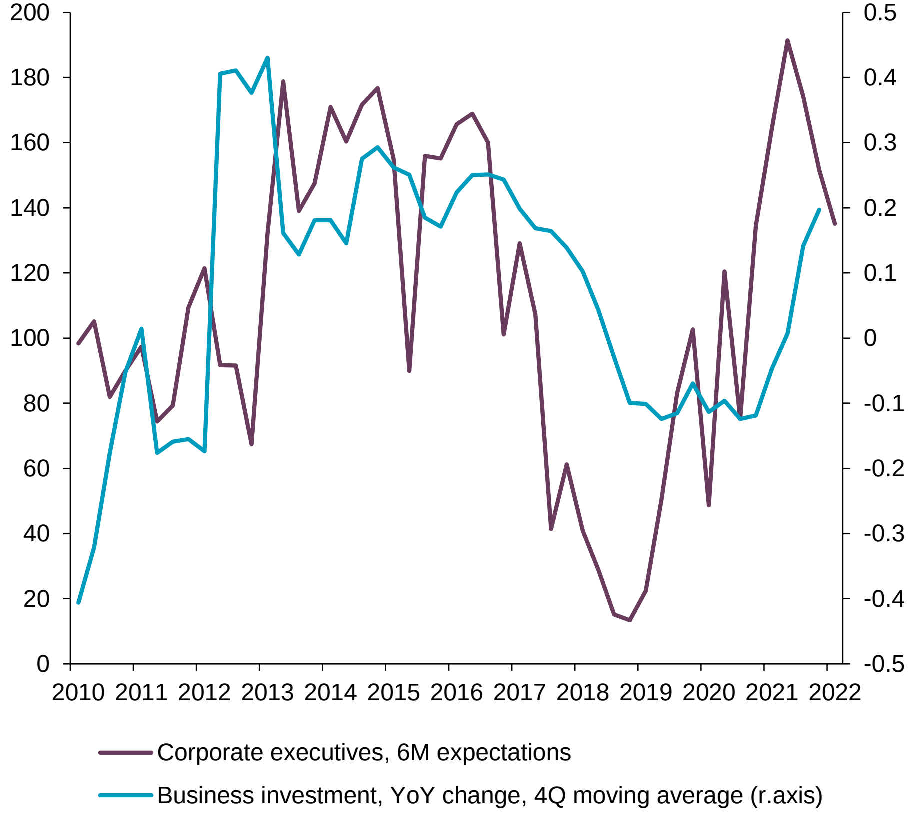
Investment, real change, and contribution of subcomponents

%



Executives' expectations and business investment

Index value (left) and % change year-on-year (right)



Source: Statistics Iceland, Gallup.

Unemployment continues to fall

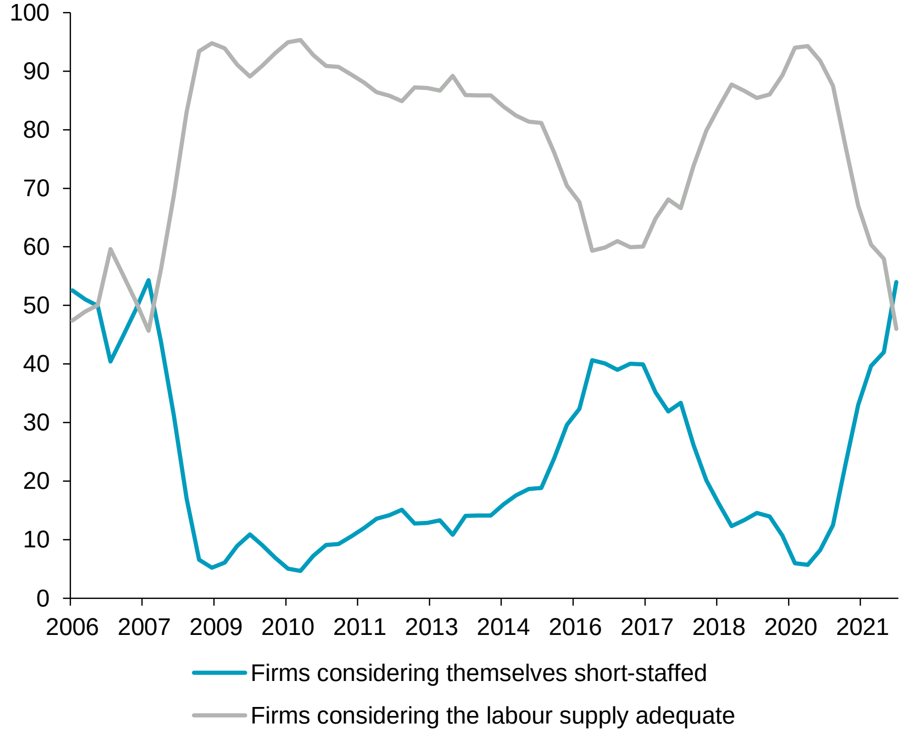
A growing labour shortage will probably be one of the greatest challenges

Highlights

- Unemployment has fallen swiftly after peaking in January 2021 as the relatively swift economic recovery in 2021 has fostered job growth
- Registered unemployment measures 3.3% in June 2022 and looks set to fall even further in coming months
- ISB Research forecasts average year-2022 unemployment at 4.4%
- According to a recent Gallup survey, 54% of company executives consider themselves short-staffed
- Construction and tourism companies in particular envision adding on staff
- As foreign workers have been prominent in these sectors, labour importation is likely to increase markedly this year
- Unemployment seems likely to fall to a new equilibrium in the coming term, averaging 3.7% in 2023 and 3.6% in 2024, which will bring it back to the 2019 level

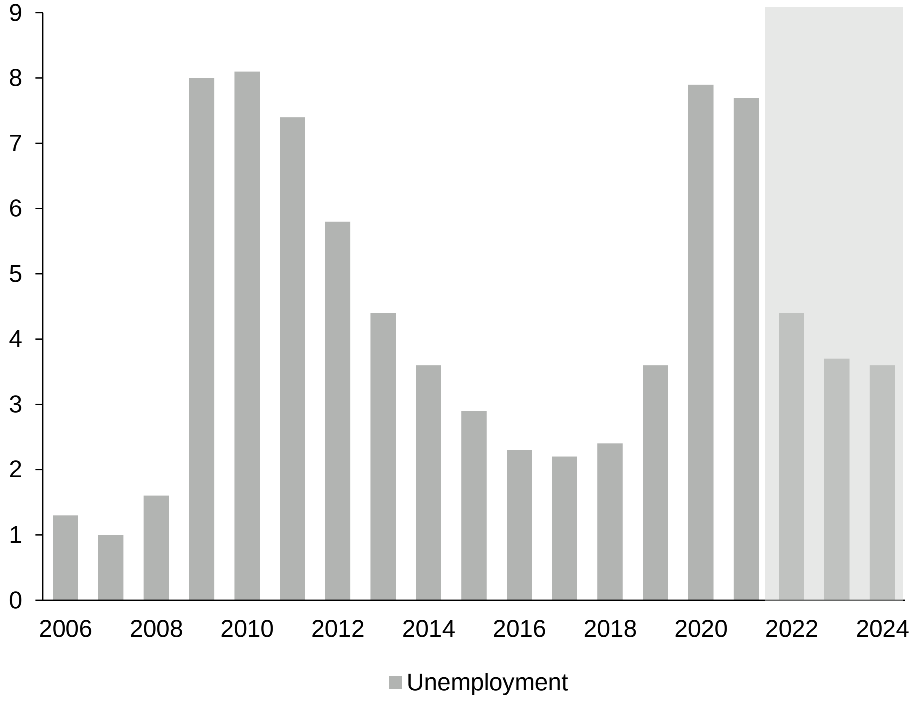
Labour supply according to corporate executives

%



Unemployment[1]

% of workforce, annual average



1. Excluding recipients of part-time unemployment benefits. Source: Statistics Iceland, The Central Bank of Iceland, Gallup.

