Íslandsbanki: Investor Presentation

8 June 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
706
number of FTEs at Íslandsbanki at period end

12 branches

Listed on Nasdaq Iceland as of June 2021

Market share[1]

31% retail customers

37% SMEs

35% large companies

Sustainability 1Q22

- Íslandsbanki regarded as most sustainable bank in Iceland according to a Gallup survey
- Estimates of the financed emissions for 2020 and 2019 published
- Íslandsbanki issued a EUR 300m 0.75% fixed rate senior preferred sustainable bond

Key Figures 1Q22

ROE	10.2%	LCR Group, all currencies	195%
Cost-to-income ratio	47.6%	NSFR Group, all currencies	123%
CET1 ratio[2]	18.8%	Leverage ratio[2]	12.4%
Total capital ratio[2]	22.5%	Total assets	ISK 1,446bn

Ratings and certifications

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

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 1Q22

- Unified digital sales platform released[3]
- Up to date price information for securities implemented in the app
- Cardless ATM services

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. 2. Including 1Q22 profit. 3. In beta version at 31 March 2022, and released on 27 April 2022

Financial overview of the issuer

8 June 2022

The Bank's strategy is key for the achievement of significant milestones from 2008 and onwards

Proven track record in delivering future goals

1875

History stretching back to 1875 when the Savings Bank Sparisjóður Álftaneshrepps (one of Íslandsbanki's predecessors) was founded

1904

The original Íslandsbanki hf. was founded as the first privately owned bank in Iceland

2008

Back to banking basics

- Incorporated on 14 October 2008 with a clean balance sheet and no legacy exposures
- Since then, Íslandsbanki is one of the very few banks in Europe that has never had to raise additional equity

2011-2013

Consolidation

- Bolt-on acquisitions for future organic growth including Byr Savings Bank
- Successful integration and cost reduction without loss in market share
- Back to same number of branches as before the merger

BYR

2013 – 2016

Building a sustainable future

- Relationship banking model introduced
- Transparent, safe and simple business model focused on efficiency and minimising complexity
- ISFI ownership

2017-2019

Digital transformation

- Successful core banking system replacement including migration to global standardised core banking system (Sopra) for payments and deposits
- Strategic shift to open banking strategy

2019 – Future

Moving Iceland forward

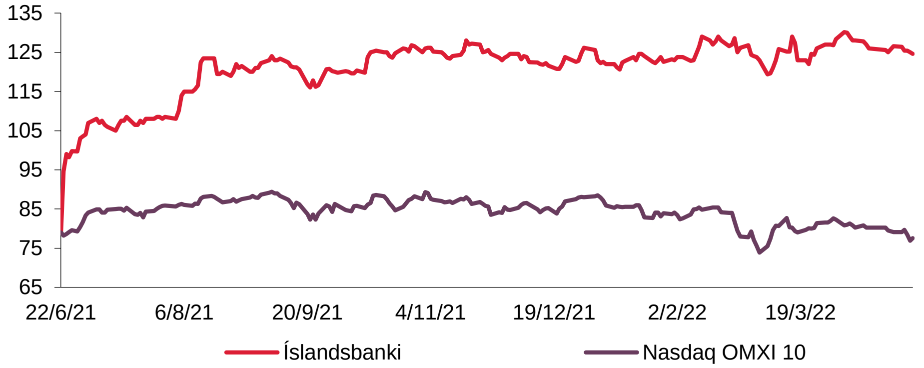
- Commitment to empowering customers to succeed
- More active role of the Bank in shaping and progressing society
- Clear future vision and strategy to drive further efficiency and competitive advantages

Strong and diversified shareholder group

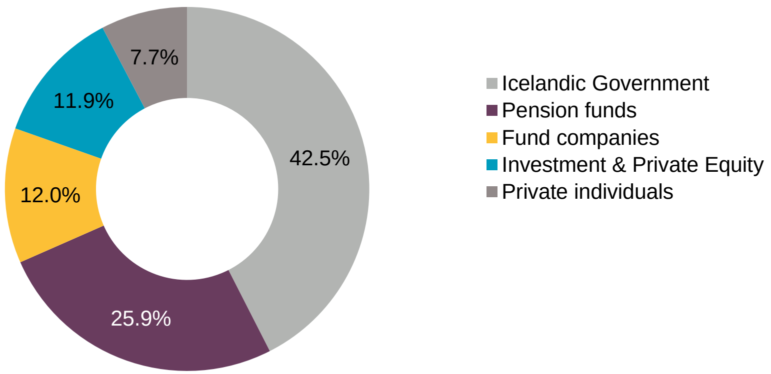
Icelandic government sold a 22.5% stake at the end of March

Íslandsbanki's share price development since IPO

Closing price



Shareholder composition



Largest shareholders

31.3.2022

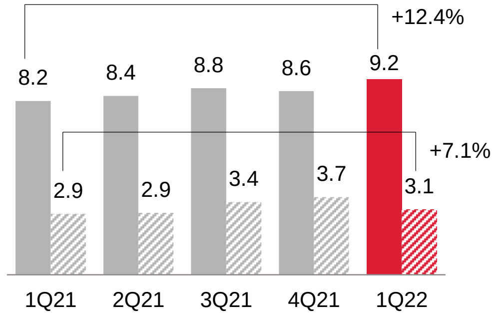
Largest shareholders	Capital
The Icelandic Government	42.5%
LSR Pension Fund	6.0%
Gildi Pension Fund	5.1%
Capital Group	5.1%
Live Pension Fund	4.6%
Brú Pension Fund	2.0%
Arion Banki hf.	2.0%
Stapi Pension Fund	1.6%
Iceland Funds	1.6%
Landsbankinn hf.	1.5%
RWC Asset Management LLP	1.3%
Lífsverk Pension Fund	1.2%
Jakob Valgeir ehf.	1.0%
Frjálsi Pension Fund	1.0%
Other shareholders	23.6%
	100.0%

Delivering on financial targets and guidance

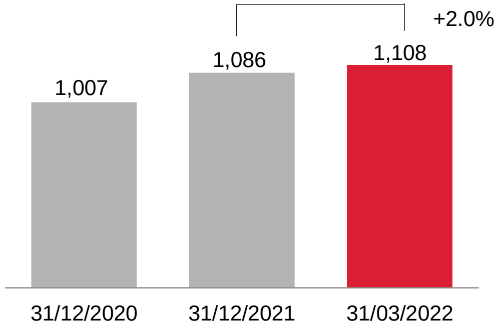
Operating income increased by 8.7% in 1Q22 (YoY) and costs were flat despite high inflation

Growth in line with guidance

NII and NFCI, ISKbn

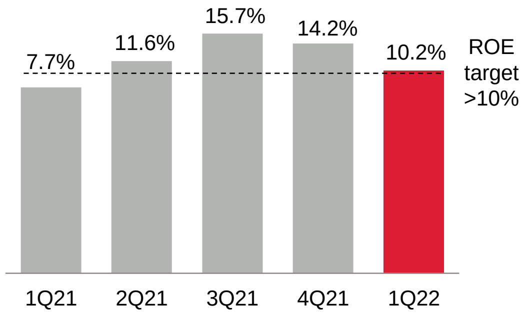


Loans to customers, ISKbn

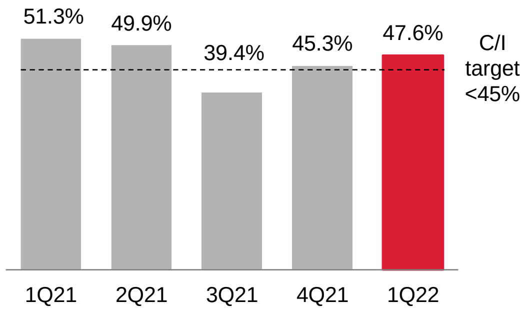


ROE in upper range of guidance

ROE

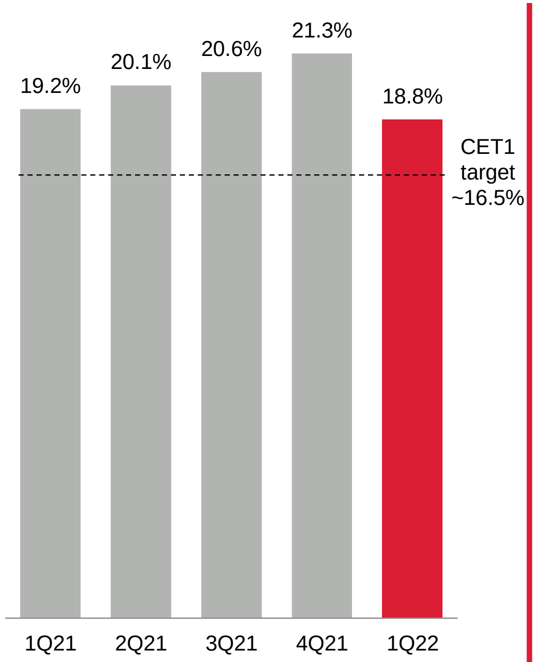


C/I ratio



Excess capital optimised in the next 12-24 months

CET1 ratio[1]



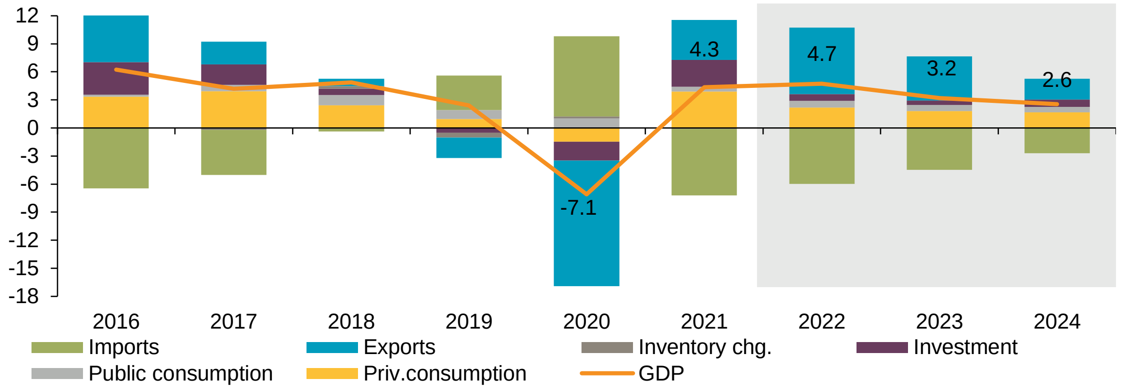
1. Including first quarter profit for 1Q22 and third quarter profit for 3Q21

Economic recovery continues

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

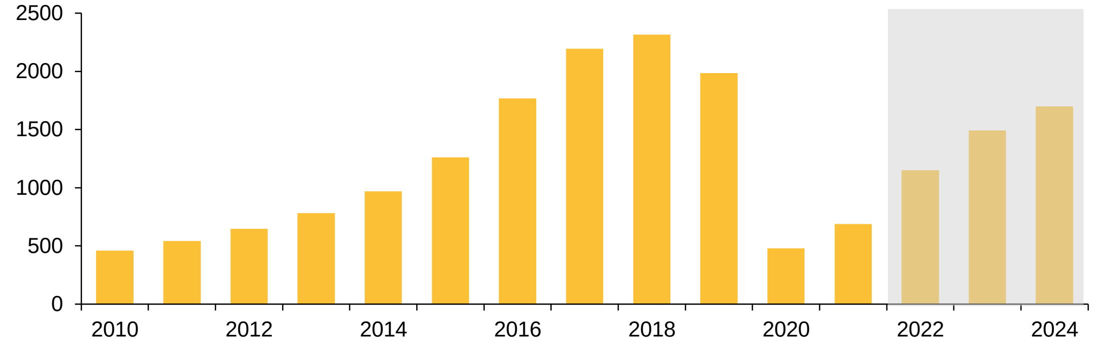
Exports replace domestic demand as the key catalyst of healthy GDP growth...

Real GDP and main subitems, YoY change, %



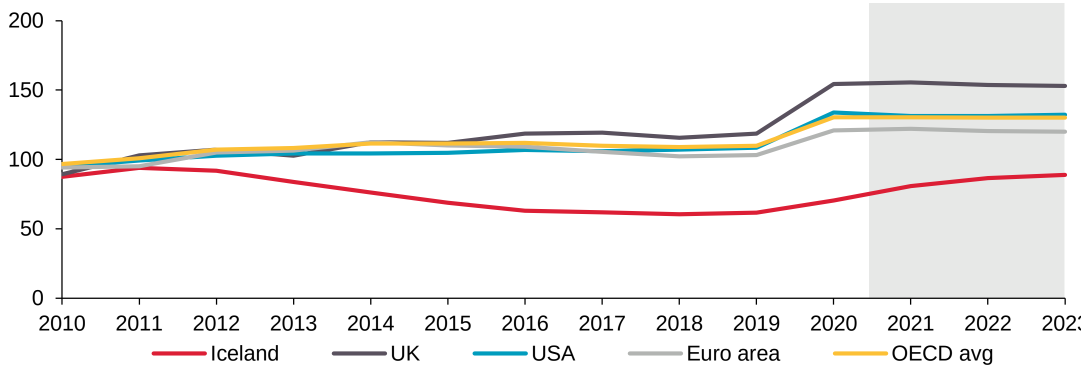
...as tourism rebounds due to fading pandemic impact

Number of foreign tourists per year, thousands



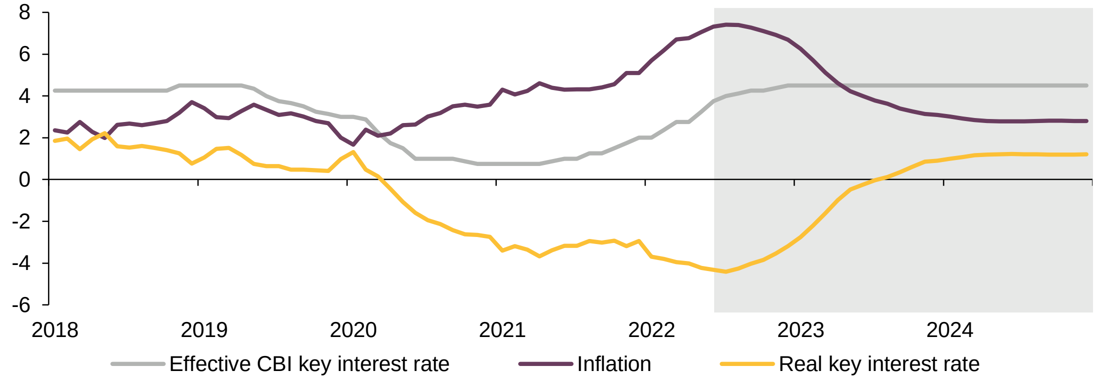
Government finances remain on a sustainable path post-pandemic..

General government gross debt as % of GDP



...and monetary policy normalises as inflation peaks and economy recovers

Inflation and policy rate, %



1. Shaded areas indicate ISB Research forecasts. 2. Source: Statistics Iceland, the Central Bank of Iceland and ISB Research

An eventful first quarter of 2022

Strong ROE in all business units

Personal Banking

- 10.3% ROE
- 60.3% Cost-to-income ratio
- 2.6% NIM

Market share
31% individuals[2]

NPS ranking
#2 vs domestic peers[2]

- Continued growth in mortgage lending
- New sales platform where retail and SME customers can now check out products in seconds

Business Banking

- 20.2% ROE
- 44.6% Cost-to-income ratio
- 5.2% NIM

Market share
37% Iceland[3]

NPS ranking
#1 vs domestic peers[3]

- Good lending activity with 2.8% growth from YE21
- 95% of SME customers are now app users

Corporate & Investment Banking

- 11.0% ROE
- 40.7% Cost-to-income ratio
- 2.8% NIM

Market share
35% Iceland's largest companies[4]

NPS ranking
#1 vs domestic peers[4]

- Highest share of combined turnover in listed bonds and equities in Iceland

Iceland Funds

- 27.5% ROE
- 49.0% Cost-to-income ratio[1]

Market share
30% Domestic mutual funds[5]

AUM
ISK 413bn

- EQUUS fund continued with the highest return of all funds at the end of 1Q22

Sustainability

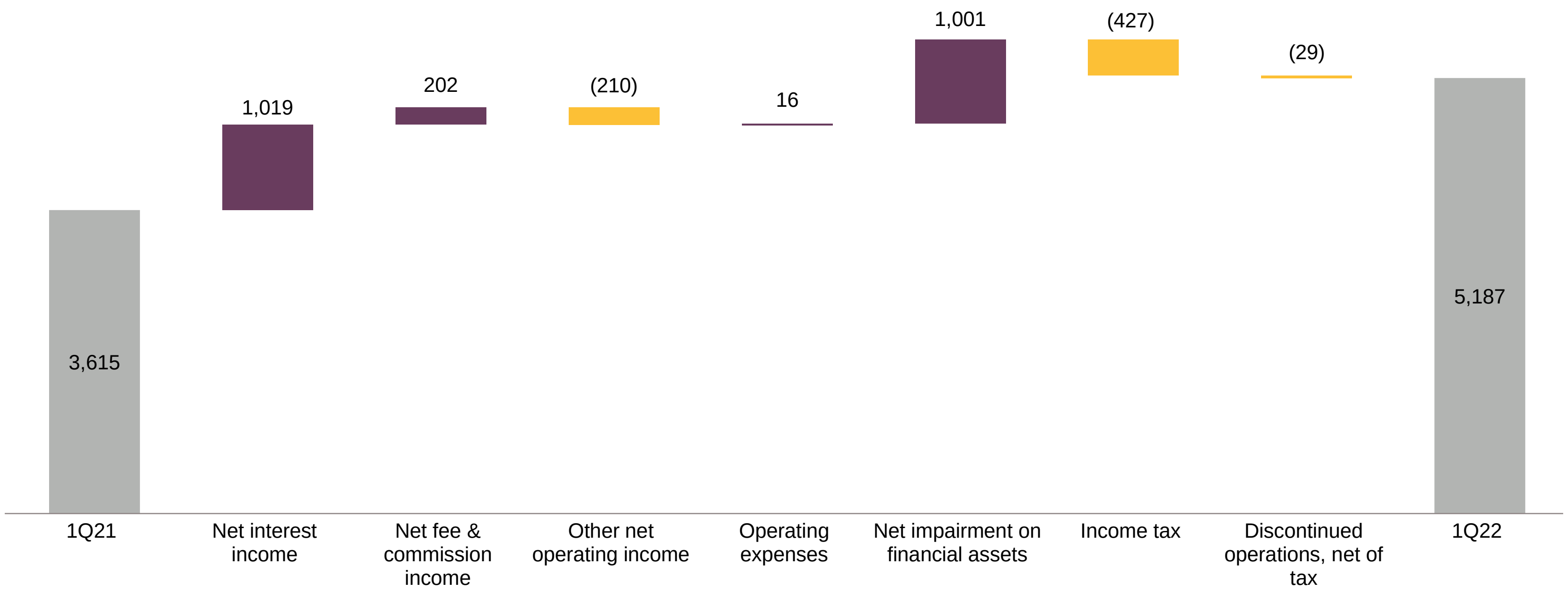
- Publication of initial financed emissions
- New sustainable savings account
- NIB and Íslandsbanki signed a EUR 79m loan for green and SME lending
- Íslandsbanki issued a EUR 300m 0.75% fixed rate senior preferred sustainable bond
- Íslandsbanki and its employees held a fundraising for the Red Cross Emergency Fund
- Nordic CEOs for a Sustainable Future publish Diversity & Inclusion Guide

1. As calculated from the Bank's Consolidated Income Statement. 2. Gallup Iceland Internet-panel survey age 18+, rolling average 12 months conducted for Islandsbanki. 3. Gallup Iceland telephone/internet survey among companies with +4 employees in Iceland as of December 2021 conducted for Íslandsbanki. 4. Gallup Iceland telephone/internet survey among 300 largest companies in Iceland December 2021 conducted for Islandsbanki. 5. Market share of Icelandic fund management companies as of 31.12.2021

Good performance in 1Q22 supported by an increase in NII

Flat expenses and reversed impairments further enhance a positive result

Profit for the period – 1Q21 vs 1Q22
ISKm



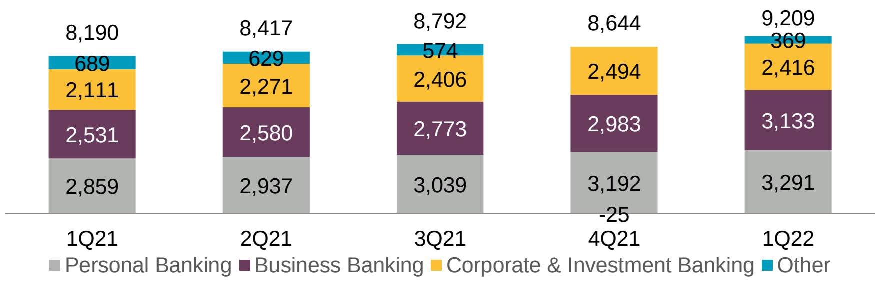
NII growing strongly in the quarter and between years

NIM rises to 2.6% due to a higher interest rate environment

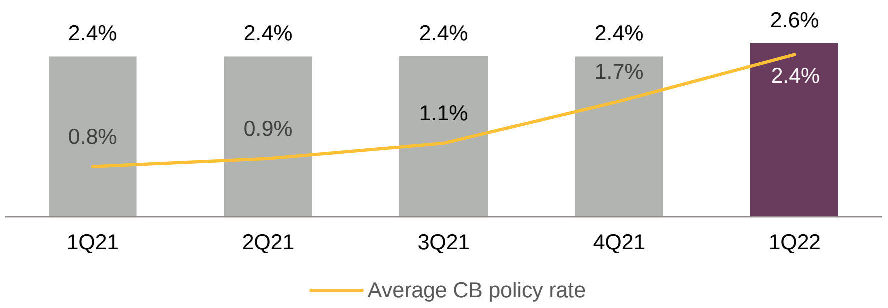
Highlights

- Rise in NII in 1Q22 is a result of rise in the Bank´s loan book and higher interest rate environment net positively affecting other interests
- NIM on loans was 2.0% in 1Q22 (2.2% in 1Q21) while NIM on deposits was 1.6% in 1Q22 (1.1% in 1Q21)

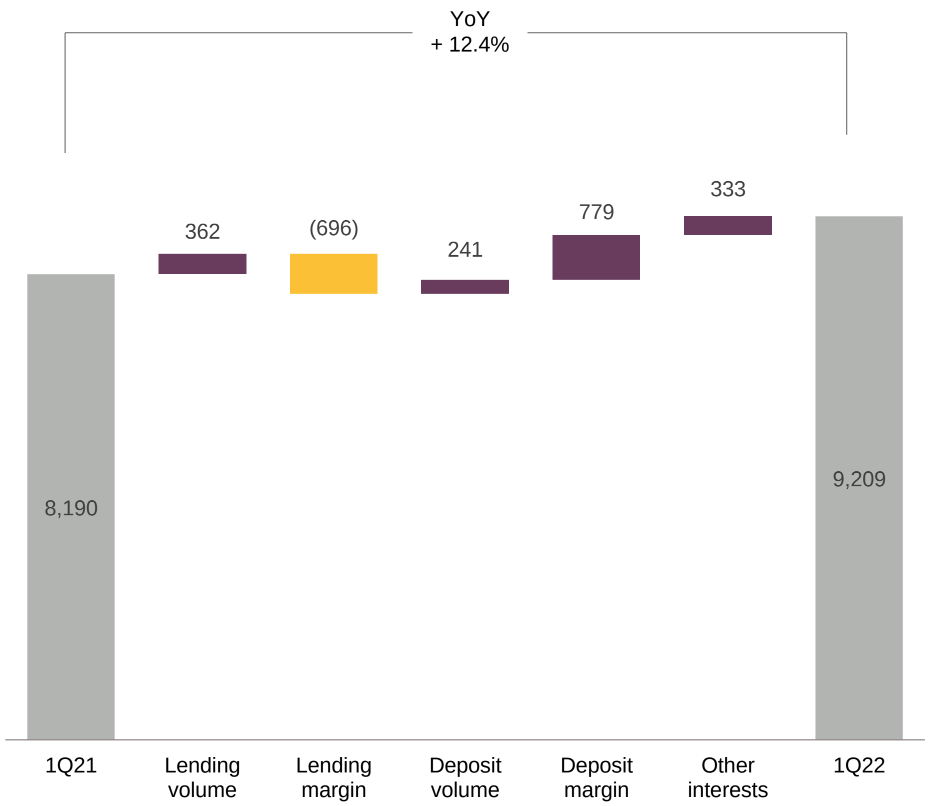
Net interest income
By business segments, ISKm



Net interest margin
On total assets



NII – comparison 1Q YoY
ISKm



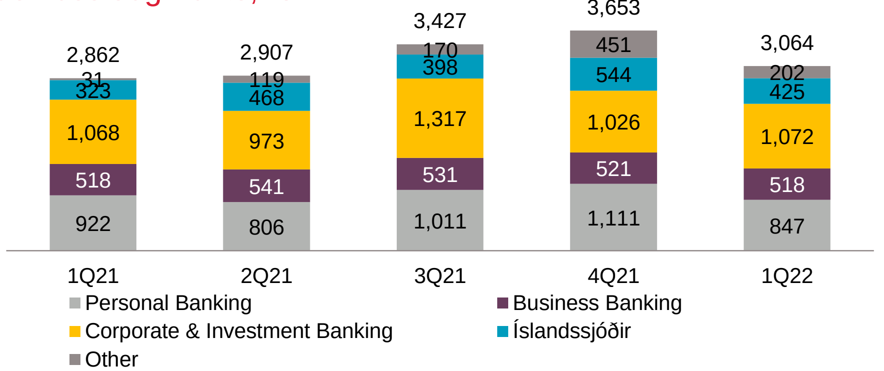
NFCI continues an upwards trend with a 7.1% rise YoY

Broad-based fee generation across the business units

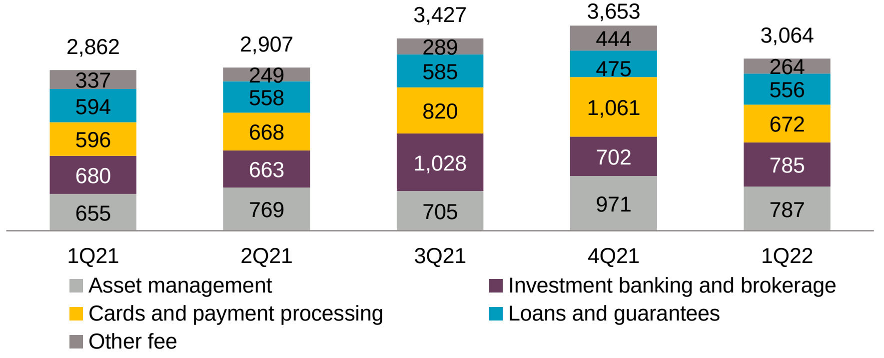
Highlights

- Revenue from Cards and payment processing increased in 1Q22 YoY due to increased card activity
- Seasonality in revenues explains the drop in fees from cards and payment processing between quarters
- Strong growth in fees from asset management between years, but reduction between quarters due to performance related fees in 4Q21

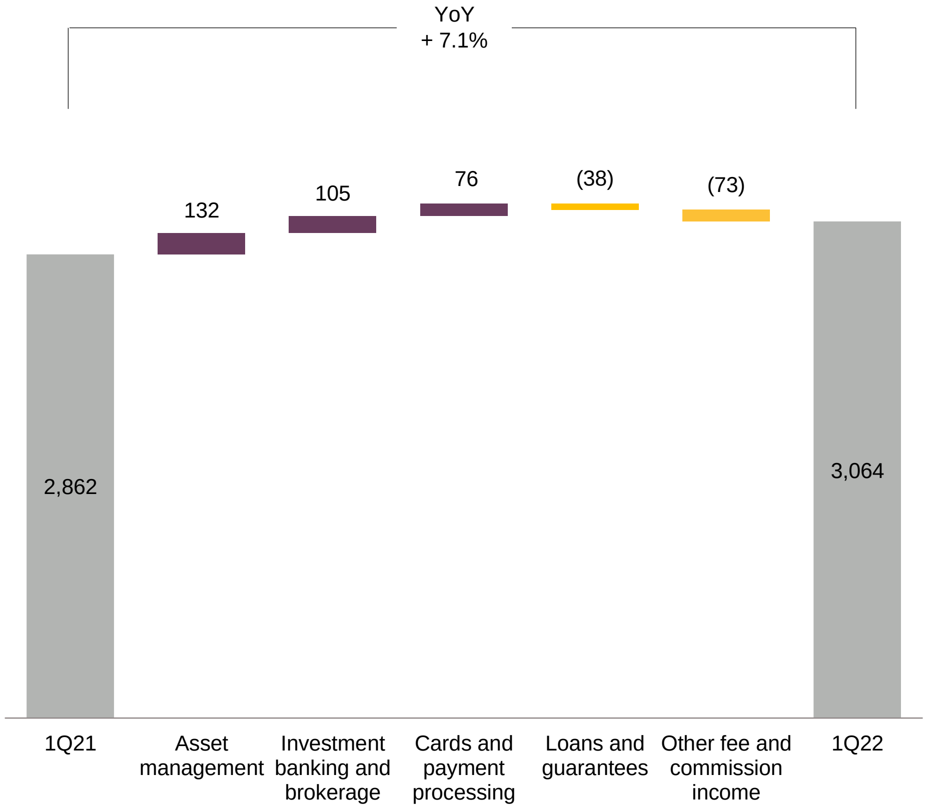
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



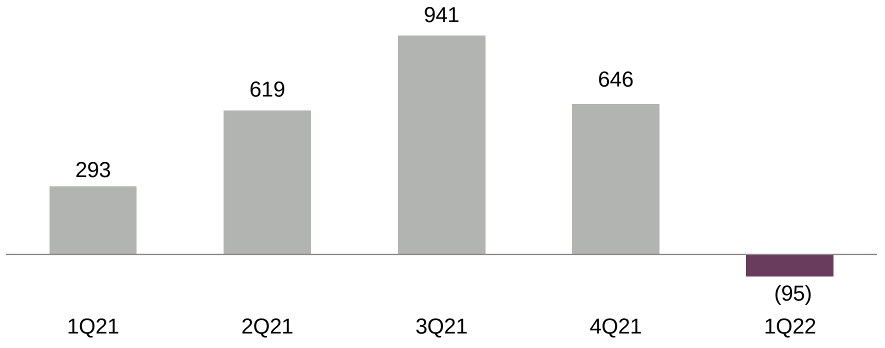
NFCI – comparison 1Q YoY
ISKm



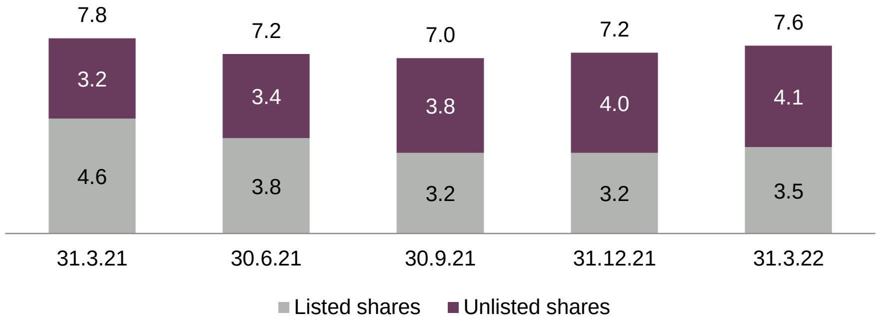
Unfavourable credit markets affect NFI in 1Q22

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

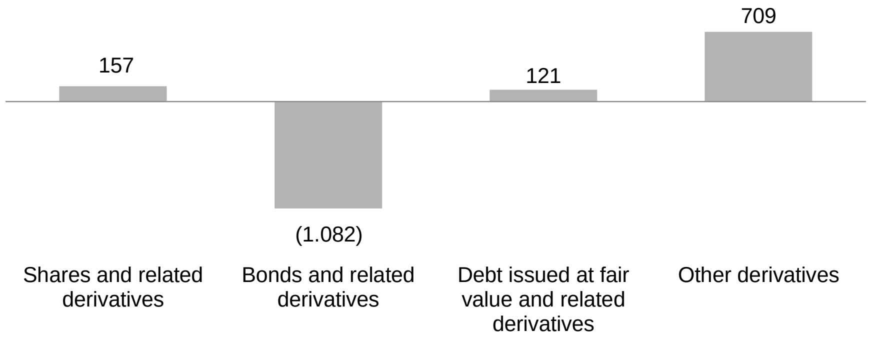
Net financial income
ISKm



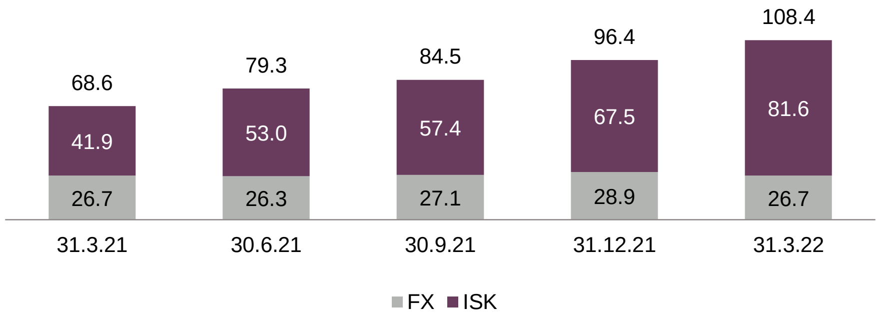
Shares and equity instruments[1]
ISKbn



Net financial income by type in 1Q22
ISKm



Bonds and debt instruments[2]
ISKbn

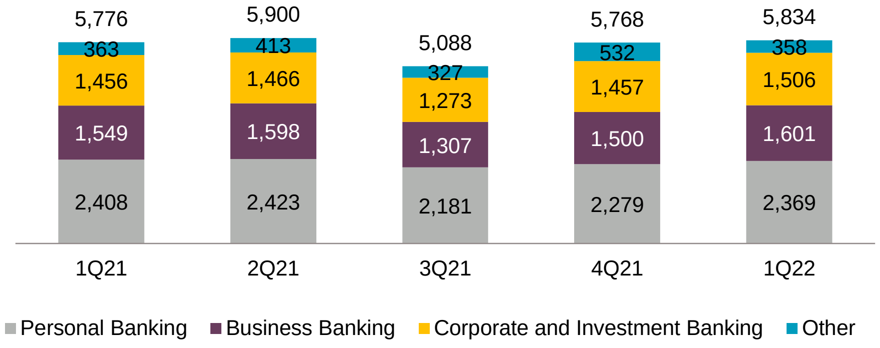


1.Excluding listed shares and equity instruments used for economic hedging. 2. Excluding listed

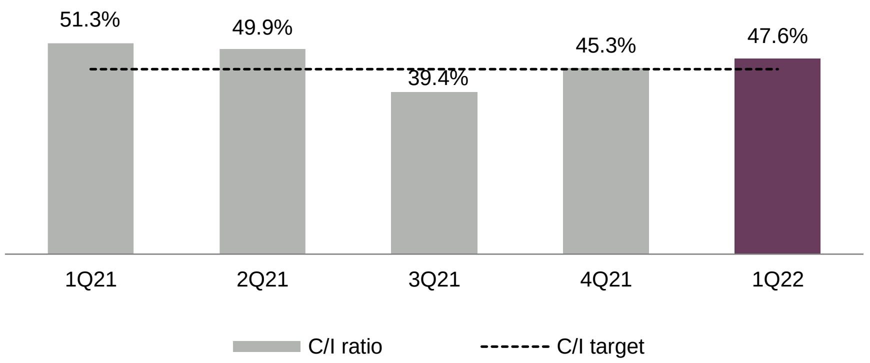
Administrative expenses stable in 1Q22

6.1% reduction in real terms driven by lower salary cost

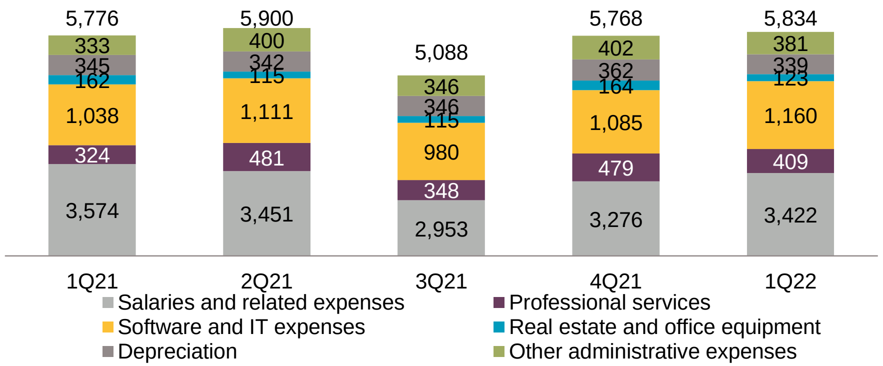
Administrative expenses[1]
ISKm



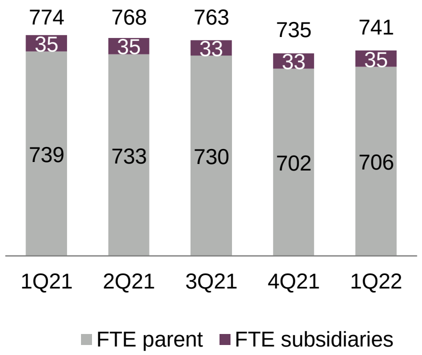
Cost-to-income ratio[2]



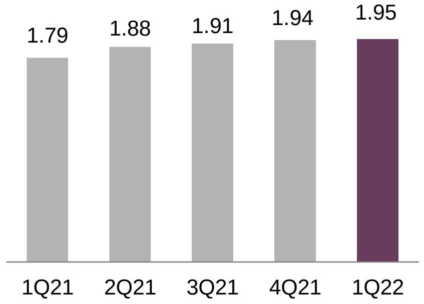
Administrative expenses[1] – by type
ISKm



FTE period end[3]



Total assets / FTE[3]
ISKbn



1. Administrative expenses in 1Q21 and 2Q21 are excluding one-off cost related to the Bank's IPO, ISK76m in 1Q21 and ISK588m in 2Q21. 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

Positive net impairment in 1Q22 as the economy recovers

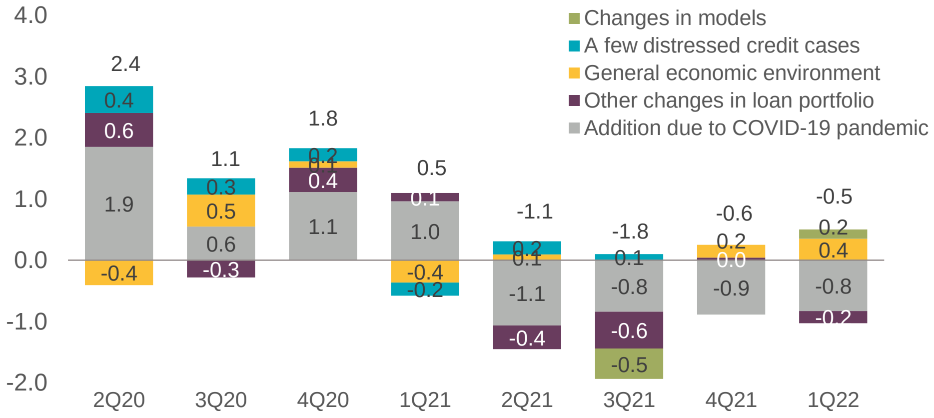
Majority of forbearance borrowers have resumed payments