Inflation erodes household purchasing power

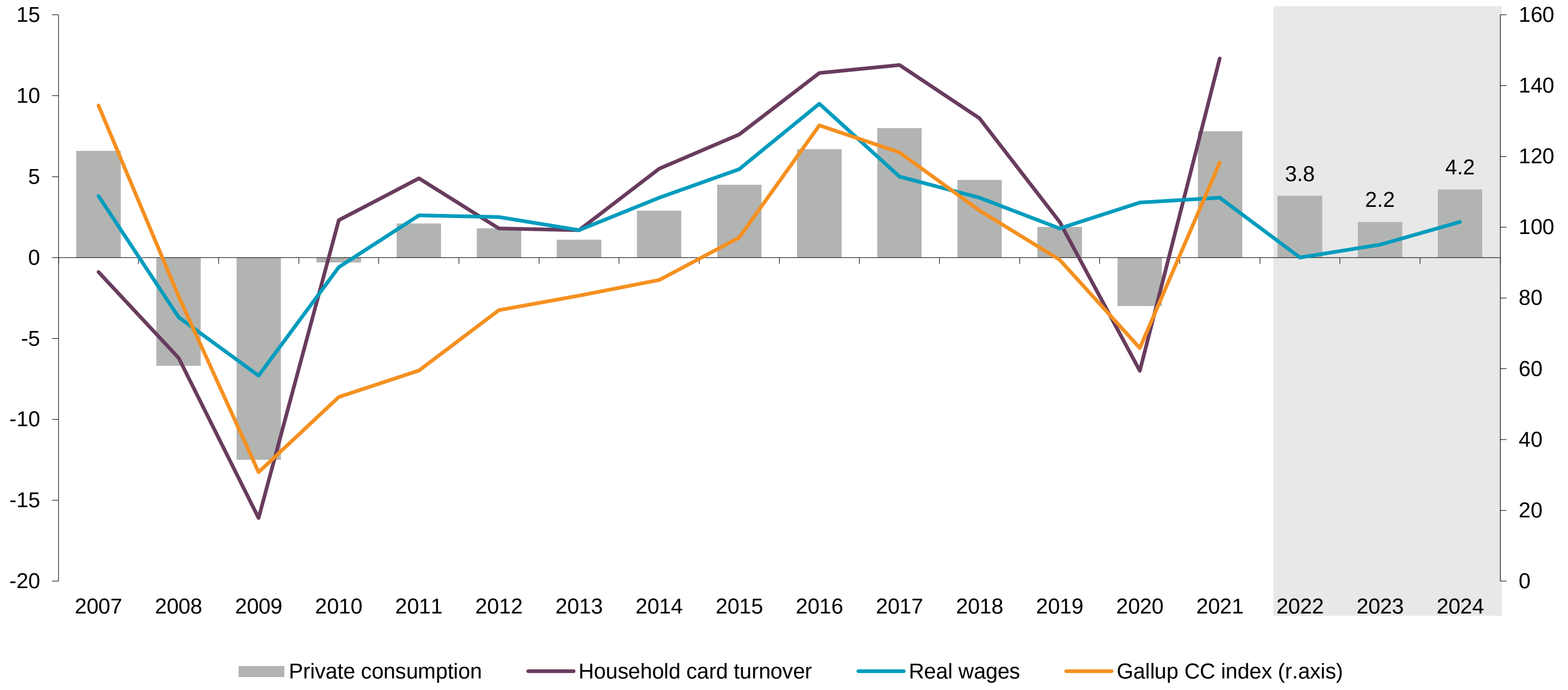
Private consumption growth will be weaker in the near term as a result

Highlights

- Private consumption rallied last year, growing by 7.6% YoY, after contracting by 3% in 2020
- In real terms, private consumption was 4.4% more in 2021 than in 2019, indicating that Icelanders have more than recovered their pre-pandemic consumption level
- Private consumption is estimated to have increased by 8.8% YoY in 1Q2022, largely due to increase in travel and direct purchases abroad by resident households
- Relevant indicators, such as card turnover and real wage growth suggest a relatively strong 2Q2022
- As the year advances, private consumption growth will probably lose momentum due to declining optimism among households and both inflation and higher rates eroding their purchasing power
- Real wage growth is likely to be halted by an inflation spike in 2022, to return slowly in coming years
- Households are well positioned and have accumulated significant savings which will probably help sustain private consumption growth for the rest of the year
- Private consumption growth is forecast at 3.8% in 2022, 2.2% in 2023 and 4.2% in 2024

Private consumption and related indicators

% change year-on-year (left) and index value (right)

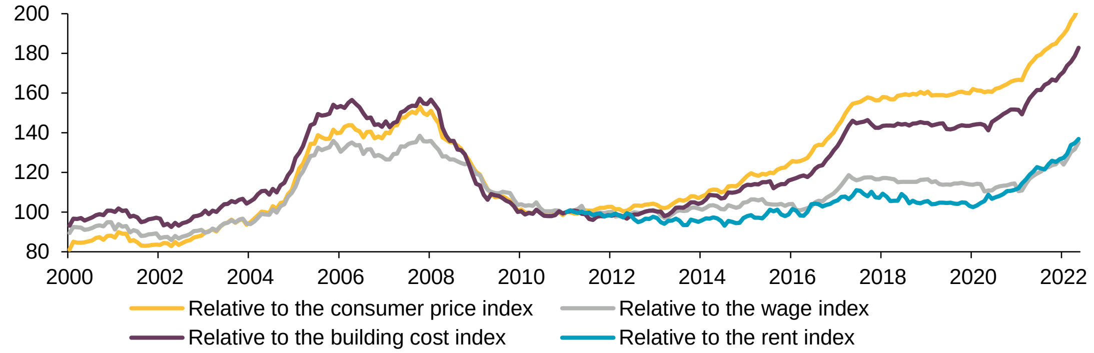


Sources: Central Bank of Iceland, Gallup, Statistics Iceland, ÍSB Research.