Highlights

- Reserve coverage ratio (RCR) ratio for impairment allowance on Stage 3 was 27.2% at end of 1Q222
- The definition of forbearance includes a 24-month probation period. Therefore, loans are classified with forbearance even after normal payments have resumed. Loans amounting to ISK 70bn or 80% are expected to exit forbearance probation in 2022

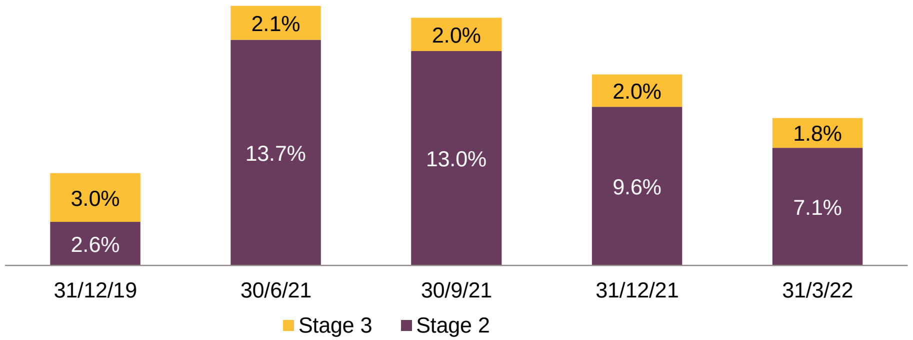
Net impairment on financial assets[1]

By period, ISKbn



Loans to customers: Stage 2 and 3 (NPLs)

Development of gross carrying amount as ratio of total loans

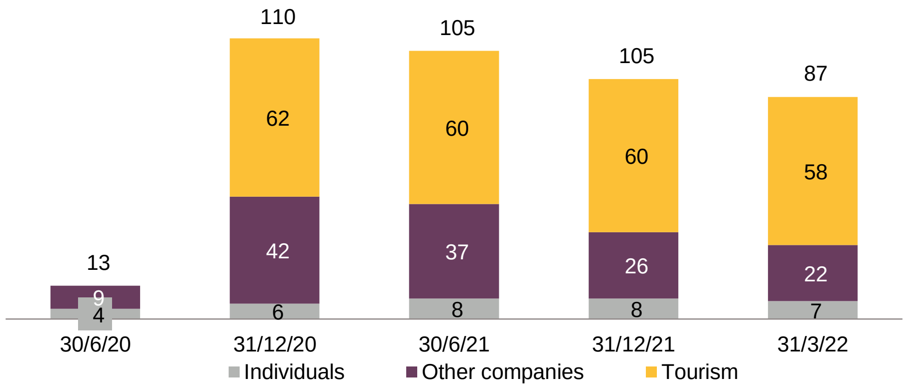


Current and expected cost-of-risk

- Annualised cost of risk was -17bps in 1Q22 compared to +20bps for 1Q21
- Additional impairment allowance currently attributable to the tourism overlay and stage transfer is approx. ISK 1.2bn at end of 1Q22 down from 2.0bn at YE21
- The probability weights of economic scenarios were shifted to 20% (good), 45% (baseline), and 35% (bad) at end of 1Q22. A shift of 5% from baseline to the bad scenario would increase the impairment allowance by ISK 0.4bn while a 5% shift from the baseline to good would decrease the allowance by ISK 0.2bn
- The Group stands to receive approximately ISK 700m on a loan that had previously been fully written off, as a result of a favourable court ruling passed in the second quarter 2022

Performing loans with forbearance

Gross carrying amount, ISKbn

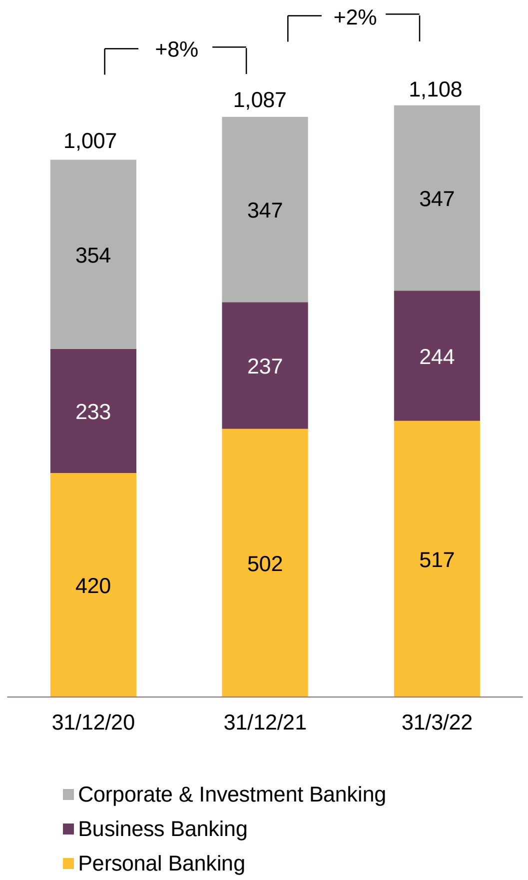


1. See further in note 2 in Consolidated Financial Statements first quarter 2022

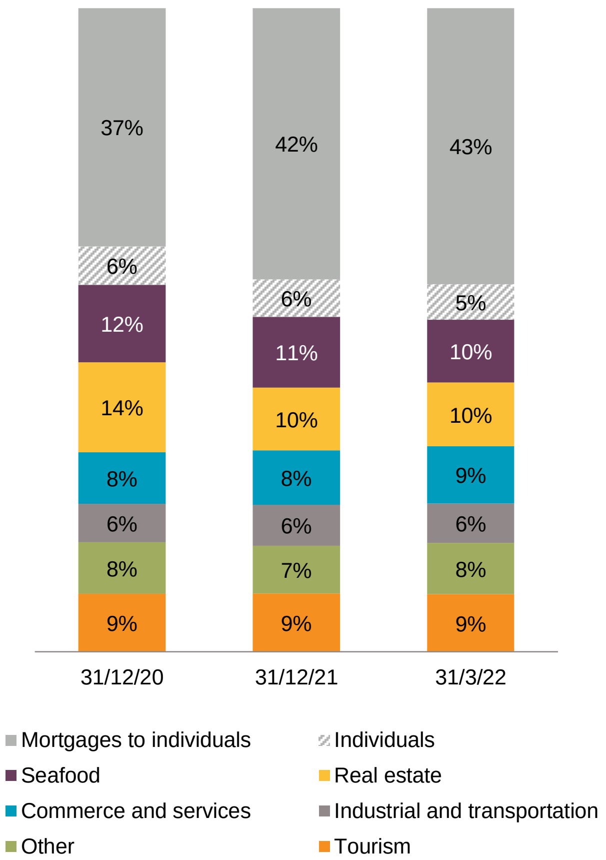
Diversified and highly collateralised loan portfolio

Loans to individuals are 48% of loans to customers, mainly residential mortgages

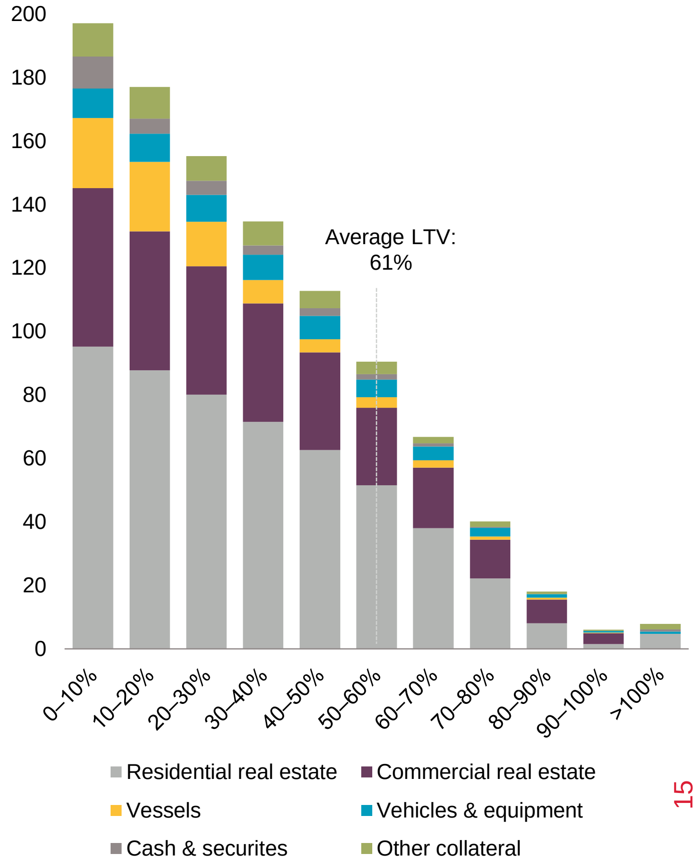
Loans to customers
By business division, ISKbn



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



LTV distribution by underlying asset class
31.3.2022, loan splitting approach, ISKbn



8 June 2022

Strong growth in mortgages and increased market share

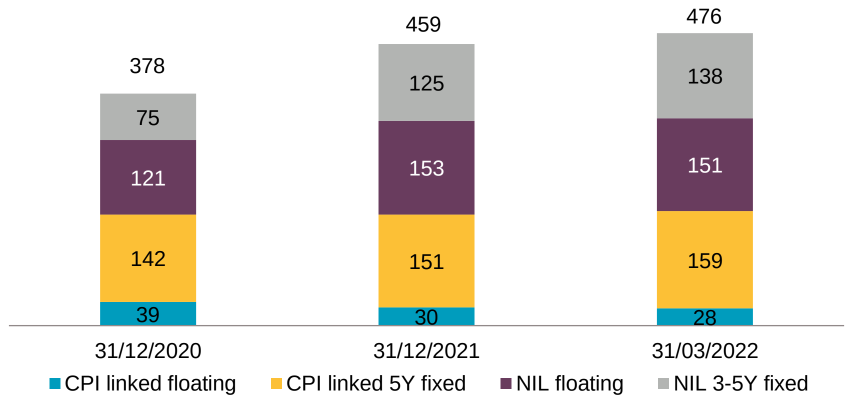
Average LTV's stable and built-in buffers for rate increases

Highlights

- Conservative payment assessment for non-indexed variable rates mortgages in low interest environment
- Sensitivity analysis if rates rise shows that the financial impact on the Bank is expected to be insignificant
- The Bank offers services to facilitate hedging against rising rates with possibility of changing to fixed rates

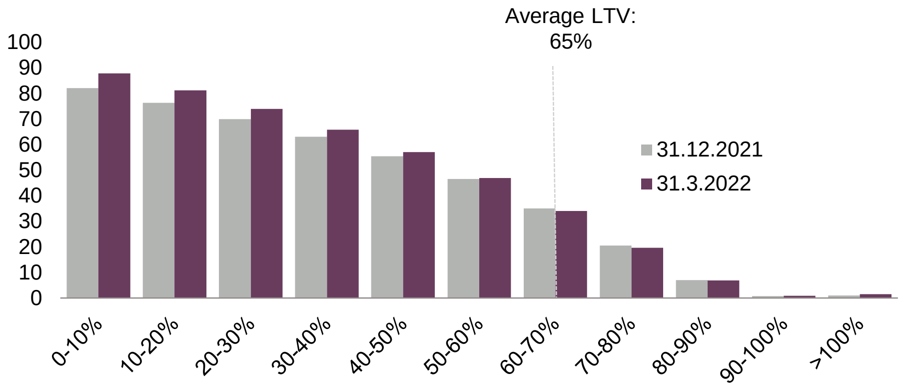
Mortgage loans

Gross carrying amount, ISKbn



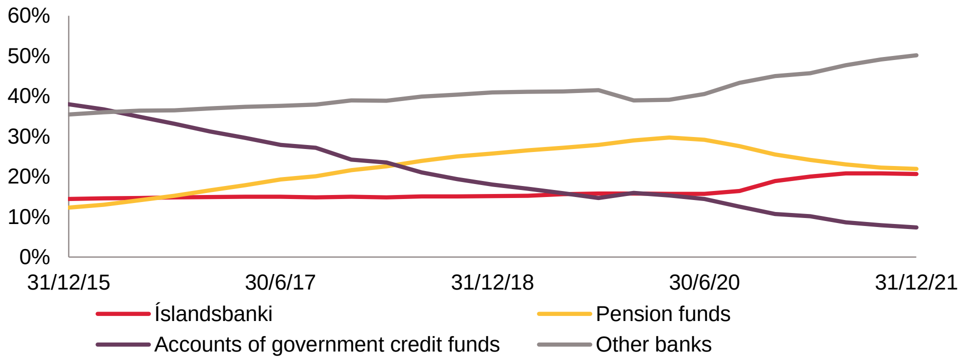
LTV distribution of mortgages to individuals

Gross carrying amount, ISKbn



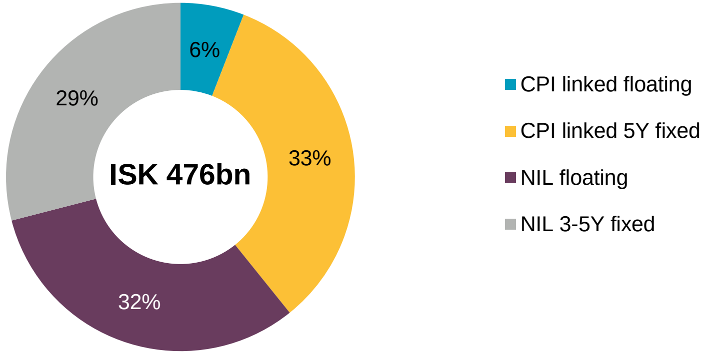
Mortgage market[1]

Market share development



Mortgages portfolio[2]

Gross carrying amount, 31.3.2022



1. Source: Central Bank of Iceland 2. NIL stands for non-index linked loans.

Deposits are the largest source of funding

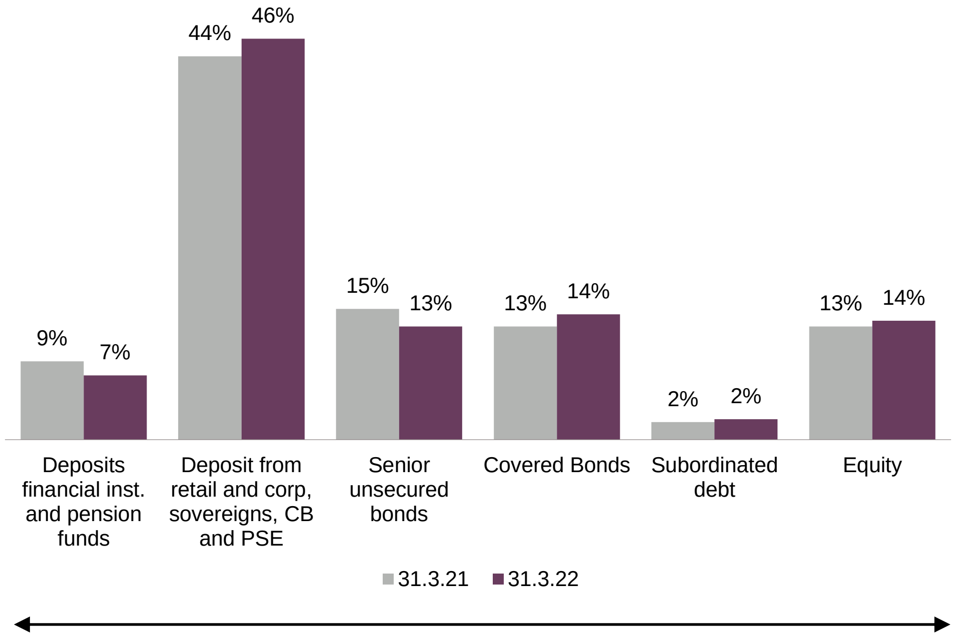
Deposits from individuals continue to increase

Highlights

- Term deposits are 19% of total deposits
- Deposit concentration is stable. 13% of the Bank's deposits belonged to the 10 largest depositors and 28% to the 100 largest depositors at 1Q22, compared to 12% and 28% respectively at YE21
- At 1Q22 75% of deposits were in non-indexed ISK, 13% CPI-linked and 12% in foreign currencies
- In addition to ISK covered bonds, our covered bond programme has recently been updated to allow for EUR covered bond issuance

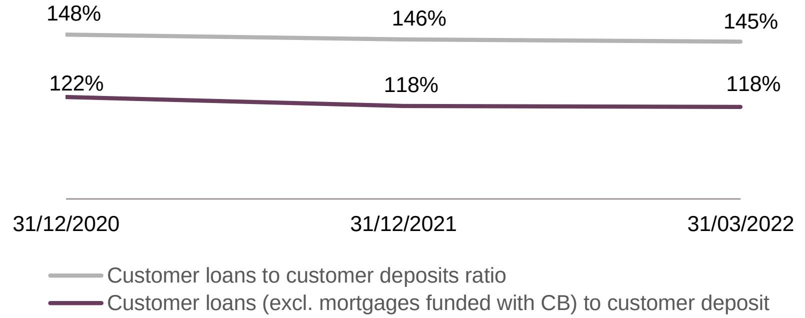
Funding sources

By type, % of total liabilities and equity



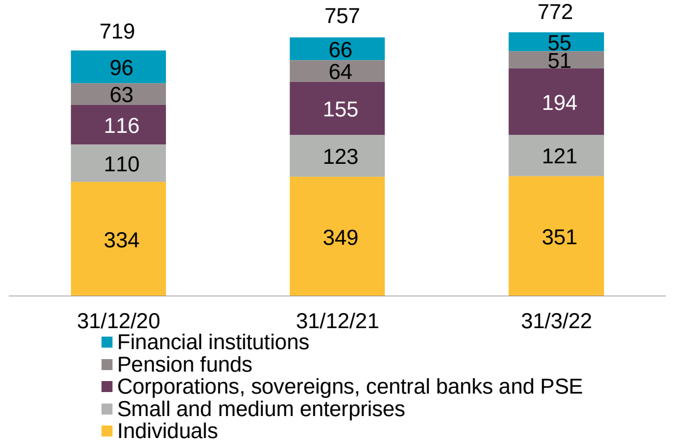
Customer loans to customer deposits ratio

Development, %



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

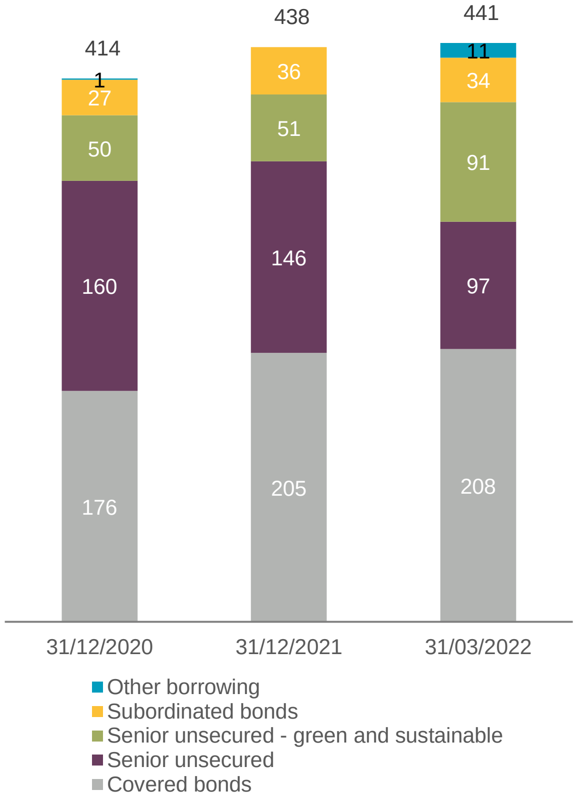
Majority of 2022 maturities already funded through a recent €300m sustainable bond issue

Highlights

- S&P Global ratings BBB/A-2 with stable outlook confirmed on 25 January 2022
- As of 1Q22 the Bank has EUR 100m outstanding maturing in foreign currency this year after a successful EUR 300m issue in January and a EUR 200m buyback of the EUR 300m April maturity
- NIB and Íslandsbanki signed a USD 87m loan for on-lending to environmental projects and SMEs in Iceland
- At end of 1Q22, total LCR ratio was 195%, FX LCR was 235% and total NFSR was 123%
- The Banks 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

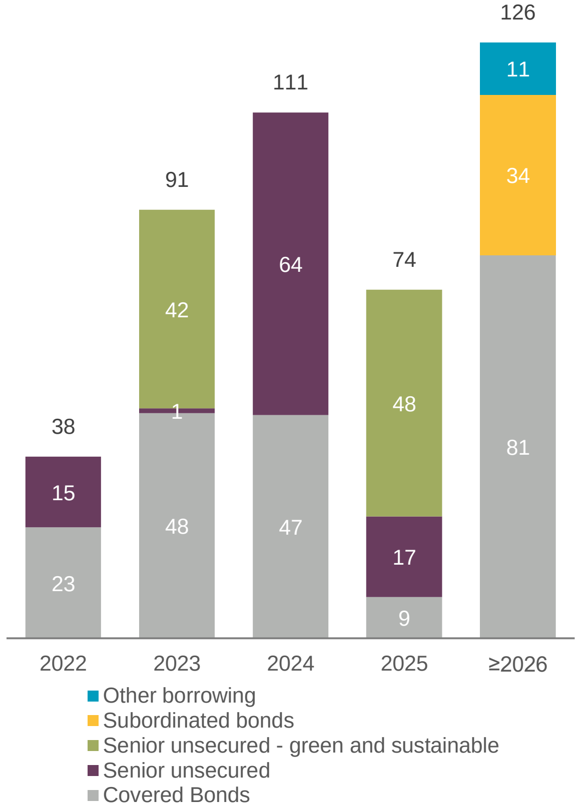
Sources of borrowings

Development, ISKbn



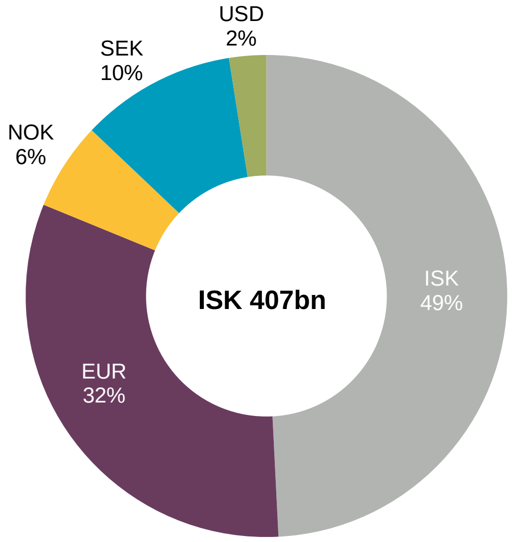
Contractual maturity profile of borrowings

ISKbn



Currency split of borrowings

31.3.21



Strong capital position and dividend capacity

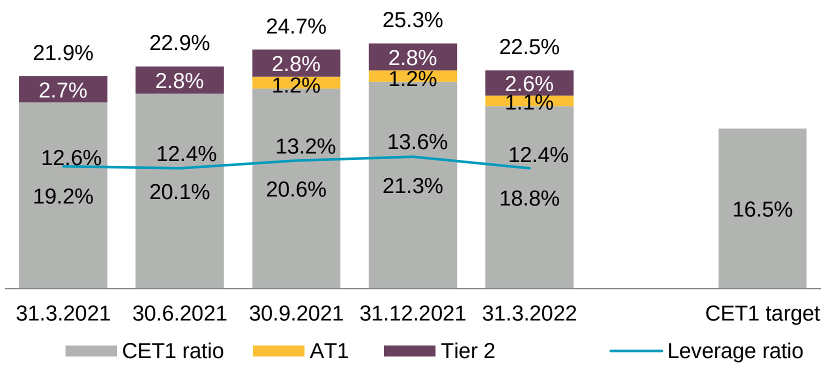
Opportunity exist to optimise capital composition and to continue consistent dividends

Highlights

- Current and long term expected total capital requirements of 17.8% and 19.0% respectively
- Additional AT1 issuance potential of ISK 6-7bn to optimise capital structure
- Drop in CET1 in Q1 due to
  - Planned ISK 15bn buyback excluded from CET1
  - REA growth
- The rise in REA is a result of rise in loans to customers and loans to credit institutions as well as in derivatives and more accurate data processing regarding off-balance sheet items and the SME factor

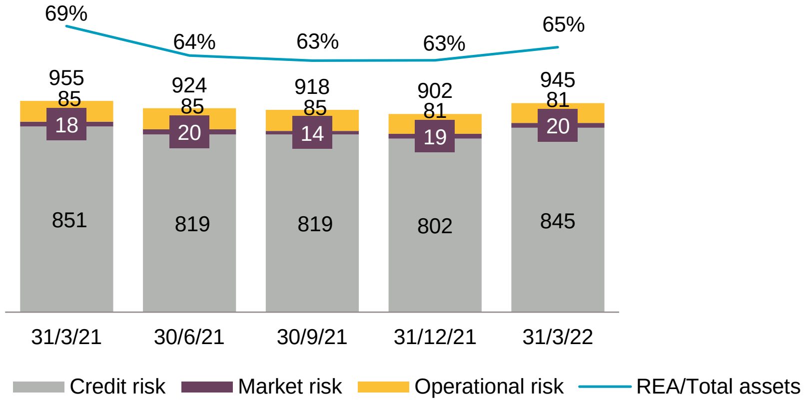
Capital ratios and leverage ratio[1]

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



Risk exposure amount (REA)

ISKbn



1. Including 1Q22 profit

Capital distribution plans

- **A dividend of ISK 5.95 per share was disbursed in March**
  - Amounting to 50% of profit, in line with the dividend policy
- **ISK 35-40bn of excess CET1 capital**
  - Optimised in the next 12-24 months
  - Distribution in the form of share buybacks or special dividends, method and timing subject to the market conditions
  - ISK 15bn buyback of own shares in the coming months

Mortgage origination and underwriting

8 June 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 tax evaluation. 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 tax evaluation
- 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 tax evaluation (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	5.65%	70%	40
Variable non-indexed mortgage rates - additional loan	6.75%	80%[1]	40
Fixed non-indexed mortgage for 3 years	6.85%	70%	40
Fixed non-indexed mortgage for 3 years - additional loan	7.95%	80%[1]	40
Fixed non-indexed mortgage for 5 years	6.95%	70%	40
Fixed non-indexed mortgage for 5 years - additional loan	8.05%	80%[1]	40
Indexed mortgages, with interest rate reset every 5 years	1.35%	70%	30
Indexed mortgages, with interest rate reset every 5 years - additional loan	2.45%	80%[1]	30
Indexed mortgage, with variable interest rates	1.80%	70%	30
Indexed mortgage, with variable interest rates - additional loan	2.90%	80%[1]	30
Variable non-indexed first purchase loan (max ISK 3 million loan)	7.10%	90%	10

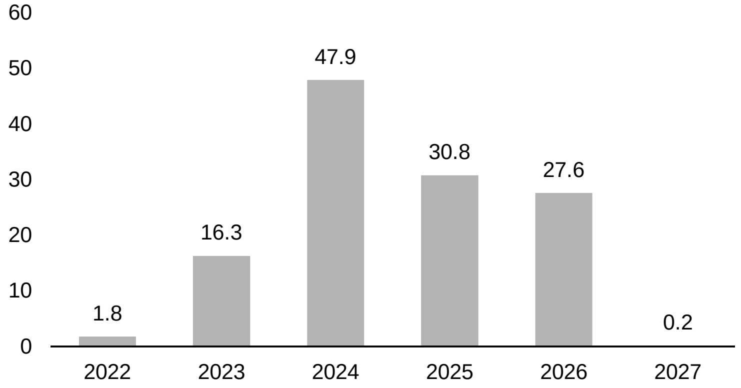
Mortgage book breakdown as at 31 March 2022 (ISKbn)	
Variable Non-indexed	146
Fixed Non-indexed	138
Variable Non-indexed first-time buyer loan	5
Total (Non-indexed)	289
Variable Indexed	28
Fixed Indexed	159
Total (Indexed)	187
Mortgage Total	476

1. 80% LTV when buying real estate and 70% of tax evaluation when refinancing

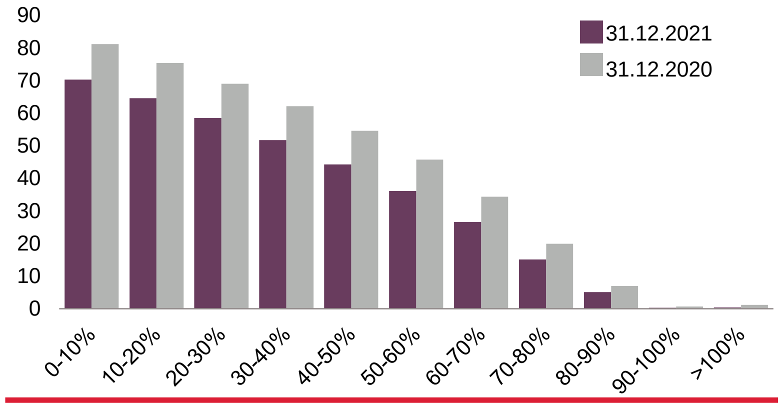
A granular and diversified mortgage book

Snapshot of the main features

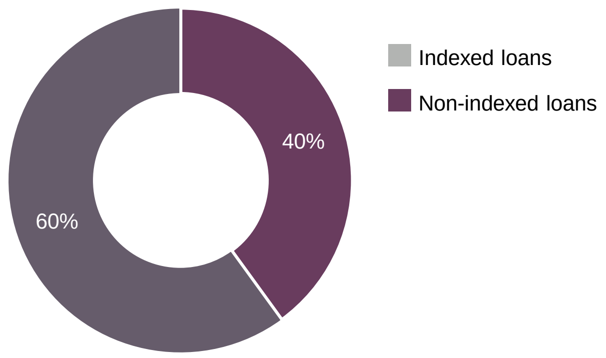
Loans switching from fixed to floating interest rate
By loan balance, ISKbn, 31 December 2021



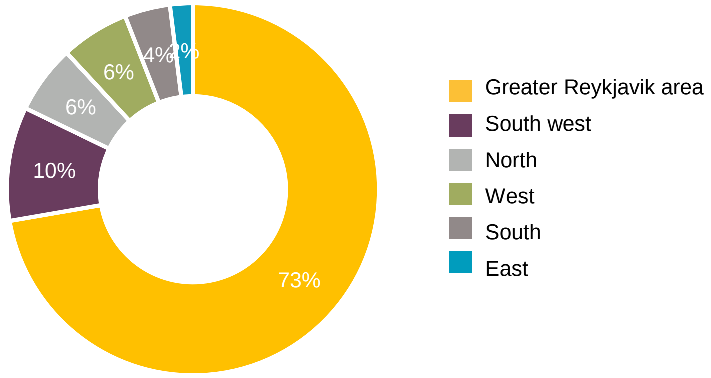
LTV splitting of mortgages to individuals
Loan splitting approach, ISKbn



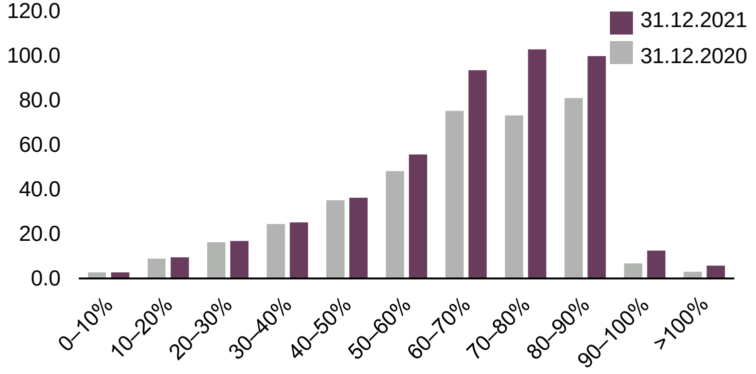
Indexed vs. non-indexed loans
By loan balance, 31 December 2021



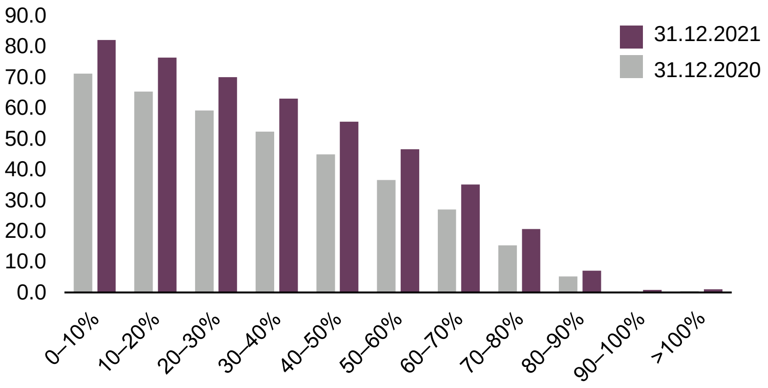
Geographical split
By loan balance, 31 December 2021



Breakdown of mortgage portfolio by LTV calculated for each property
By net carrying amount, ISKbn



Breakdown of mortgage portfolio by LTV bands
By net carrying amount, ISKbn



Property valuations are regularly updated

LTVs are generally determined based on the tax valuation

Highlights

- Property valuations are updated at least once a year by an external surveyor
- Íslandsbanki uses an official tax valuation method 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 tax valuation
- Additional loan (B) is up to 80% of property price
- In terms of refinancing, the maximum loan is 70% of tax valuation (A - Base loan)

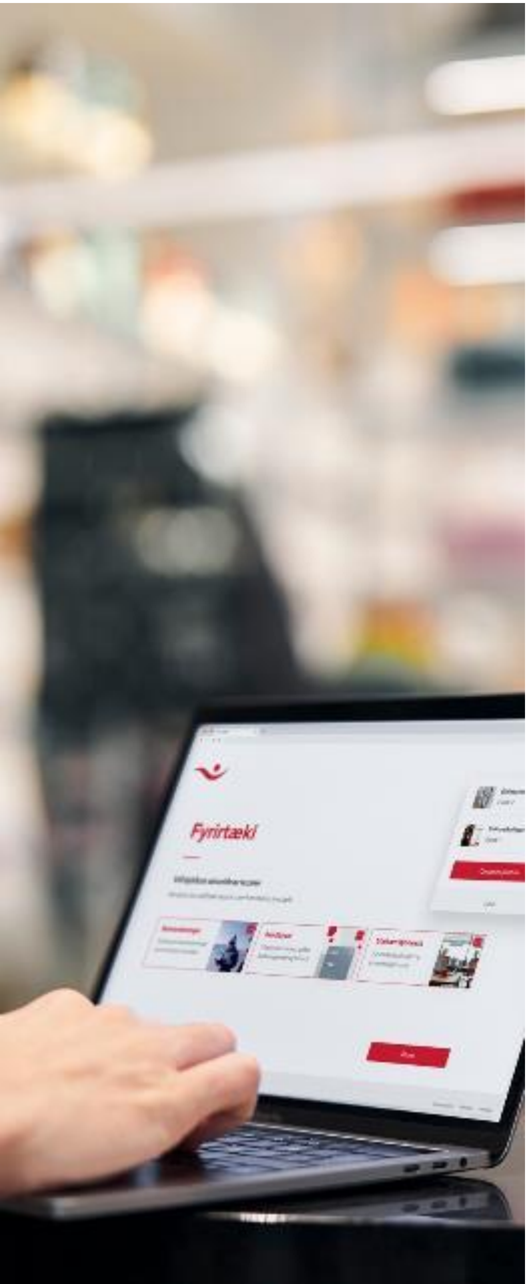
Example

An individual buys an apartment for the first time. The price is ISK 50.000.000 and the tax evaluation 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 tax evaluation, 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

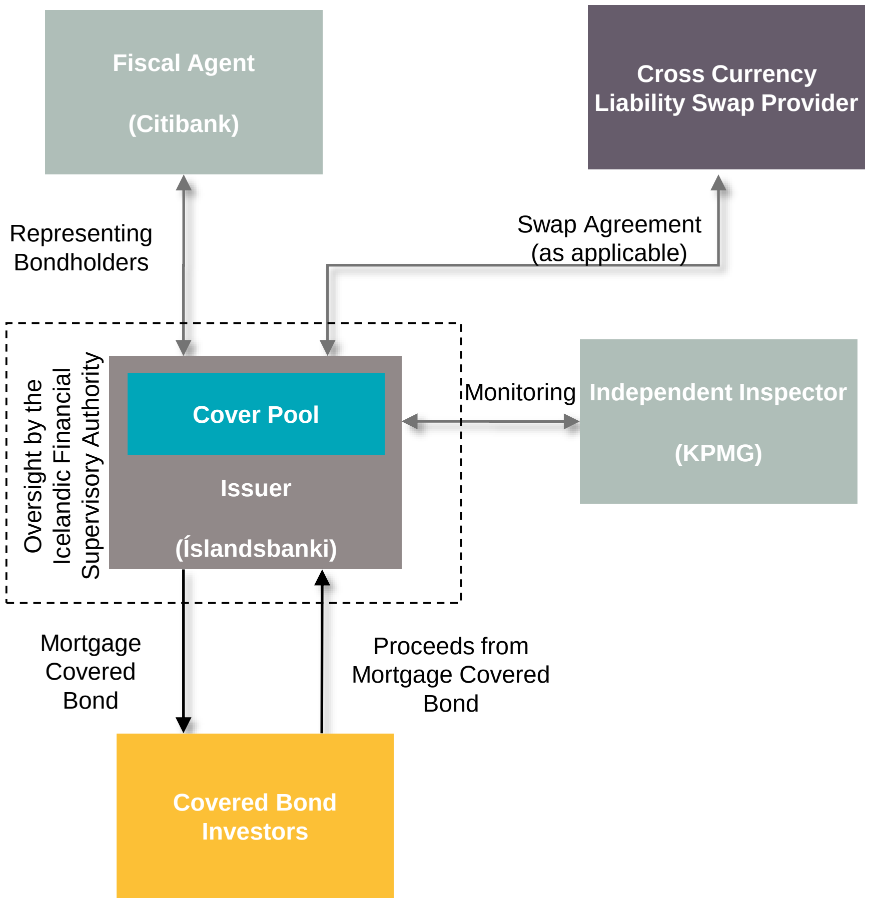
- If the debt is secured, letter number two is a payment challenge 15 days after the collection letter. A forced sale request is sent out 15 days after a demand for payment is published by a policy witness or when a confiscation of property is available. The sheriff issues a time when the first forced 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 will establish a collateral reserve account which will be funded on day 1
- Íslandsbanki will covenant to post collateral in the collateral reserve account according to the amounts and thresholds in S&P’s rating methodology
- Covered bondholders will 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 will provide hedging from currency risk arising from mismatches between the mortgage loans denominated in ISK included in the cover pool and the amounts payable on the covered bonds
- 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-), the issuer shall establish one or more of the following bank accounts in its name with an Eligible Institution: transaction account, liquidity reserve account denominated in ISK and any other currency for which there are covered bonds outstanding at the time. The collateral reserve account will be opened and funded at issuance of a EUR covered bond
- 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 to covered bondholders and counterparties to derivative agreements
- Íslandsbanki contractually commits to funding a Liquidity Reserve Ledger equal to the amount that will be 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 amount outstanding 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