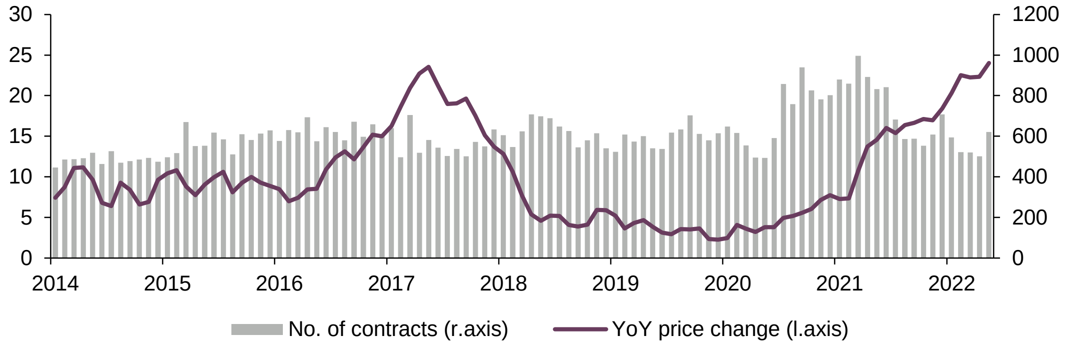
Real estate markets still buoyant

Commercial property prices rising again while residential house price rises have gained steam

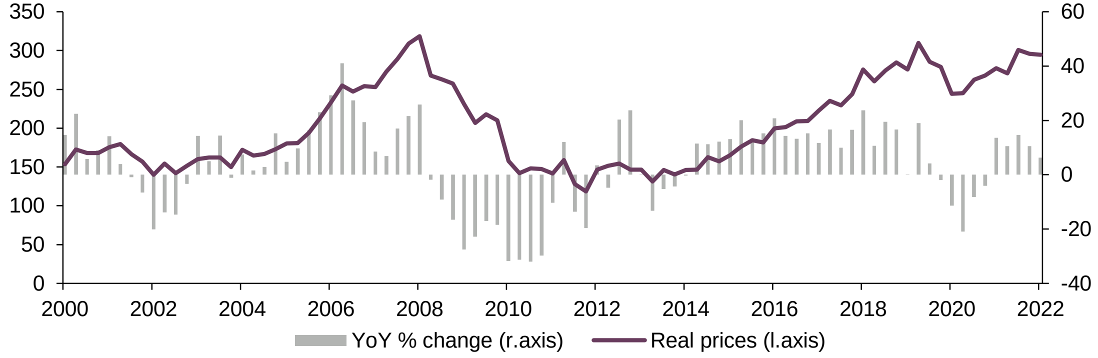
Capital area house prices relative to macroeconomic fundamentals
Index, January 2011=100



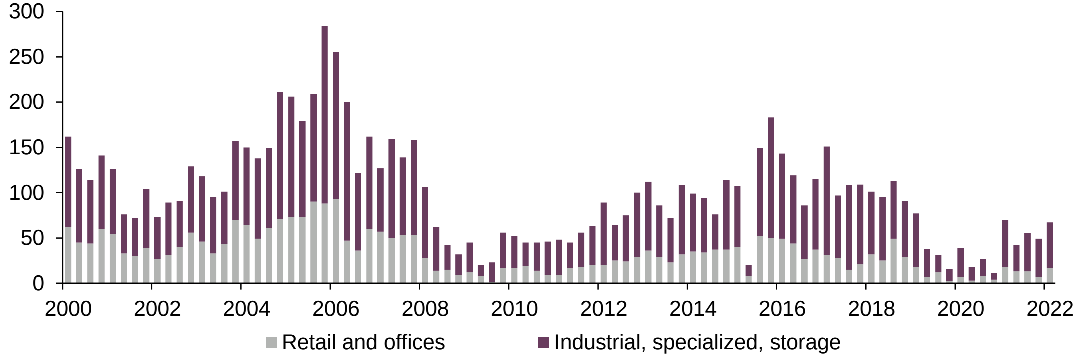
Residential house prices and turnover in greater Reykjavik
% change (l.axis) and number (r.axis)



Commercial property real prices in greater Reykjavik
Index, 1995=100 (l.axis) and % change (r.axis)



Commercial real estate market activity
No. of registered purchase agreements



Source: The Central Bank of Iceland.

Inflation to spike in autumn 2022

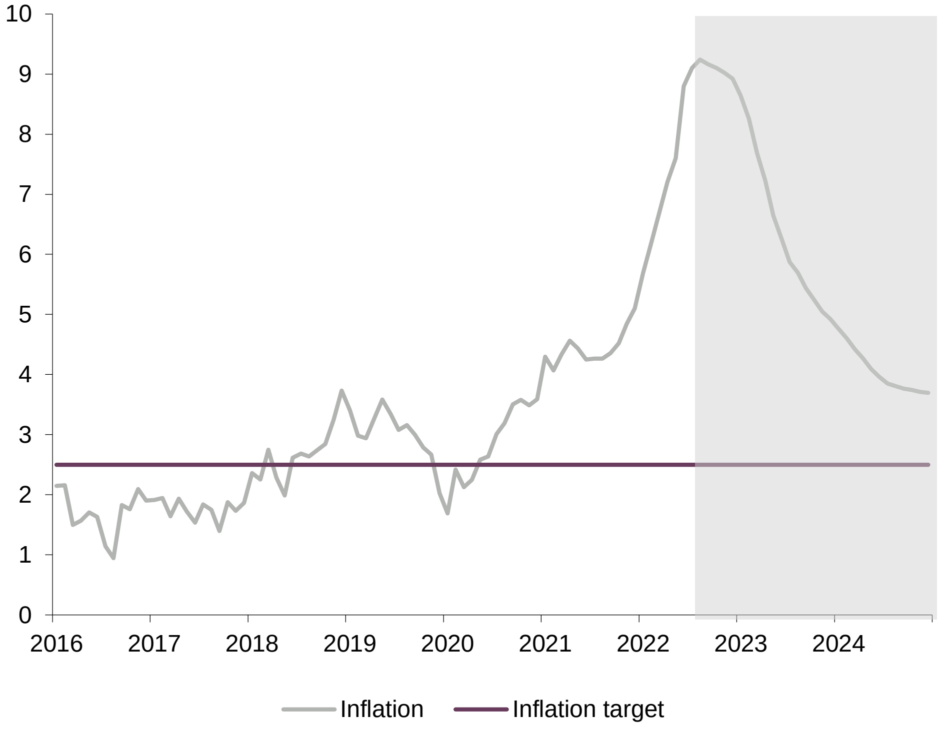
House prices and import costs the main drivers short-term but wage costs also matter