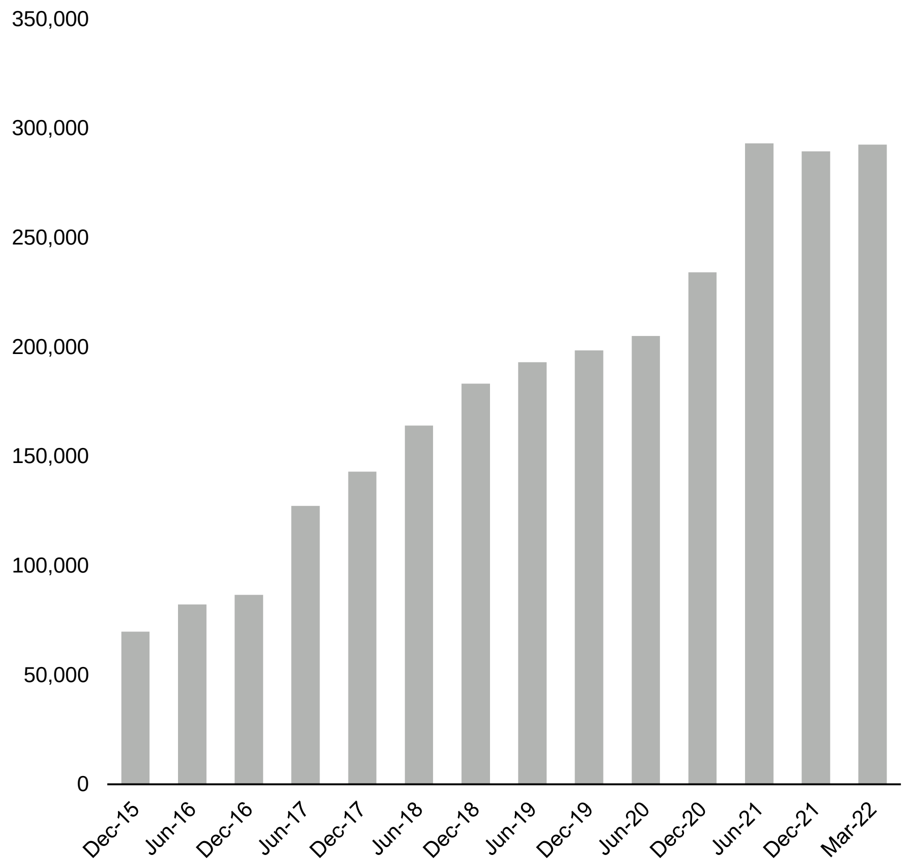
Cover pool made of entirely residential mortgage loans

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 the calculation of 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



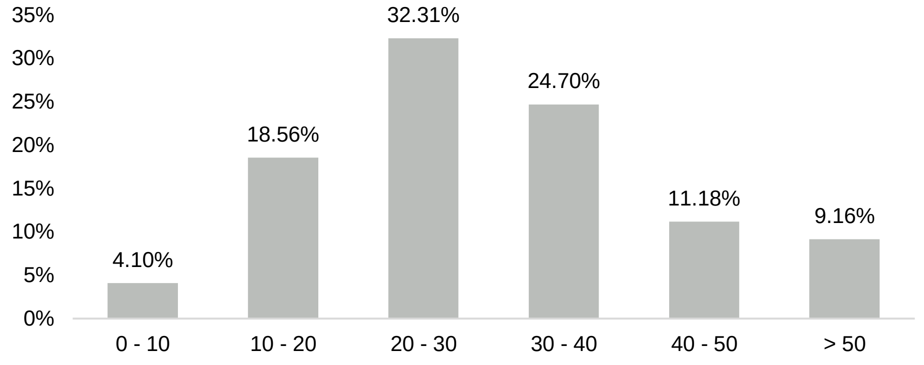
Cover Pool – main features – cont'd

Nearly ISK 300bn of collateral backing the loans

Cover pool composition as at 31 March 2022	
Cut-off Date	31/03/2022
Current Balance (ISKm)	292,591
Cover Pool Balance (ISKm)	292,591
Number of Loans	12,700
Number of Borrowers	11,489
WA Current LTV	54.87%
WA Seasoning (Years)	2.58
WA Remaining Term (Years)	33.22
Fixed rate (%)	73.28%
Variable rate (%)	26.72%
WA Interest Rate (%)	3.51%

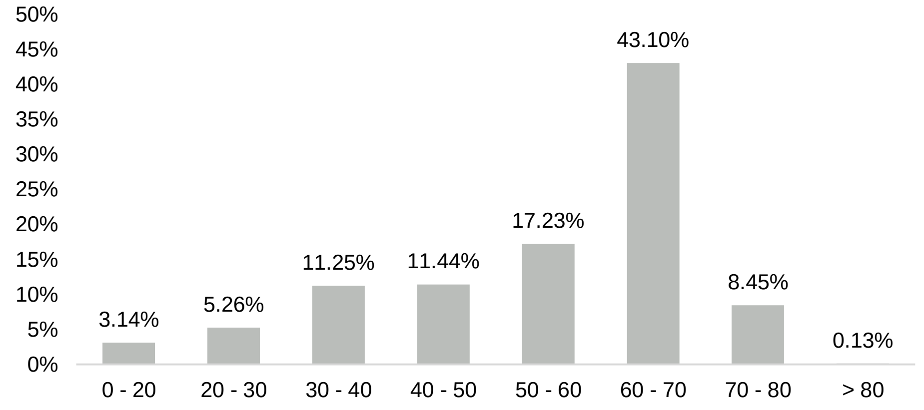
Current balance range

ISKm, 31 March 2022



LTV range

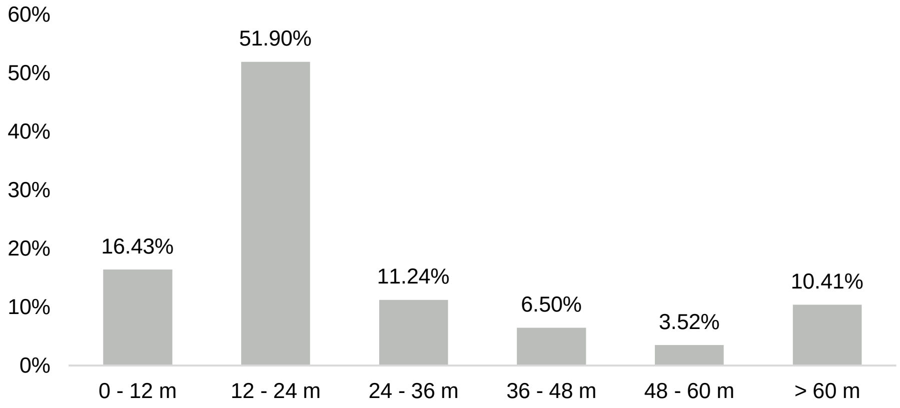
(% of current principal balance), 31 March 2022



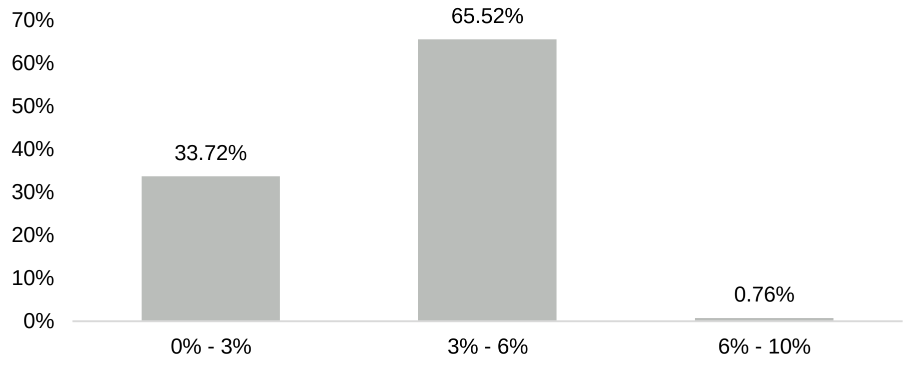
Cover Pool – main features – cont’d

Loan features are aligned with market standards

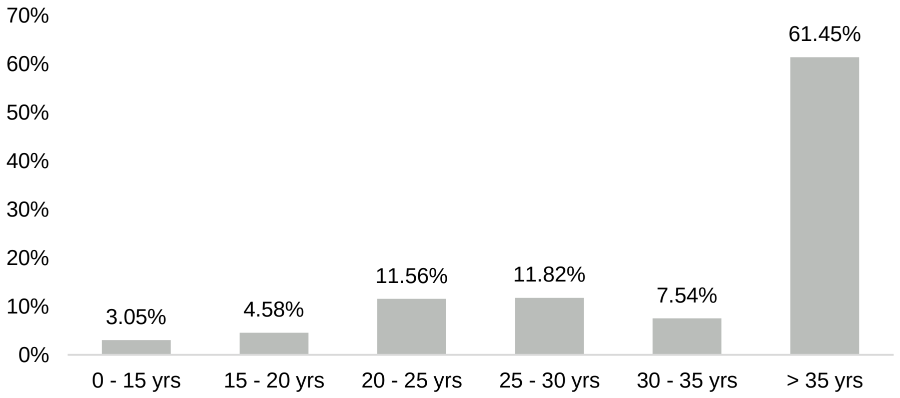
Seasoning profile, months
(% of current principal balance), 31 March 2022



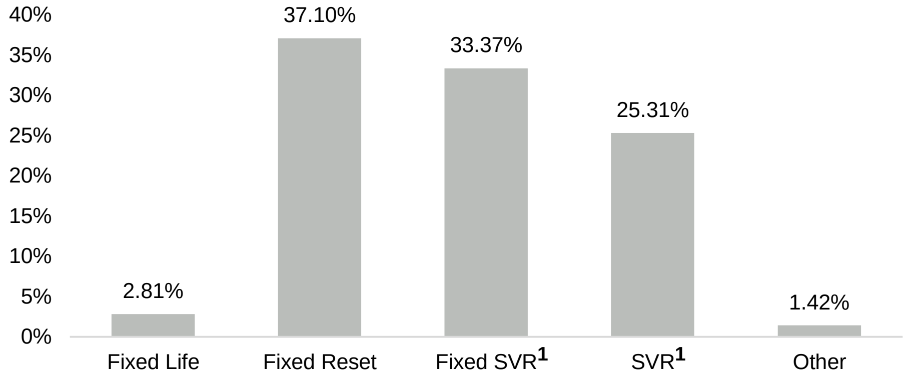
Interest rate range
(% of current principal balance), 31 March 2022



Remaining maturity term, years
(% of current principal balance), 31 March 2022



Current interest rate type
(% of current principal balance), 31 March 2022



1. SVR stands for Standard Variable Rate

Appendix I – About Íslandsbanki and additional financial information

8 June 2022

Financial targets on track

Clear path to ROE expansion, attractive capital return and optimisation

Targets	Revised	2022 Guidance	1Q22	4Q21	2021
Return on equity	>10%	8-10% by 2023	10.2% ✓	14.2% ✓	12.3% ✓
Cost-to-income ratio[1]	<45%	45-50%	47.6% ✓	45.3% ✓	46.2% ✓
CET1 capital ratio[2]	~16.5%	Normalise before YE2023	18.8% ✓	21.3% ✓	21.3% ✓
Dividend-payout-ratio	50%	50%			50% ✓

1. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 2. Long term CET1 capital target is subject to regulatory requirements and includes a management buffer of 50-200bp. 2. Including profit for 1Q22

Financial overview

Key figures & ratios

		1Q22	4Q21	3Q21	2Q21	1Q21
PROFITABILITY	Profit for the period, ISKm	**5,187**	7,092	7,587	5,431	3,615
	Return on equity	**10.2%**	14.2%	15.7%	11.6%	7.7%
	Net interest margin (of total assets)	**2.6%**	2.4%	2.4%	2.4%	2.4%
	Cost-to-income ratio[1]	**47.6%**	45.3%	39.4%	49.9%	51.3%
	Cost of risk	**(0.17%)**	(0.23%)	(0.64%)	(0.42%)	0.20%

		31.3.22	31.12.21	30.9.21	30.6.21	31.3.21
BALANCE SHEET	Loans to customers, ISKm	**1,107,893**	1,086,327	1,081,418	1,089,723	1,029,415
	Total assets, ISKm	**1,446,355**	1,428,821	1,456,372	1,446,860	1,385,235
	Risk exposure amount, ISKm	**945,321**	901,646	917,764	924,375	954,712
	Deposits from customers, ISKm	**761,471**	744,036	754,442	765,614	698,575
	Customer loans to customer deposits ratio	**145%**	146%	143%	142%	147%
	Non-performing loans (NPL) ratio[2]	**1.8%**	2.0%	2.0%	2.1%	2.4%
LIQUIDITY	Net stable funding ratio (NSFR), for all currencies	**123%**	122%	121%	122%	119%
	Liquidity coverage ratio (LCR), for all currencies	**195%**	156%	225%	187%	172%
CAPITAL	Total equity, ISKm	**197,201**	203,710	197,381	190,355	185,471
	CET 1 ratio[3]	**18.8%**	21.3%	20.6%	20.1%	19.2%
	Tier 1 ratio[3]	**19.9%**	22.5%	21.8%	20.1%	19.2%
	Total capital ratio[3]	**22.5%**	25.3%	24.7%	22.9%	21.9%
	Leverage ratio[3]	**12.4%**	13.6%	13.2%	12.4%	12.6%

1. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 2. Stage 3, loans to customers, gross carrying amount. 3. Including 3Q21 profit for 30.9.21 and 1Q22 profit for 31.3.22

Income growth of 9% YoY driven by NII and NFCI

Robust profitability in 1Q22 a result of strong business foundations

Income statement, ISKm	1Q22	1Q21	Δ%	4Q21	Δ%	2021
Net interest income	**9,209**	8,190	12%	8,644	7%	34,043
Net fee and commission income	**3,064**	2,862	7%	3,653	(16%)	12,849
Net financial income (expense)	**(95)**	293	-	646	-	2,499
Net foreign exchange gain	**166**	130	28%	159	4%	479
Other operating income	**265**	123	115%	15	1,667%	302
Total operating income	**12,609**	11,598	9%	13,117	(4%)	50,172
Salaries and related expenses	**(3,422)**	(3,574)	(4%)	(3,276)	4%	(13,397)
Other operating expenses	**(2,412)**	(2,278)	6%	(2,492)	(3%)	(9,799)
Administrative expenses	**(5,834)**	(5,852)	(0%)	(5,768)	1%	(23,196)
Contribution to the Depositor's and Investors' Guarantee Fund	**(165)**	(183)	(10%)	(170)	(3%)	(688)
Bank tax	**(430)**	(410)	5%	(389)	11%	(1,683)
Total operating expenses	**(6,429)**	(6,445)	(0%)	(6,327)	2%	(25,567)
Net impairment on financial assets	**483**	(518)	-	639	(24%)	3,018
Profit before tax	**6,663**	4,635	44%	7,429	(10%)	27,623
Income tax expense	**(1,463)**	(1,036)	41%	(1,416)	3%	(5,119)
Profit for the period from continuing operations	**5,200**	3,599	44%	6,013	(14%)	22,504
Discontinued operations held for sale, net of income tax	**(13)**	16	-	1,079	-	1,221
Profit for the period	**5,187**	3,615	43%	7,092	(27%)	23,725

Key ratios						
Net Interest Margin (NIM)	**2.6%**	2.4%		2.4%		2.4%
Cost-to-income ratio (C/I)	**47.6%**	51.3%		45.3%		46.2%
Return on Equity (ROE)	**10.2%**	7.7%		14.2%		12.3%
Cost of risk (COR)	**(0.17%)**	0.20%		(0.23%)		(0.28%)

Balance sheet reflects balanced loan and funding profile

Broad product offering, strong liquidity portfolio and stable funding

Assets

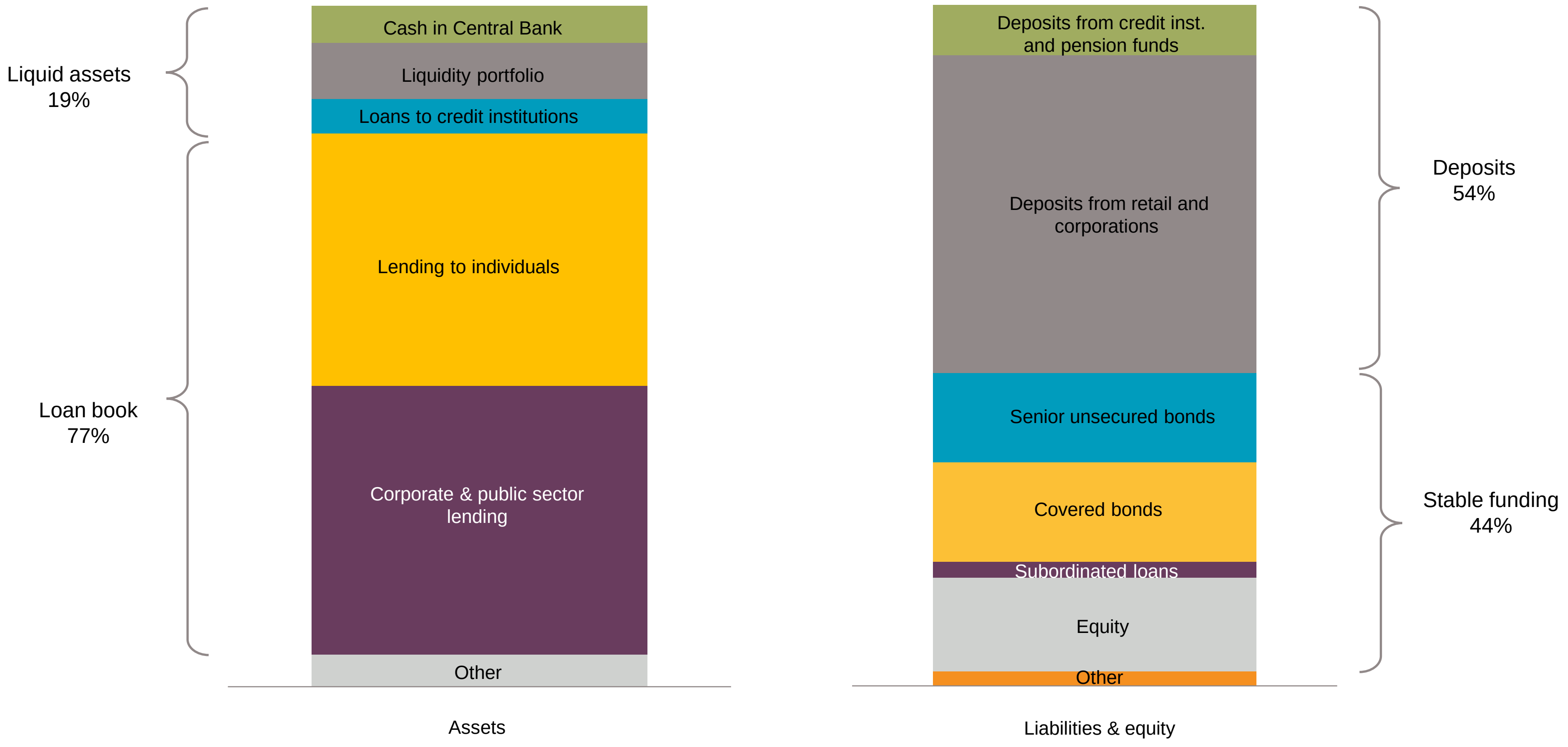
- Vast majority of assets consist of lending to individuals and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporations 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

31.3.2022, ISK 1,446bn



Growth in loans to customers continues

Steady mortgage growth supported by a strong capital base

Assets, ISKm	31.3.22	31.12.21	Δ	Δ%
Cash and balances with Central Bank	**77,799**	113,667	(35,868)	(32%)
Loans to credit institutions	**73,220**	43,988	29,232	66%
Bonds and debt instruments	**130,700**	132,289	(1,589)	(1%)
Derivatives	**4,245**	2,445	1,800	74%
Loans to customers	**1,107,893**	1,086,327	21,566	2%
Shares and equity instruments	**28,655**	31,677	(3,022)	(10%)
Investment in associates	**767**	939	(172)	(18%)
Property and equipment	**6,911**	7,010	(99)	(1%)
Intangible assets	**3,327**	3,351	(24)	(1%)
Other assets	**11,170**	5,784	5,386	93%
Non-current assets and disposal groups held for sale	**1,668**	1,344	324	24%
Total Assets	**1,446,355**	1,428,821	17,534	1%
Key ratios				
Risk Exposure Amount (REA)	**945,321**	901,646	43,675	5%
Non-performing loans (NPL) ratio[1]	**1.8%**	2.0%		
Asset encumbrance ratio	**19.2%**	19.6%		

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

Diversified funding base

Deposits are largest source of funding

Liabilities & Equity, ISKm	31.3.22	31.12.21	Δ	Δ%
Deposits from Central Bank and credit institutions	**10,949**	13,384	(2,435)	(18%)
Deposits from customers	**761,471**	744,036	17,435	2%
Derivative instruments and short positions	**11,013**	9,467	1,546	16%
Debt issued and other borrowed funds	**406,845**	402,226	4,619	1%
Subordinated loans	**34,139**	35,762	(1,623)	(5%)
Tax liabilities	**6,980**	6,432	548	9%
Other liabilities	**16,802**	12,848	3,954	31%
Non-current liabilities and disposal groups held for sale	**955**	956	(1)	(0%)
Total Liabilities	**1,249,154**	1,225,111	24,043	2%
Total Equity	**197,201**	203,710	(6,509)	(3%)
Total Liabilities and Equity	**1,446,355**	1,428,821	17,534	1%

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

1. Including 1Q22 profit

Appendix II – Icelandic economy update

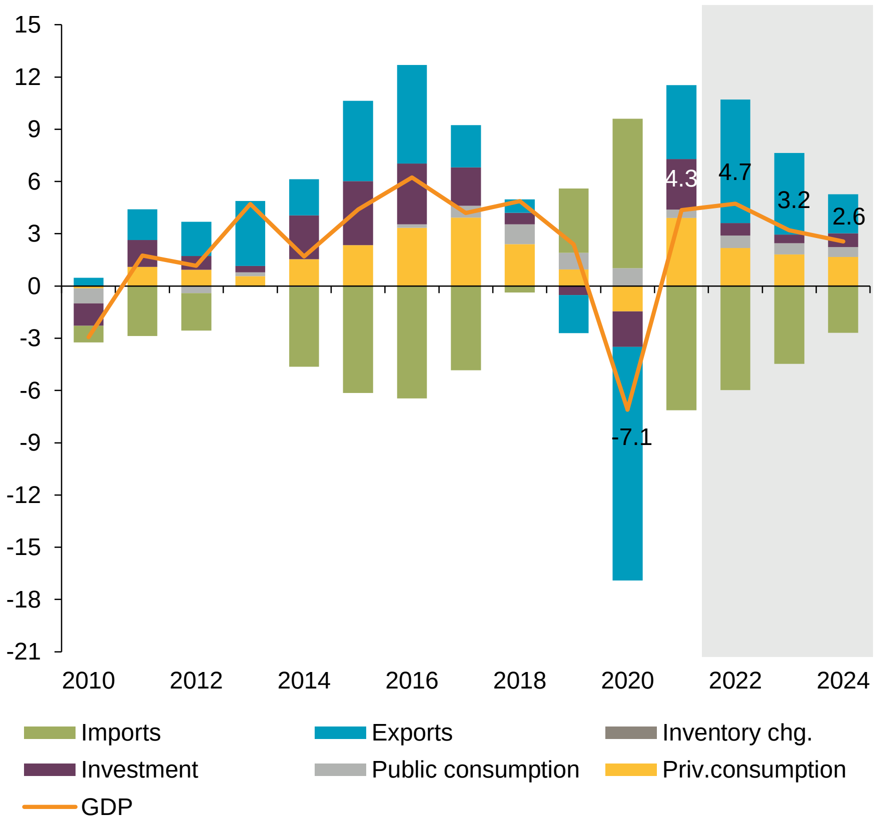
Economic recovery likely to accelerate as pandemic recedes

Exports replace domestic demand as the key catalyst of growth

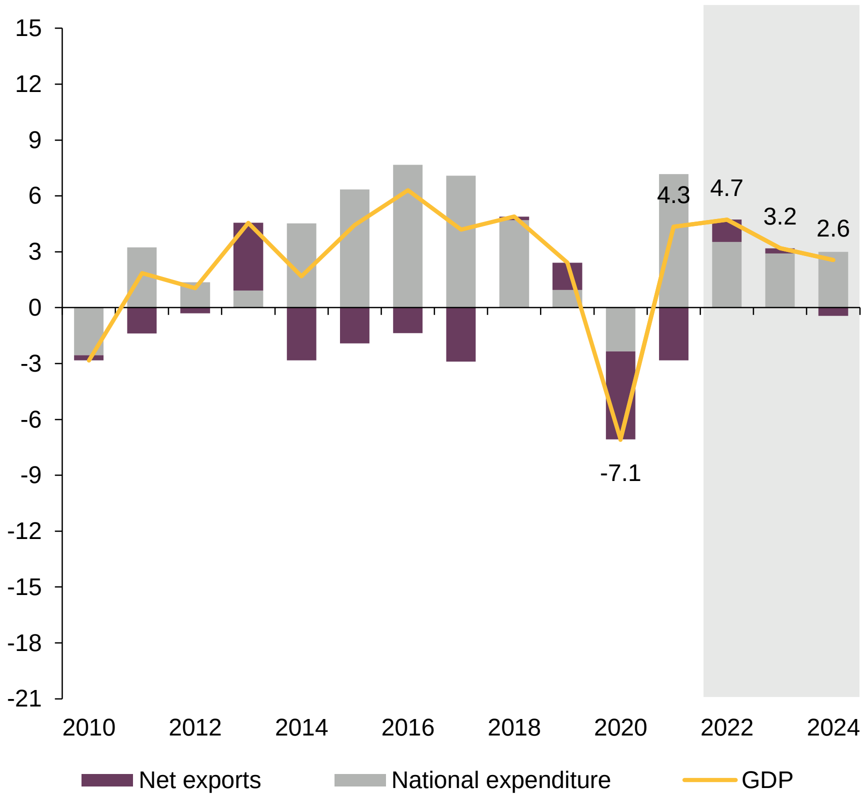
Highlights

- After a deep contraction in 2020, the economic recovery took hold in Iceland in 2021. Year-2021 GDP growth is estimated at 4.3%
- Domestic demand gained considerable traction and, despite a modest current account deficit, exports also rebounded strongly
- ISB Research (forecast published in Jan-22) forecasts GDP growth at 4.7% in 2022, the fastest growth rate since 2018
- The surge is due mostly to robust growth in exports, mainly tourism and fishing. Private consumption also fuels GDP growth in 2022, while the share of investment will ease markedly relative to 2021
- For 2023, 3.2% growth is projected, driven by exports and domestic demand in roughly equal measure
- For 2024, the final year of the forecast horizon, GDP growth at 2.6% is forecast. By then, export growth will have started to ease significantly, and tighter economic policy and capacity constraints will slow the pace of domestic demand growth

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

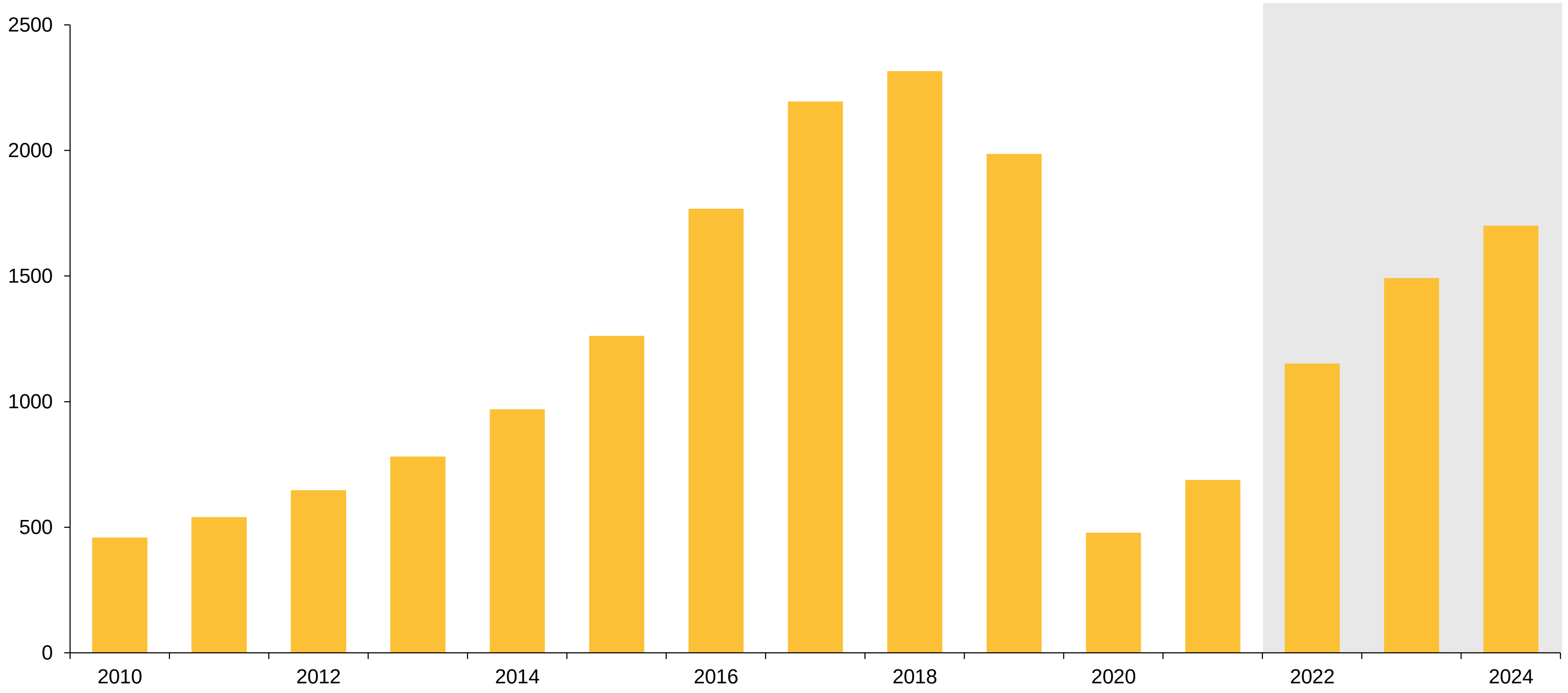
Tourism reloaded

At least 1.1 million tourists are projected to visit Iceland in 2022, rising to 1.5 million in 2023

Highlights

- Nearly 700,000 tourists visited Iceland in 2021, an increase of nearly 45% relative to 2020 but still only a third of the 2019 total
- The short-term outlook for tourism has undeniably worsened with the rise of the Omicron variant in Iceland and elsewhere. Even so, appetite for travel is keen and many seem to view Iceland as a desirable destination
- Recent survey data as well as booking trends reported by Icelandic travel companies give grounds for cautious optimism from the summer onwards
- 1.1-1.2 million tourist arrivals are expected this year. This would be close to 2015 numbers, albeit only 60% of 2019 numbers
- Tourist numbers are expected to rise to 1.5 million in 2023 and 1.7 million in 2024
- Recent trends in booking data and flight frequency at KEF airport suggest uncertainty in the forecast for 2022 is increasingly to the upside
- Even though the pandemic has upended tourism in the past two years, those who visited Iceland in 2021 generally stayed longer and spent more than pre-pandemic travelers did. A continuation of this trend would provide a further boost for the sector

Number of foreign tourists, by year
Thousands



Sources: Icelandic Tourist Board, ÍSB Research

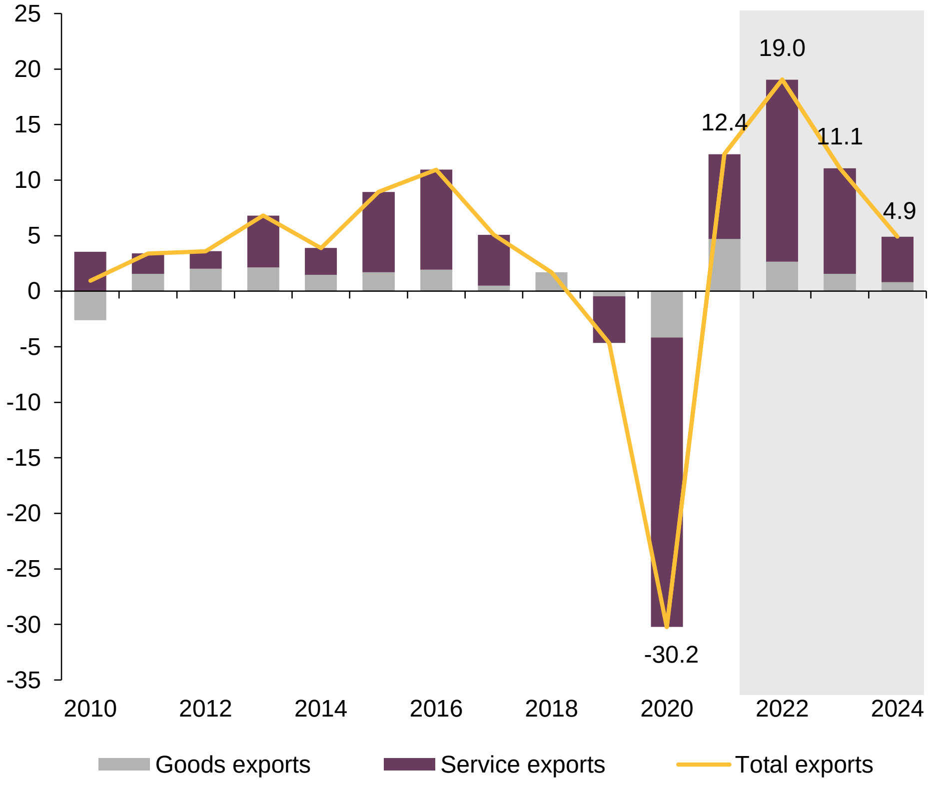
Current account likely revert to surplus following a deficit in 2021

The short-lived deficit is due to domestic demand, which is a few steps ahead of the recovery of exports

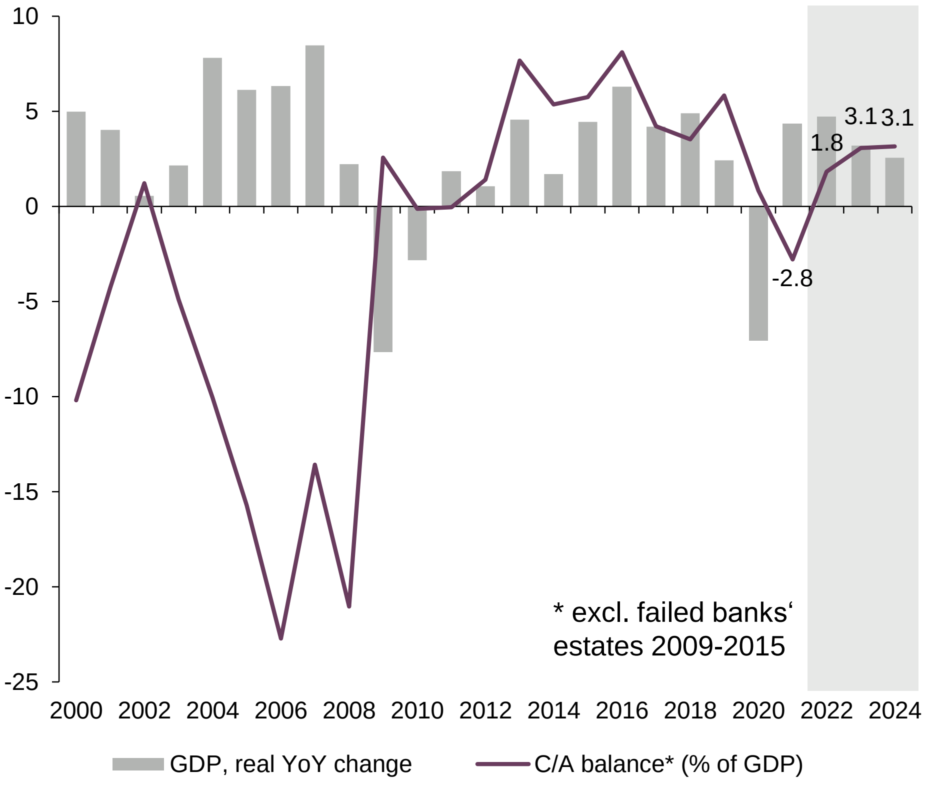
Highlights

- A surge in tourist arrivals will deliver the lion's share of the forecasted 20% export growth in 2022 and just over 7% growth in 2023
- Furthermore, the outlook is for stronger exports, for instance, of capelin and farmed fish, aluminium and other industrial goods, and increasingly, intellectual property usage as well. Pulling in the opposite direction are weaker exports of groundfish, as a result of quota reductions
- 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
- ÍSB Research forecasts that export growth will deliver current account surpluses measuring 1.8% of GDP in 2022 and 3.1% of GDP in 2023
- The country's net external assets are currently equivalent to just over 40% of GDP – a situation that could improve further over the forecast horizon, as external trade strengthens