Highlights

- Inflation started rising in mid-2020, in the wake of the COVID-19 Crisis and the depreciation of the ISK
- Rising import costs due to pandemic-related supply/demand imbalances and, more recently, the Ukraine war have been partly offset by ISK appreciation
- Rapid house price increases play an outsized role in recent inflation increase due to inclusion in SI inflation measurement
- In June inflation reached a 13 year peak of 8.8%
- Inflation has proven more persistent than expected, but ultimately it will fall
- ÍSB Research expects inflation to average 8.1% in 2022, 6.4% in 2023, and 4.1% in 2024
- The forecast assumes that the ISK will appreciate in coming quarters. On the other hand, inflationary pressures from wages and/or house prices could turn out stronger than anticipated
- Furthermore, imported inflation could turn out higher if price hikes abroad continue unabated

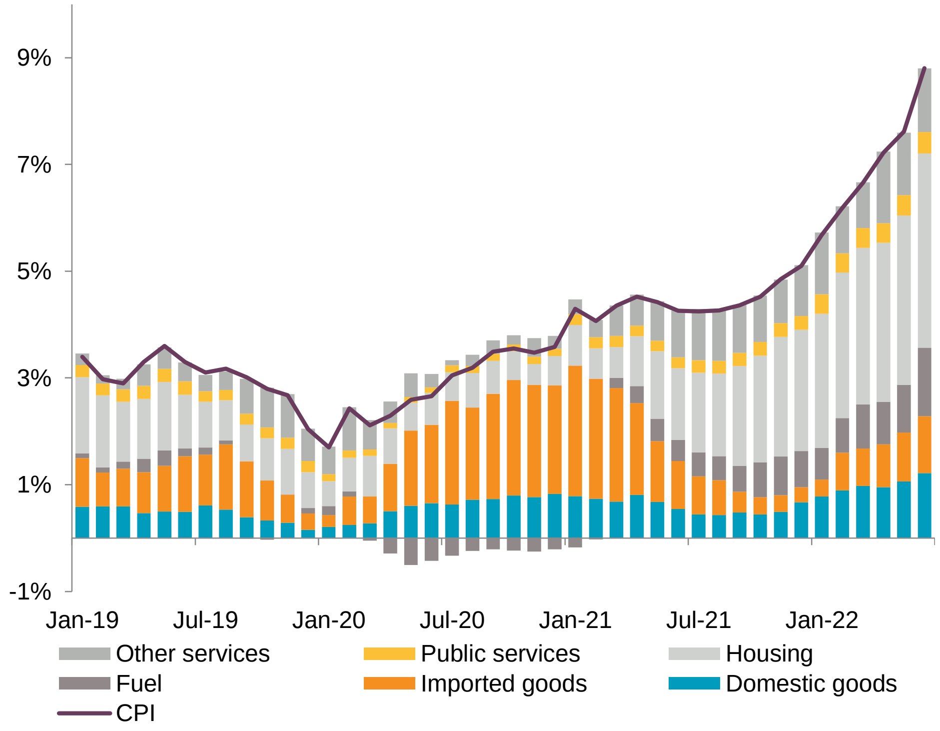
Inflation and the CBI inflation target

%



Inflation by contribution of main categories

%



Sources: Statistics Iceland, ÍSB Research.

Policy rate to rise rapidly throughout 2022

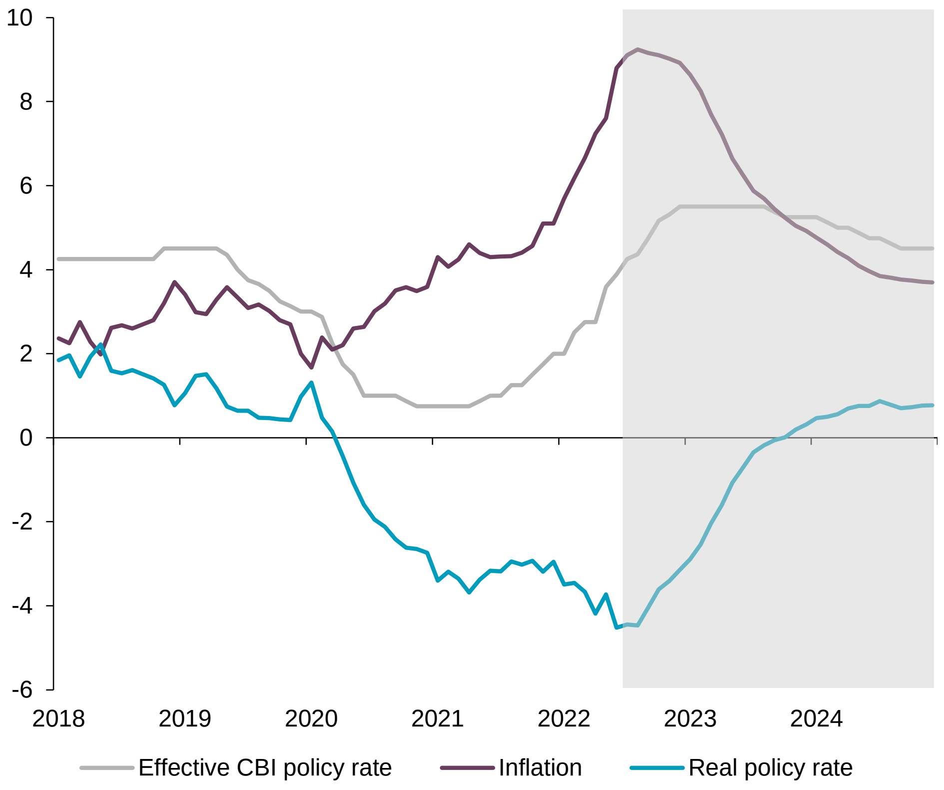
Gradual easing further ahead; equilibrium rate in sight by the end of the horizon

Highlights

- The Central Bank of Iceland has hiked its policy by 4 percentage points since May 2021, after reaching an all-time low of 0.75% in 4Q2020
- The policy rate is now 4.75%, its highest since 2Q2017. The real policy rate remains negative, however
- Further steep rate hikes are expected in the near future, so as to rein inflation in, keep inflation expectations under wraps, and push the real policy rate above zero
- We forecast that the policy rate will continue to rise swiftly, peaking at 5-6% by end-2022 before declining gradually from 2H2023 onwards
- Long term nominal rates are likely to remain elevated during the policy rate hike cycle, then decrease moderately
- Long term real rates, currently around the 1% mark, are expected to rise gradually in coming quarters

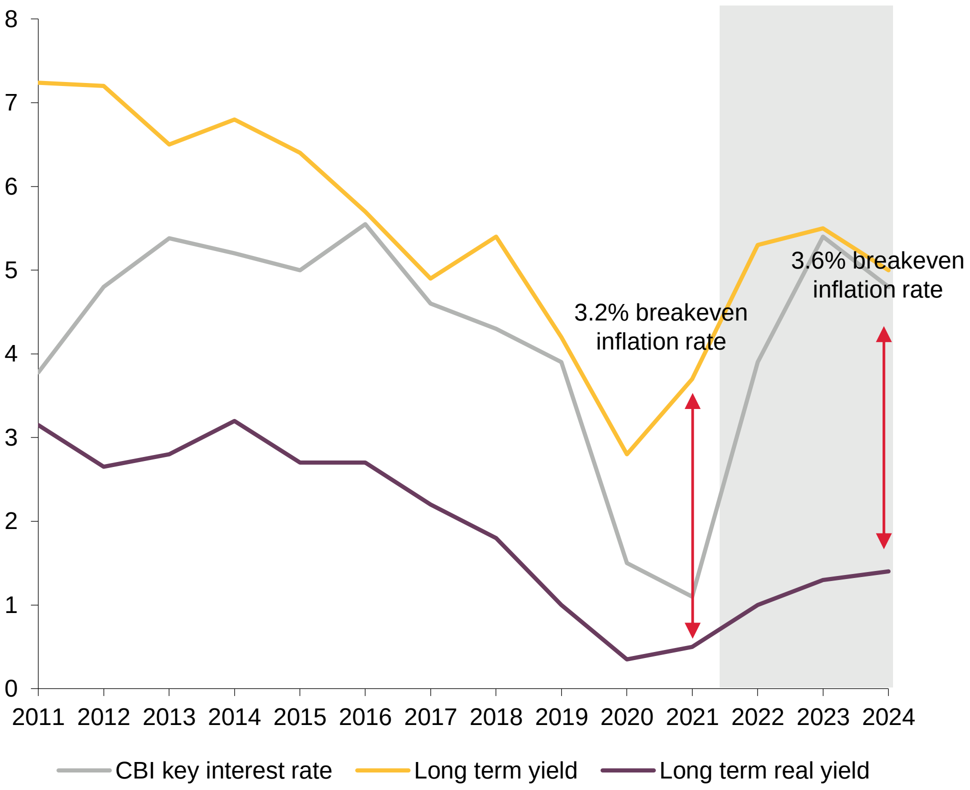
Policy rate and inflation

%



Interest rates

%



Sources: Central Bank of Iceland, Kodiak, Statistics Iceland, ÍSB Research.

ISK likely to appreciate further

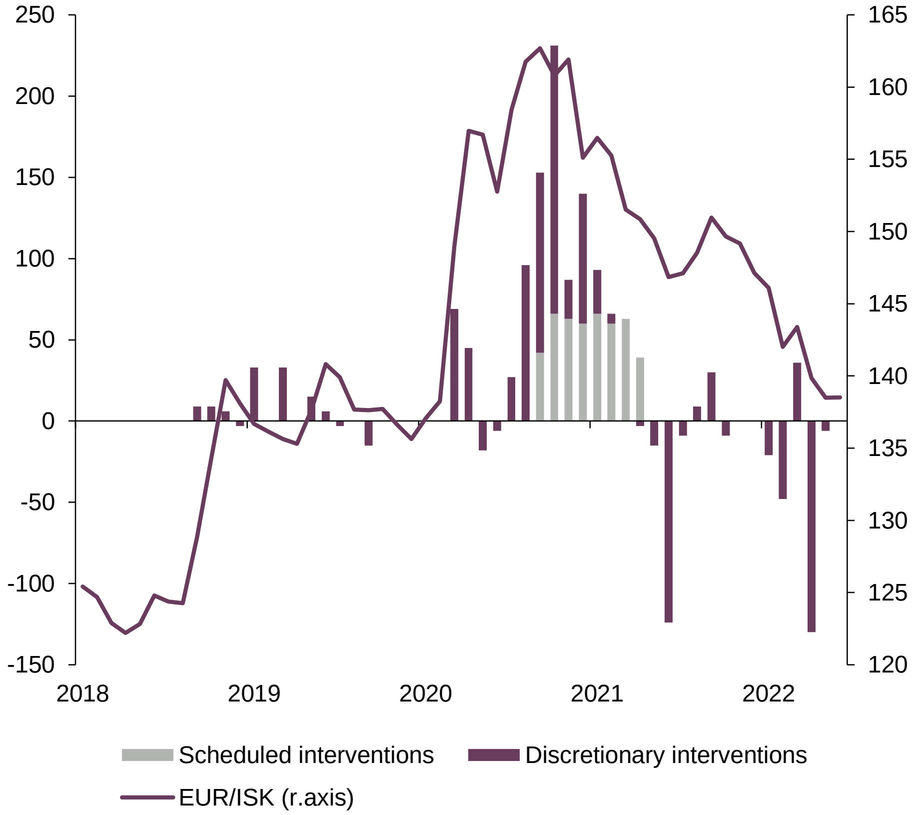
CA surplus and inflows for securities purchases offset pension funds' foreign investments

Highlights

- Following nearly 3% appreciation in 2021, the ISK strengthened further by just over 5% in 1H2022
- The CBI steadily scaled down its FX market intervention over the course of 2021
- Increased ISK volatility in the first third of 2022 led to the CBI stepping up FX interventions once more, mainly leaning against short-term appreciation trends
- Improving C/A balance outlook, rising interest rates, Iceland's strong IIP, solid growth outlook and limited non-residents' securities holdings all weigh in favour of stronger ISK in the medium term
- Increasing foreign investment by pension funds and possible CBI FX reserve purchases may weigh against ISK strengthening
- It is impossible to pinpoint how the appreciation will materialise, but ISB Research's forecast assumes that the ISK will be about 5% stronger at the end of the forecast horizon than at the end of June 2022
- The real exchange rate in terms of relative consumer prices will then be similar to that in 2018

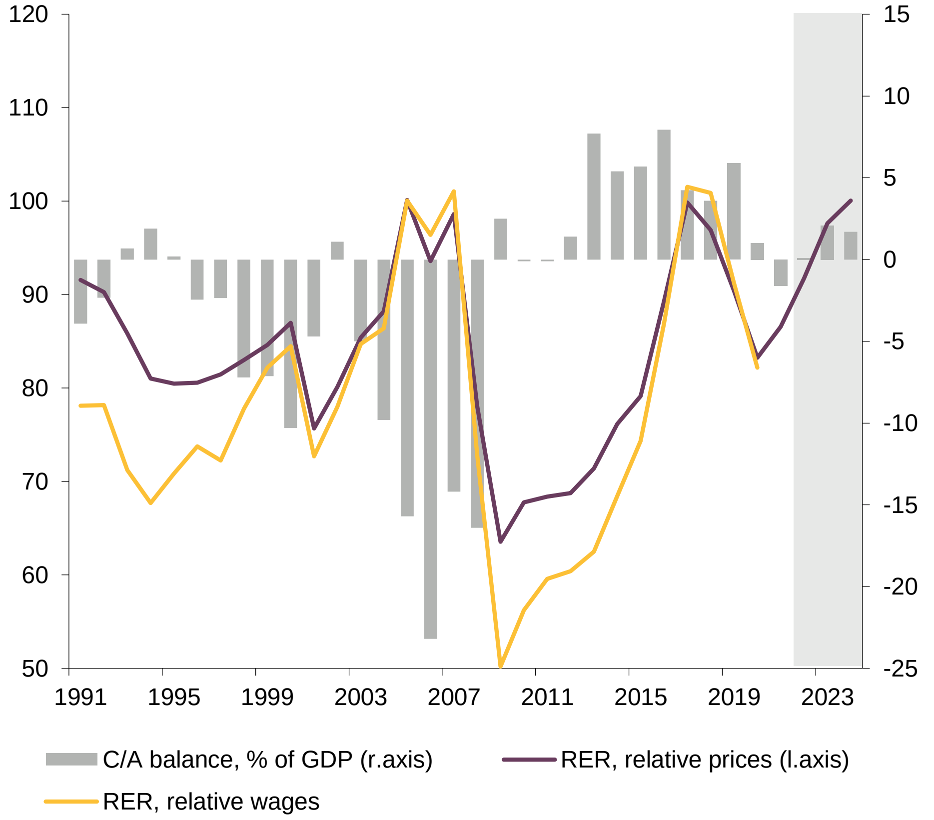
ISK exchange rate and CBI FX market intervention