Exports and contribution from subcomponents
% change



Current account balance and GDP growth
% of GDP and % change YoY

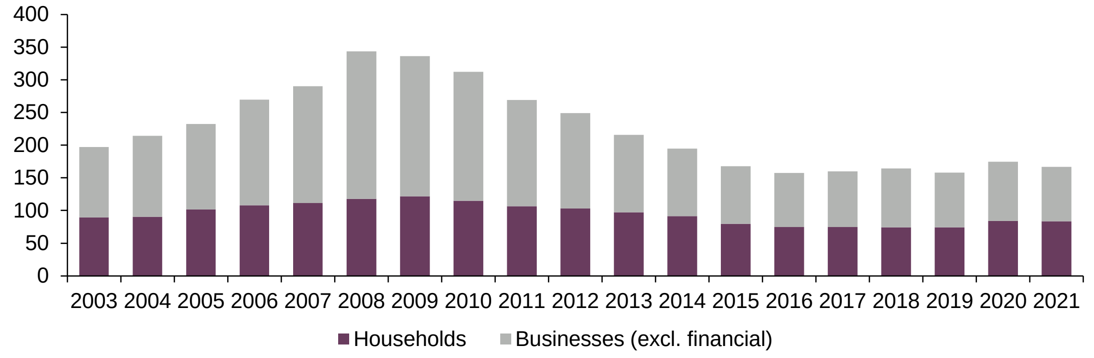


Sources: Statistics Icelandic, Central Bank of Iceland, ÍSB Research

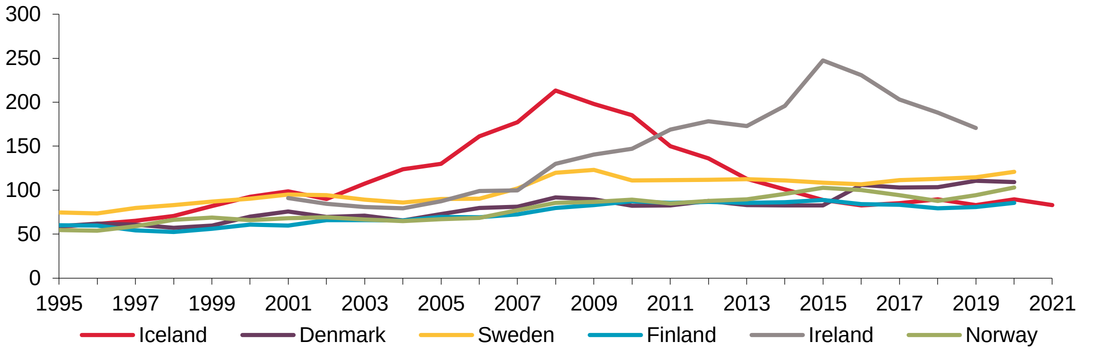
Domestic balance sheets still healthy despite COVID-19

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

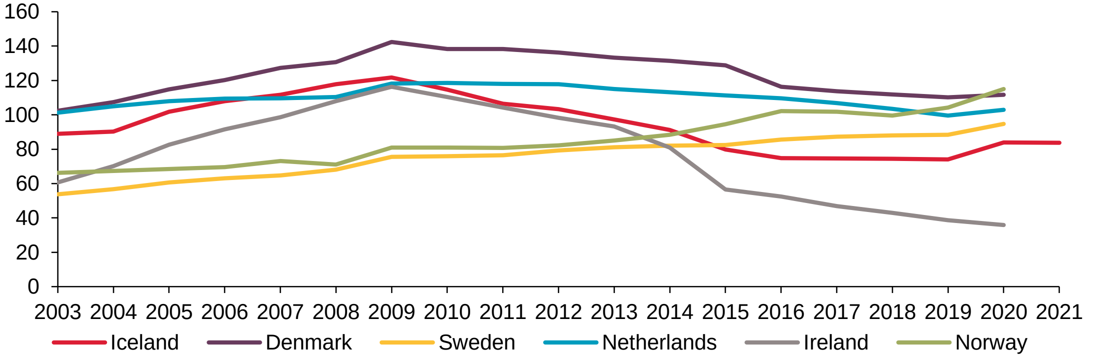
Private sector debt
% of GDP



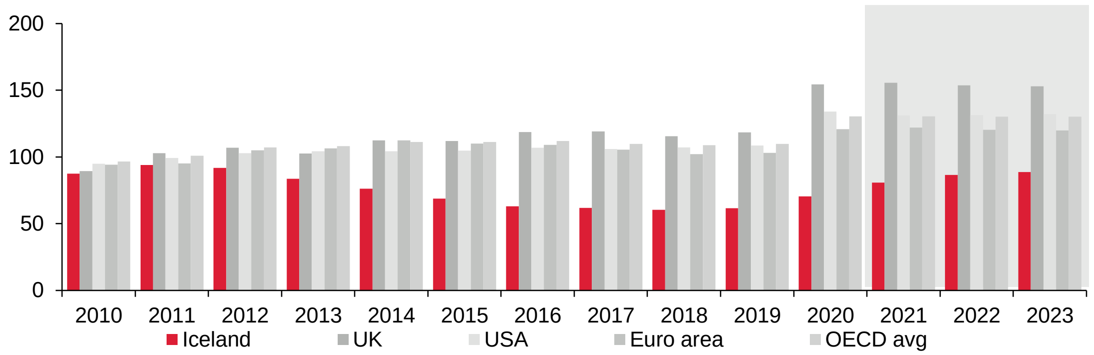
Corporate debt
% of GDP



Household debt
% of GDP



General government gross financial liabilities
% of GDP



Shaded areas indicate OECD forecasts. Sources: Central Bank of Iceland, Statistics Iceland, OECD, ÍSB Research

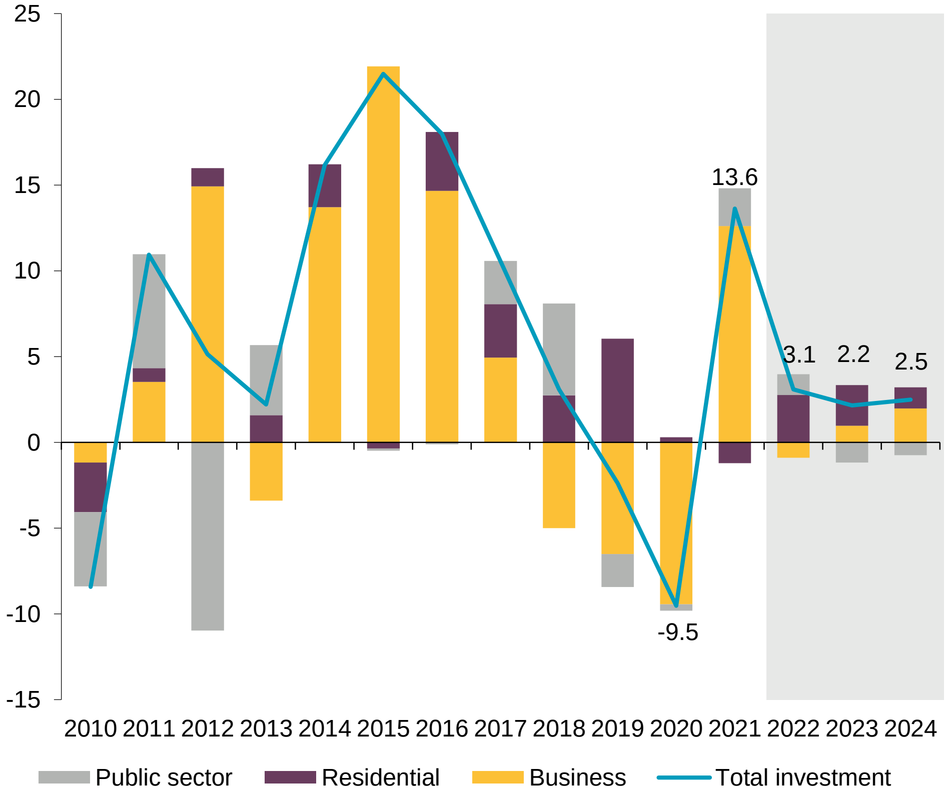
Moderate investment growth following a spike in 2021

Residential investment to gain steam, while public investment will contract further ahead

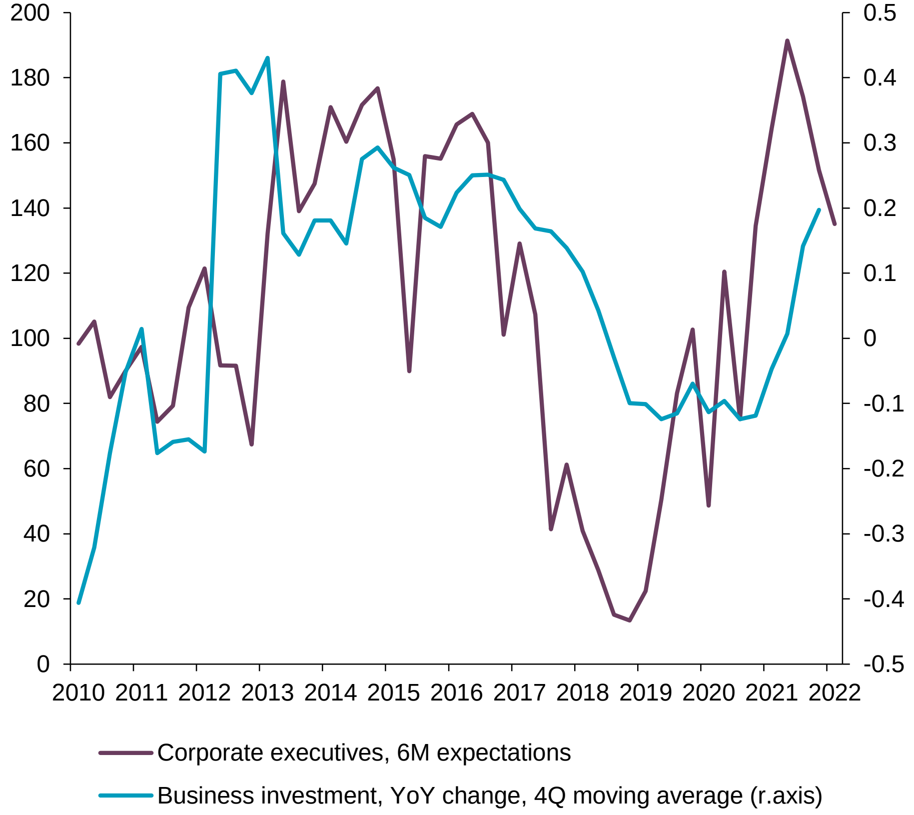
Highlights

- After a two-year contraction, investment spiked in 2021, increasing by almost 14% which is the fastest growth rate in five years
- The growth was fueled in particular by over 23% growth in business investment and 12% in public investment, whereas residential investment contracted
- For 2022, the outlook is for residential investment to finally rebound after last year's contraction as flats in early stages of construction have increased markedly in number and demand for new homes is strong
- Furthermore, public investment will gain momentum this year, although business investment looks set to contract slightly
- In 2023, however, household and business investment will be the main driver of growth, and public investment will contract year-on-year
- ISB Research forecasts that total investment will grow by 3.1% in 2022, 2.2% in 2023, and 2.5% in 2024. The investment level in the economy will therefore be relatively stable, and rather high in historical context

Investment, real change, and contribution of subcomponents
%



Executives' expectations and business investment
Index value (left) and % change year-on-year (right)



Sources: Statistics Iceland, Gallup

Unemployment converging to a new equilibrium

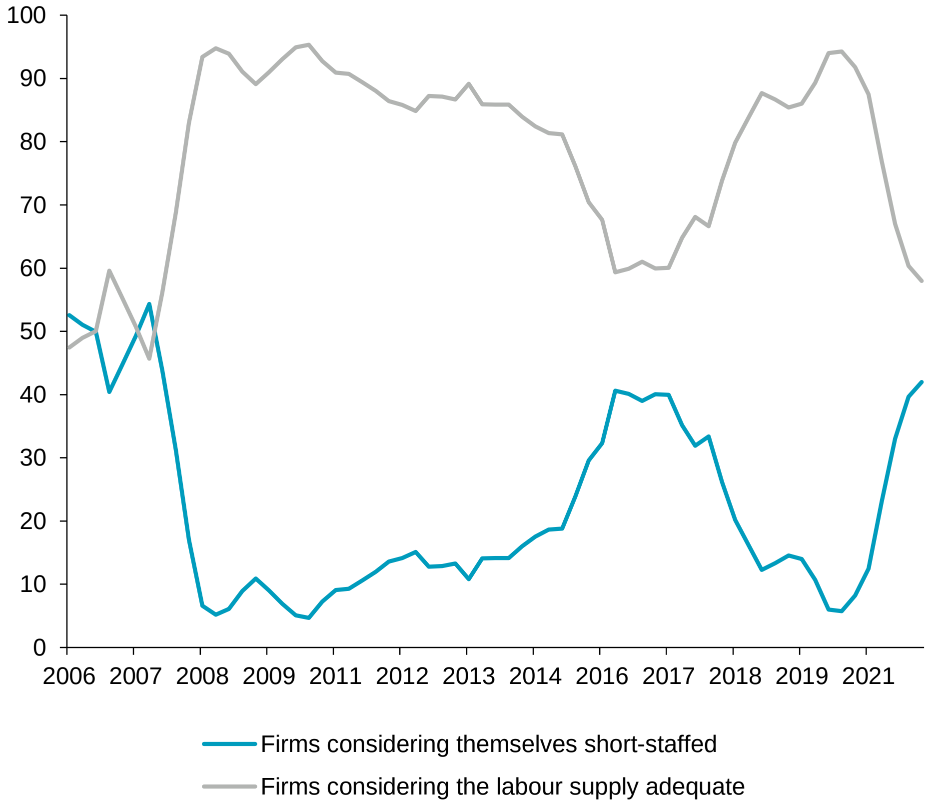
The relatively swift economic recovery has caused a rapid decline in unemployment

Highlights

- Unemployment fell rapidly in 2021, from 11.6% of the labour force at the start of the year to 4.9% by year-end
- The relatively swift economic recovery in 2021 has fostered job growth and the decline in unemployment is expected to continue in 2022, albeit more slowly than last year
- ISB Research forecasts average year-2022 unemployment at 4.5%
- According to a recent Gallup survey, 42% of company executives consider themselves short-staffed
- Construction and tourism companies in particular envision adding on staff in 1H 2022. 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. This is roughly the level seen in 2019

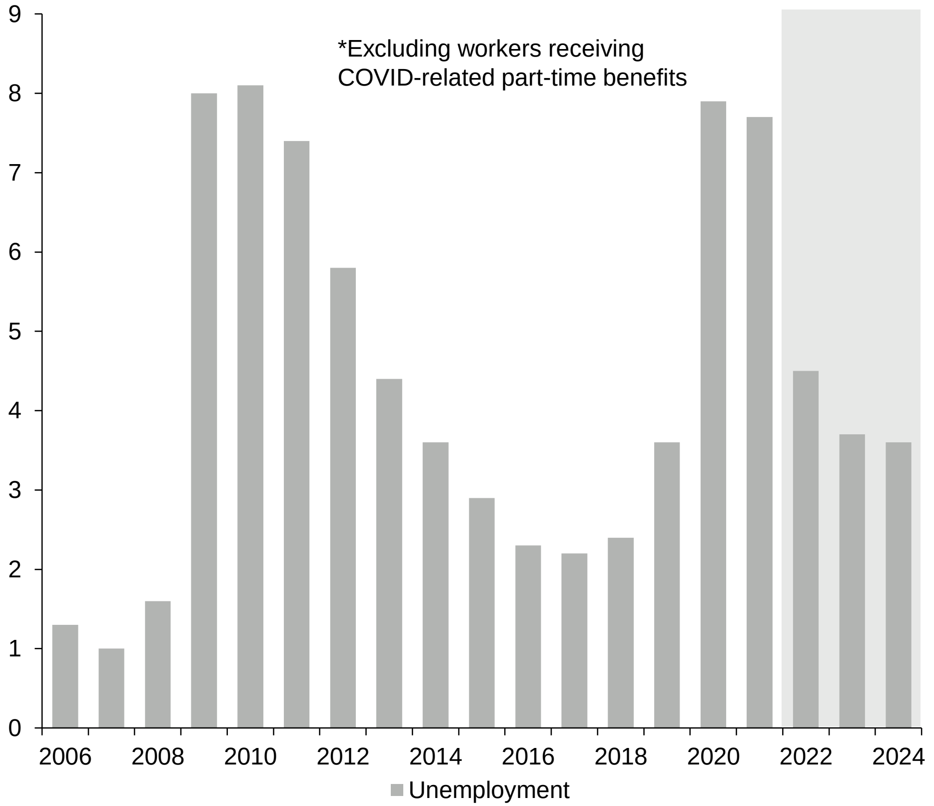
Labour supply according to corporate executives

%



Unemployment*

% of workforce, annual average



Sources: Statistics Iceland, The Central Bank of Iceland, Gallup

Further private consumption growth ahead after robust 2021

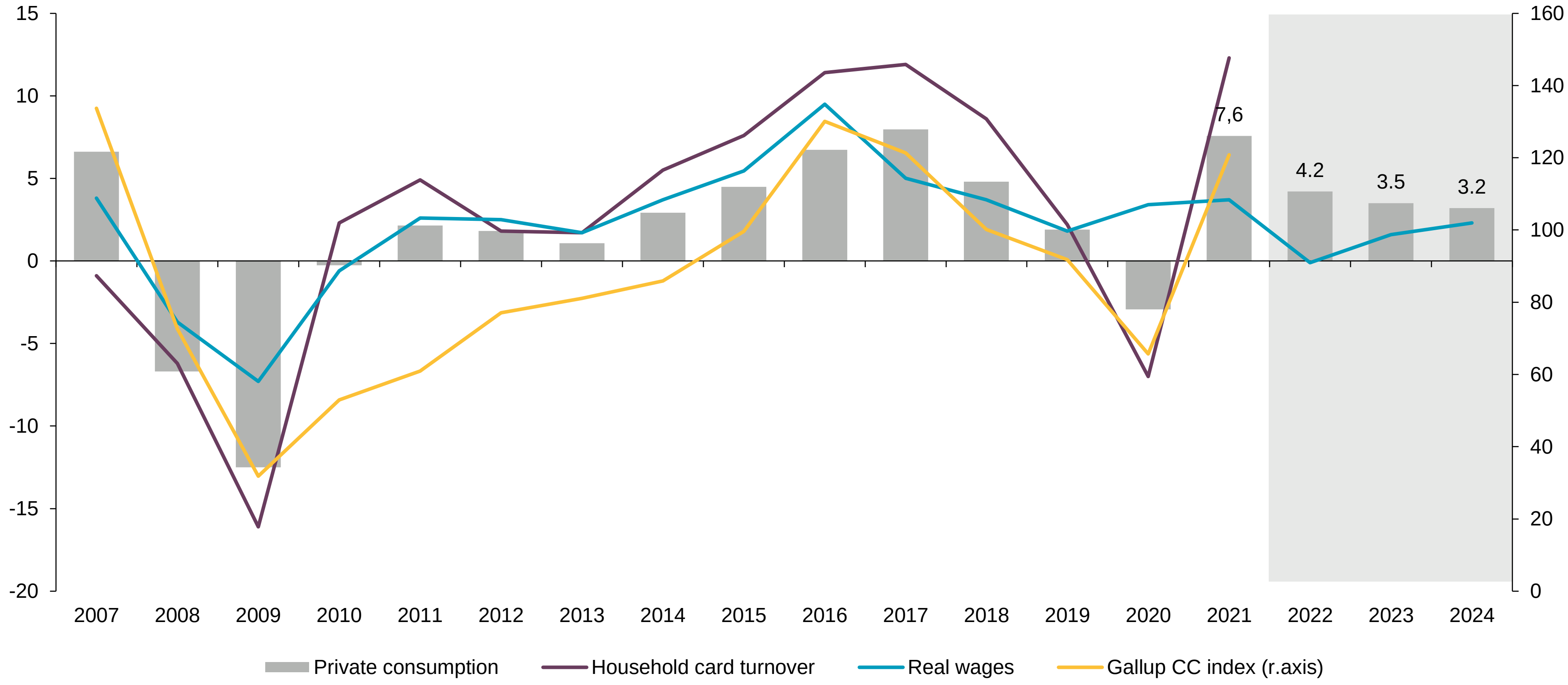
Household consumption supported by strong labour market, demographics and sound asset position