EUR m (left) and EURISK (right)



Real exchange rate and current account balance

Index and % of GDP



Source: Statistics Iceland, The Central Bank of Iceland, ISB Research.

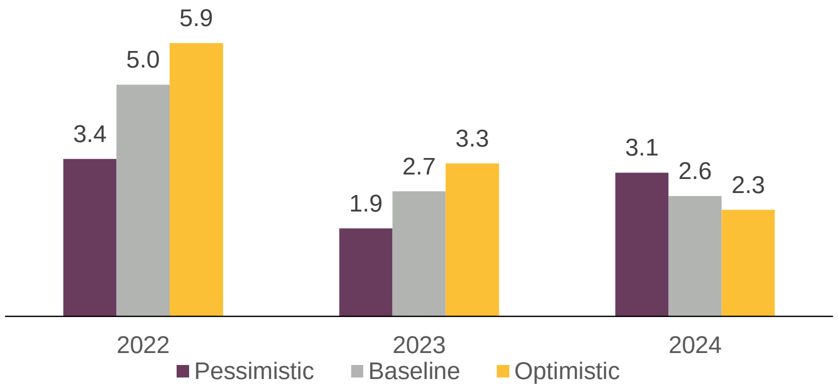
Alternative scenarios demonstrate impact of key uncertainties

COVID-19, war in Ukraine and upcoming wage negotiations could have significant impact

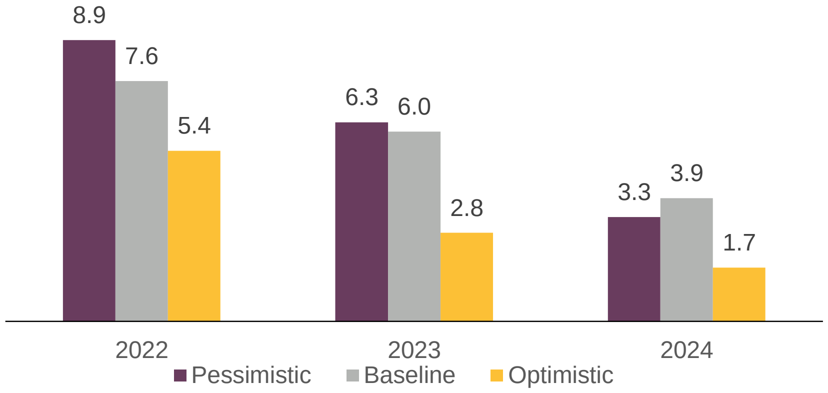
Highlights

- The economic outlook for Iceland, like the global outlook, has fluctuated widely in recent quarters
- ISB Research has identified three major sources of uncertainty for the near-to-medium term economic development:
  - The war in Ukraine
  - COVID-19 developments
  - Upcoming private sector wage negotiations in 4Q2022
- An optimistic scenario assumes a more favourable outcome for those factors than the baseline forecast while the opposite is true in the pessimistic scenario
- It is assumed that there is roughly a 10% probability of a more favourable outcome than the optimistic scenario and the converse holds for the pessimistic one
- GDP growth could prove 1.2% higher in 2022-2024 than baseline if those three factors develop relatively favourably
- Should the three factors prove more challenging, GDP growth could prove 1.9% lower in the period
- It should be noted that the pessimistic scenario is not a stress scenario, and it is possible to sketch out a more unfavourable path than is done here

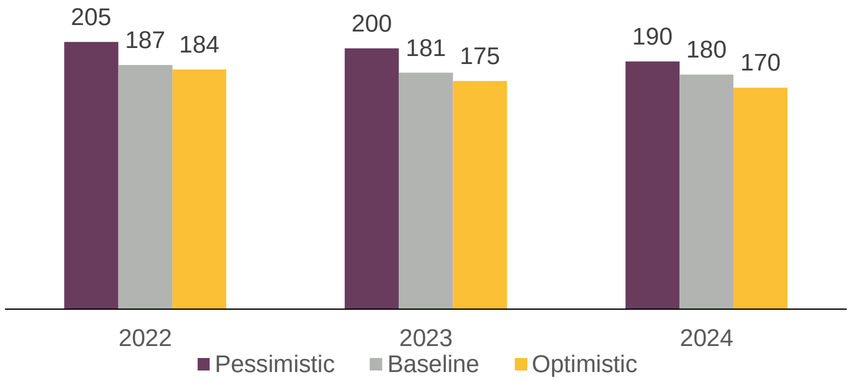
GDP growth, %



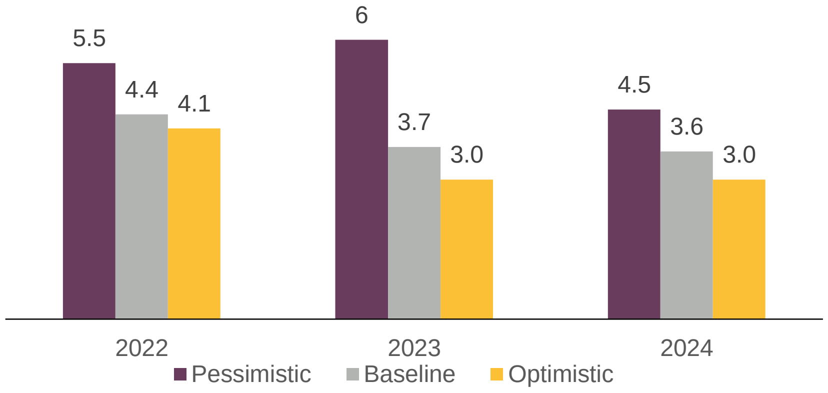
Inflation, %



Trade-weighted exchange rate index



Unemployment, % of labour force

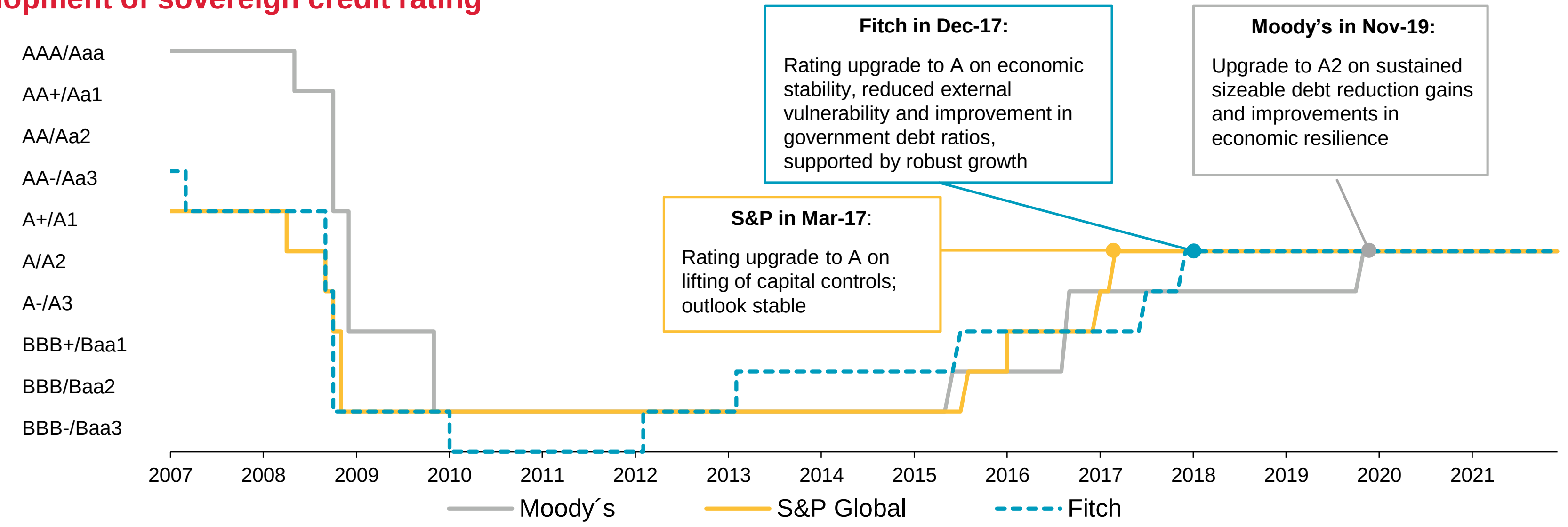


Sources: Islandsbanki Research forecast.

Iceland’s credit rating has remained at A

Rating companies acknowledge the flexibility of the economy and resilience to the pandemic shock

Development of sovereign credit rating



MOODY’S IN AUGUST 2021

- “The credit profile of Iceland is supported by its wealthy and flexible economy with favourable demographics that support its long-term growth prospects. Current-account surpluses have contributed to a net external creditor position and large foreign-currency reserves.”
- “The credit profile is mainly constrained by the economy’s small size and concentration in a limited number of sectors, which increase its vulnerability to shocks and cause volatility in growth.”

FITCH IN APRIL 2022

- Rating affirmed at A with a stable outlook
- “Iceland’s ‘A' rating is driven by its very high income per capita, very strong governance, human development and doing business indicators that are more consistent with those of 'AAA' and 'AA' rated countries”
- “The revision of the Outlook to Stable reflects the resilience shown by the Icelandic economy to the pandemic shock and Fitch Ratings’ expectation of a sustained growth recovery, which should facilitate a fiscal deficit and debt reduction over time.”

S&P IN MAY 2022

- “The stable outlook indicates S&P‘s expectation that Iceland's economy will continue to recover and remain relatively unaffected by the war in Ukraine.”
- “The agency believes fiscal deficits will continue to decrease over the next few years, stabilizing the debt to GDP ratio net of liquid assets.”
- “At the same time, ample foreign reserves will enable the CBI to deal with external pressures or exchange-rate volatility, should they occur.”

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

Appendix III – Covered bond frameworks

The Icelandic covered bond framework

Regular oversight performed by the FME

Legal framework	Governed by the Icelandic Covered Bond Act (ICBA), which came into force on March 2008, complemented by the Rules of the Financial Supervisory Authority no. 528/2008 ("ICBR")
Issuance structure	Direct on-balance sheet structure: the cover pool is held by the issuer and the assets shall remain at all times on the issuer's balance sheet. The issuer is obliged to maintain a register of the cover pool
Regulator and regulatory supervision	Issuers are regulated by the FME which in January 2020 merged with the Icelandic Central Bank
Issuer type	Icelandic commercial banks, savings banks and credit undertakings that hold a license to issue covered bonds granted by the FME upon satisfaction of certain criteria
Collateral type	Mortgage loan receivables, public sector assets and substitute assets recorded in the cover register
LTV limits	Market value LTV limits depend on the mortgage type: 80% (residential), 70% (agricultural), 60% (office/commercial/industrial)
Asset – liability requirements	The aggregate nominal value of the cover assets must at all times exceed the aggregate nominal value of claims arising from the outstanding covered bonds. On an NPV basis, cover assets, including derivatives, must always exceed the corresponding value of interest and principal of outstanding covered bonds, taking into account the effects of stress-test scenarios set by the FME on interest and currency risk. The issuer shall ensure that inflows arising from cover assets and derivative agreements are such that payment obligations towards holders of covered bonds and counterparties in derivative agreements can always be met
Substitute assets	Up to 20% of the total value of the cover pool can consist of substitute collateral, although the FME may authorise an increase in the proportion, up to 30%. Eligible substitute assets include: demand deposits with a regulated financial undertaking and exposures to Member States/central banks/other legal entities deemed safe by the FME. The FME may approve additional substitute collateral if appropriate: receivables against municipalities in member states/other regulated financial firms/non-Icelandic development banks/other legal entities
Minimum OC requirement	No mandatory level – however, the FME assigns a maximum OC level to each programme
Insolvency of the issuer	The ICBA states that in case of issuer insolvency the cover assets and the respective covered bonds are segregated from the general insolvency estate of the issuer. Covered bondholders and registered derivative counterparties have a priority claim on the cover pool and the cash that derives from the pool, ensuring timely repayment at the originally agreed terms, as long as the pool complies with the ICBA criteria. An issuer default does not trigger the premature termination of registered derivative contracts. The ICBA does not provide for the appointment of a special cover pool administrator in case of issuer insolvency
Treatment of derivatives in the cover pool	Derivatives are eligible assets only if the purpose of the derivative is to hedge against interest and currency risks related to cover assets or covered bonds. The ICBA requires derivatives to be structured such that premature termination of the derivative contract is not triggered by an issuer default or a demand by the counterparty. For this reason, derivative counterparties must have a minimum long-term rating of A3/A-/A- (Moody's/S&P/Fitch) or short-term rating of P2/A2/F2. Lastly, all derivative contracts must be recorded in the cover register

Source: ECBC Factbook 2021

Covered bond framework comparison

The Iceland framework is largely aligned with the main European jurisdictions

	Iceland	Germany	Norway	Sweden
Name of instrument	Sértryggð skuldabréf	Hypothekenpfandbriefe, Öffentliche Pfandbriefe, Schiffspfandbriefe, Flugzeugpfandbriefe	Obligasjoner med fortrinnsrett (OMF)	Säkerställda obligationer
Supervision	Icelandic Financial Supervisory Authority (FME)	German Federal Financial Supervisory Authority (BaFin)	Financial Supervisory Authority of Norway (FSA) and the cover pool monitor	Swedish Financial Supervisory Authority (SFSA) and the independent inspector
Collateral type	– Residential mortgage loans – Mortgage loans backed by industrial, office or commercial properties – Loans backed by agricultural properties – Public sector loans	– Residential mortgage loans – Commercial mortgage loans – Public sector loans – Shipping loans – Aircraft loans	– Residential mortgage loans – Commercial mortgage loans – Public sector loans – Shipping loans	– Residential mortgage loans – Commercial mortgage loans – Public sector loans – Shipping loans
Segregation of collateral	Ring-fenced via registration on the issuer’s balance sheet	Ring-fenced via registration on the issuer’s balance sheet	Ring-fenced via registration on the issuer’s balance sheet	Ring-fenced via registration on the issuer’s balance sheet
Repayment	Soft bullet	Soft bullet	Hard and soft bullet	Hard and soft bullet
LTV limits	– 80% for residential mortgage loans – 60% for commercial mortgage loans – 70% of for loans backed by agricultural property	60% of mortgage lending value	– 80% for residential mortgage loans – 60% for mortgage loans backed by other properties	– 80% for residential mortgage loans – 60% for commercial mortgage loans
Substitute collateral	Up to 20% of the nominal value of the cover pool; FME can approve an increase up to 30%	Up to 15% of outstanding covered bonds	Up to 15% of outstanding covered bonds	Up to 15% of outstanding covered bonds
Protection against mismatching	Nominal value and NPV of assets at least equal to outstanding covered bonds; payment obligations covered by inflows; maturity extension	Nominal value and NPV of assets at least equal to outstanding covered bonds; 180-day liquidity requirements covered via liquid assets; maturity extension	Nominal value of assets at least equal to 105% of outstanding covered bonds; payment obligations covered by inflows; 180-day liquidity requirements covered via liquid assets; maturity extension	Nominal value and NPV of assets at least equal to 102% of outstanding covered bonds; payment obligations covered by inflows; 180-day liquidity requirements covered via liquid assets; maturity extension
Mandatory OC	No mandatory OC requirement	- 2% Nominal (if mortgage / public sector loans) - 5% Nominal (if shipping / aircraft loans) - 2% NPV	5% Nominal	2% Nominal/NPV
Voluntary OC is protected	Yes – up to limit approved by FME	Yes	Yes	Yes
Premium Covered Bond	No	Yes	Yes	Yes
Eurosystem eligibility	Yes - CBs issued prior to 8th July 2022 No - CBs issued after 8th July 2022	Yes	Yes	Yes
ECB CBPP3 eligibility	No	Yes, depending on assets	No	No

Source: ECBC Factbook 2021, National Covered Bond Frameworks

Covered bond framework comparison – cont'd

<table>
<tr><th></th><th>Iceland</th><th>Finland</th><th colspan="3">Denmark</th></tr>
<tr><td>Name of instrument</td><td>Sértryggð skuldabréf</td><td>Finnish Covered Bonds</td><td>Særligt Dækkede Obligationer</td><td>Særligt Dækkede Realkreditobligationer</td><td>Realkreditobligationer</td></tr>
<tr><td>Supervision</td><td>Icelandic Financial Supervisory Authority (FME)</td><td>Finnish Financial Supervisory Authority (FSA)</td><td colspan="3">Danish Financial Supervisory Authority (FSA)</td></tr>
<tr><td>Collateral type</td><td>– Residential mortgage loans
– Mortgage loans backed by industrial, office or commercial properties
– Loans backed by agricultural properties
– Public sector loans</td><td>– Housing loans
– Commercial property loans
– Public sector loans</td><td>– Residential mortgage loans
– Public sector loans
– Exposures to credit institutions (up to a limit)</td><td>– Residential mortgage loans
– Public sector loans</td><td>– Residential mortgage loans
– Public sector loans</td></tr>
<tr><td>Segregation of collateral</td><td>Ring-fenced via registration on the issuer's balance sheet</td><td>Ring-fenced via registration on the issuer's balance sheet</td><td colspan="3">Cover assets held on the issuer's balance sheet and assigned to individual capital centers (mortgage banks) or registers (commercial banks)</td></tr>
<tr><td>Repayment</td><td>Soft bullet</td><td>Hard and soft bullet</td><td colspan="3">Hard and soft bullet</td></tr>
<tr><td>LTV limits</td><td>– 80% for residential mortgage loans
– 60% for commercial mortgage loans
– 70% of for loans backed by agricultural property</td><td>– 80% for residential mortgage loans
– 60% for commercial mortgage loans</td><td colspan="2">– 75/80% for residential loans
– 75% for holiday property
– 60% for agricultural or commercial property</td><td>– 80% for residential loans
– 75% for holiday property
– 70% for agricultural property
– 60% for commercial property</td></tr>
<tr><td>Substitute collateral</td><td>Up to 20% of the nominal value of the cover pool; FME can approve an increase up to 30%</td><td>Up to 20% of the nominal value of the cover pool</td><td colspan="2">Up to 15% of outstanding covered bonds</td><td>No limit</td></tr>
<tr><td>Protection against mismatching</td><td>Nominal value and NPV of assets at least equal to outstanding covered bonds; payment obligations covered by inflows; maturity extension</td><td>Nominal value of assets at least equal to outstanding covered bonds; NPV of assets at least equal to 102% of outstanding covered bonds; 180-day liquidity requirements covered via liquid assets; maturity extension</td><td colspan="3">Balancing principle for mortgage banks; payment obligations covered by inflows; 180-day liquidity requirements covered via liquid assets (does not apply to match-funded programmes)</td></tr>
<tr><td>Mandatory OC</td><td>No mandatory OC requirement</td><td>2% Nominal</td><td colspan="2">2% Nominal</td><td>No mandatory OC</td></tr>
<tr><td>Voluntary OC is protected</td><td>Yes – up to limit approved by FME</td><td>Yes</td><td colspan="3">Yes</td></tr>
<tr><td>Premium Covered Bond</td><td>No</td><td>Yes</td><td colspan="2">Yes</td><td>No</td></tr>
<tr><td>Eurosystem eligibility</td><td>Yes - CBs issued prior to 8th July 2022
No - CBs issued after 8th July 2022</td><td>Yes</td><td colspan="3">Yes</td></tr>
<tr><td>ECB CBPP3 eligibility</td><td>No</td><td>Yes</td><td colspan="3">No</td></tr>
</table>

Source: ECBC Factbook 2021, National Covered Bond Frameworks

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