Highlights

- Following 3.0% contraction in 2020, domestic demand gained strongly in 2021. The growth was particularly robust in private consumption which grew by 7.6% in 2021
- Relevant indicators, such as card turnover, real wage growth and the Gallup consumer confidence index, all suggest a relatively strong start to 2022
- Real wages grew by an average of 3.7% in 2021, despite high inflation
- Real wage growth likely to be halted by a temporary inflation spike in 2022, but assumed to return in coming years
- A considerable YoY increase in employment and a sound financial position of most households are likely to support consumption growth despite near-term slowdown in real wage growth .
- ISB Research expects appetite for consumption to remain strong, and growth will continue over the forecast horizon, although the pace will ease gradually
- Private consumption growth is forecast at 4.2% in 2022, 3.5% in 2023, and 3.2% in 2024
- Recent geopolitical developments could affect consumption negatively compared to the baseline forecast for 2022

Private consumption and related indicators

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



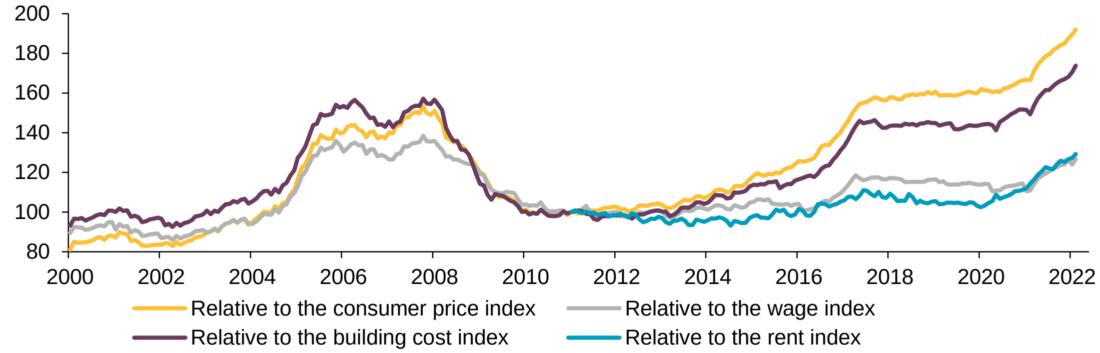
Sources: Central Bank of Iceland, Gallup, Statistics Iceland, ÍSB Research

Real estate markets lively despite pandemic

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

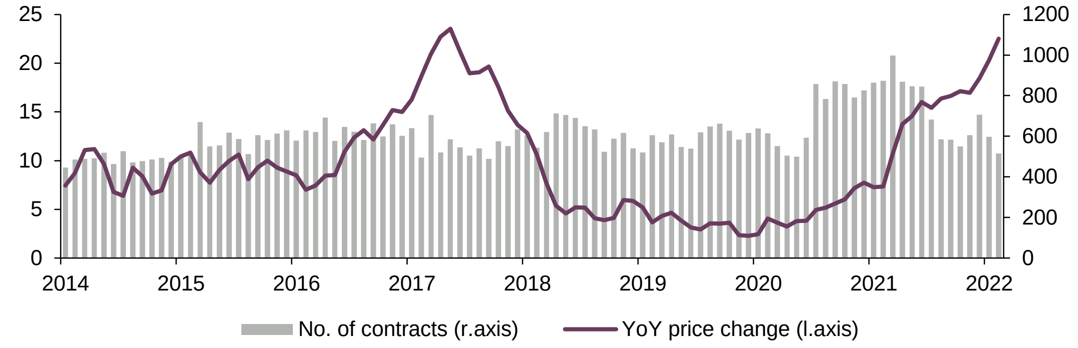
Capital area house prices relative to macroeconomic fundamentals

Index, January 2011=100



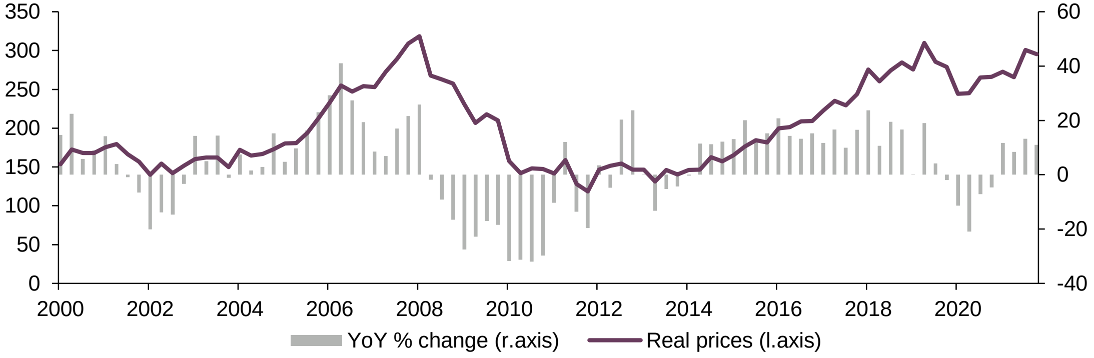
Residential house prices and turnover in greater Reykjavik

% change (l.axis) and number (r.axis)



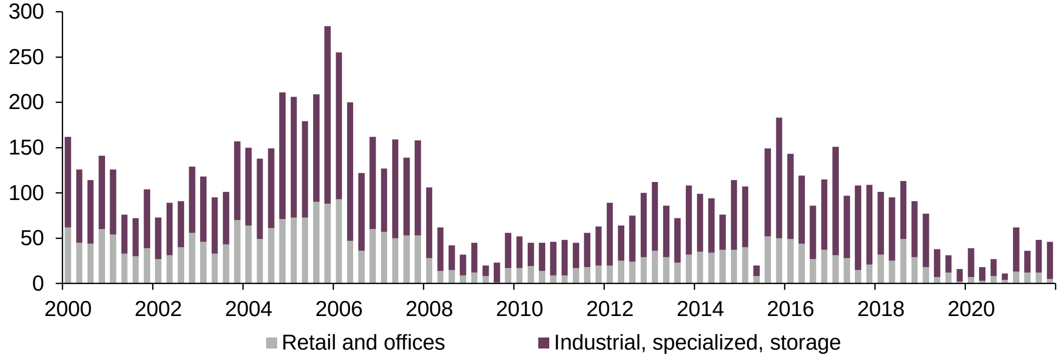
Commercial property real prices in greater Reykjavik

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 2022 and decline gradually thereafter

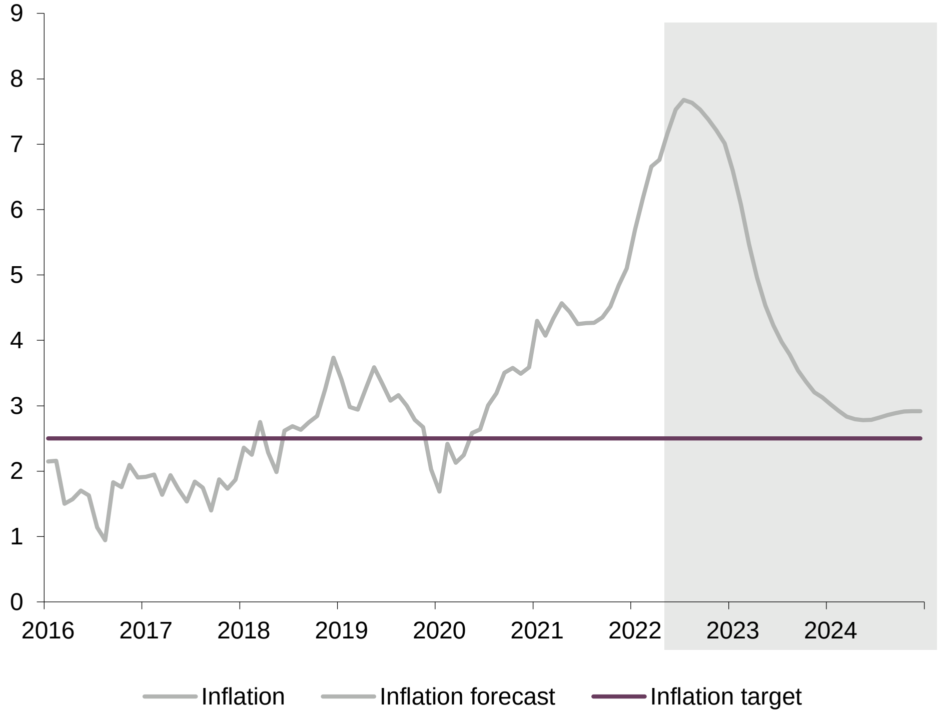
House prices and import costs the main drivers short-term but wage costs also matter

Highlights

- Inflation started rising in mid-2020, in the wake of the Corona 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 March inflation reached a 12 year peak of 6.7%
- Inflation has proven more persistent than expected, but ultimately it will fall
- ÍSB Research expects inflation to average 6.9% in 2022 and 4.2% in 2023, finally approaching the CBI's 2.5% target by Q1 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

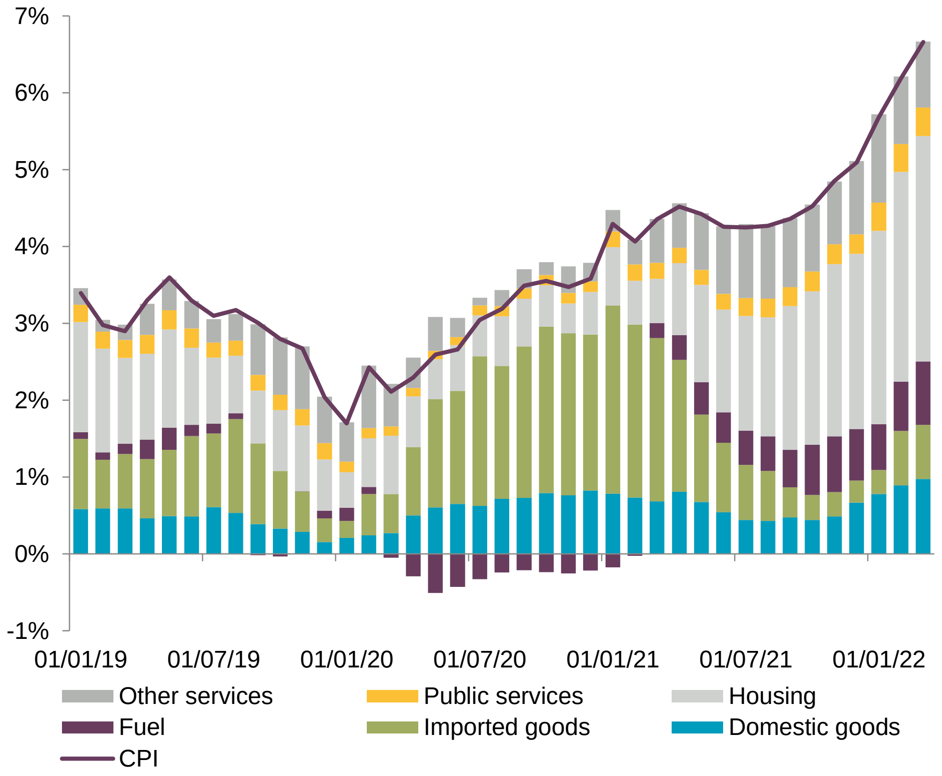
Inflation and the CBI inflation target

%



Inflation by contribution of main categories

%



Sources: Statistics Iceland, ÍSB Research

Policy rate on the rise

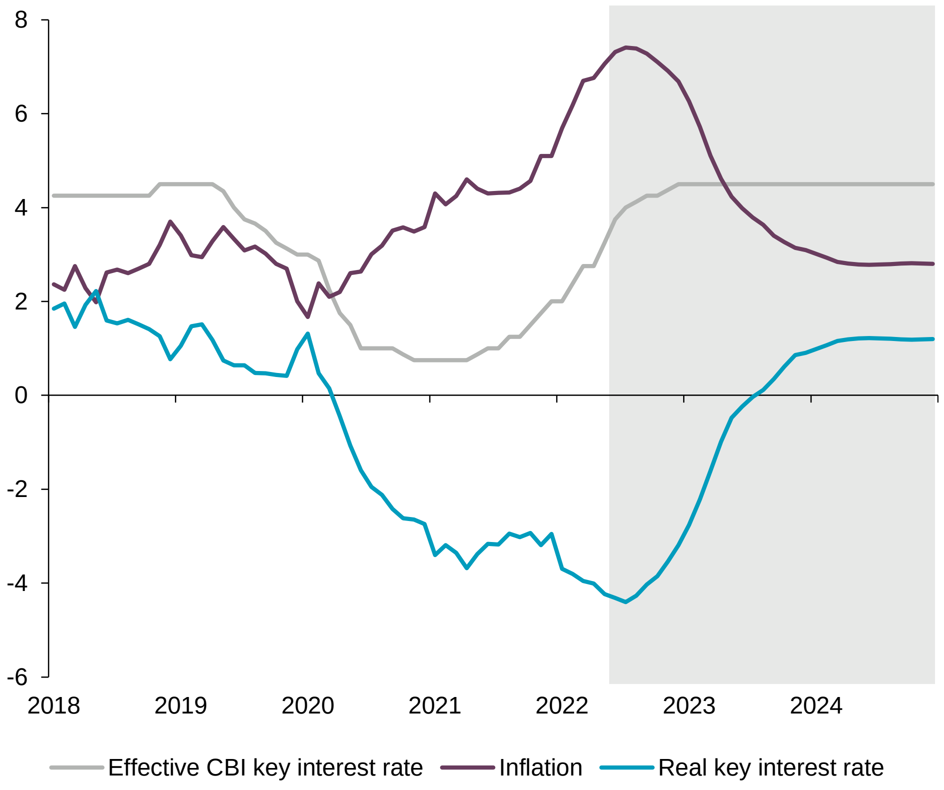
Long-term interest rates approaching equilibrium within the forecast horizon

Highlights

- The Central Bank of Iceland has hiked its policy by 3 percentage points since May 2021, after reaching an all-time low of 0.75% in Q4 2020
- The policy rate is now 3.75%, its highest since Q3 2019
- Further monetary tightening is likely as inflation peaks and the policy rate could reach 4.5% by year-end 2022
- Monetary tightening is probably already largely priced into long-term nominal rates while the real rate on CPI-linked treasury bonds remains held back by short-term inflation pressures
- Further ahead, long-term rates are expected to approach a medium-term equilibrium, which ISB Research estimates at around 4.4% for nominal rates and just over 1% for the real rate

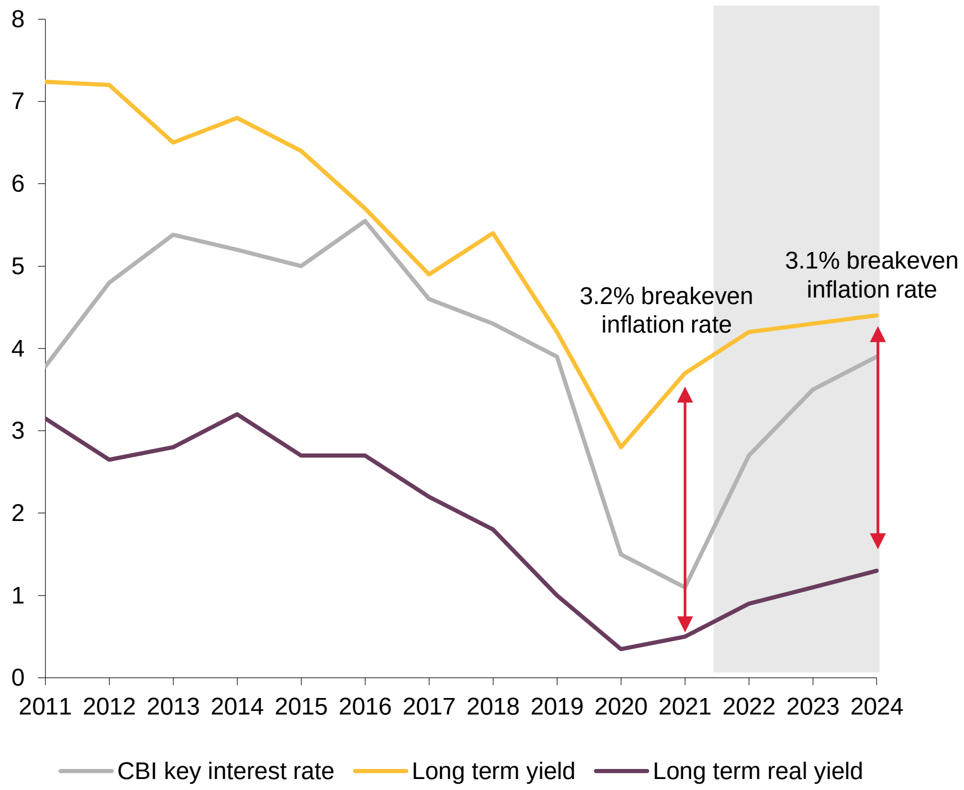
Policy rate and inflation

%



Interest rates

%



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

ISK set to appreciate further with growth in export revenues

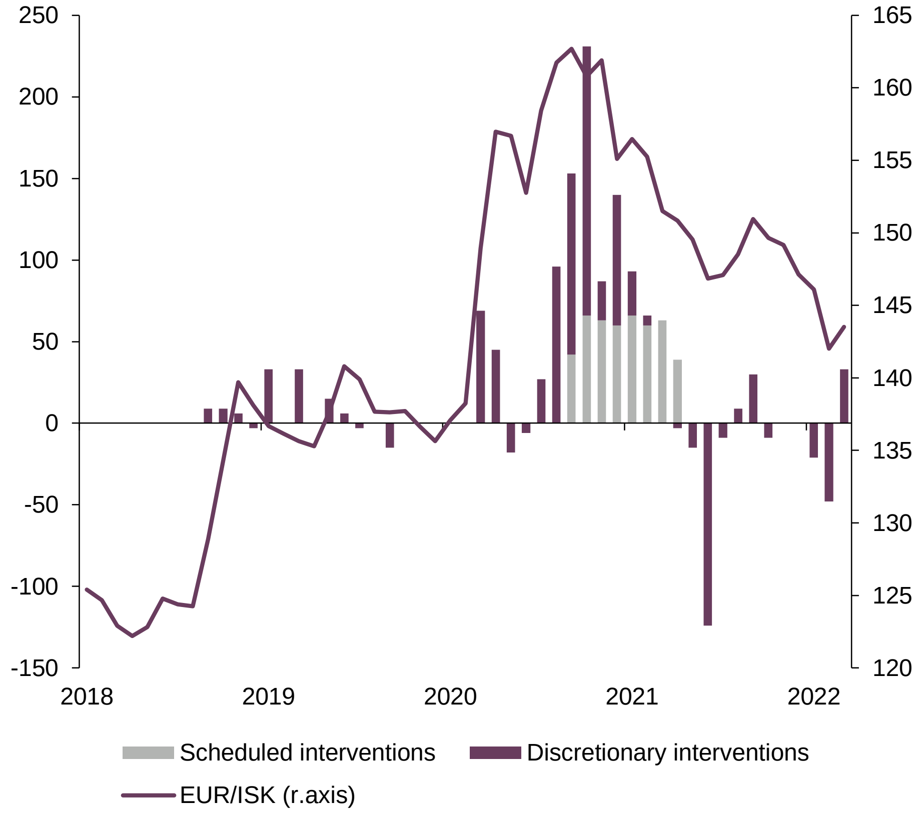
The ISK was relatively stable in 2H 2021 but has been more volatile in 2022 so far

Highlights

- The ISK appreciated by nearly 3% in 2021, with all of the strengthening occurring in H1, while in H2 it fluctuated within a relatively narrow range
- The CBI steadily scaled down its FX market intervention over the course of the year, and in Q4/2021 it hardly traded in the market at all
- Increased ISK volatility in Q1 2022 led to the CBI stepping up FX interventions once more
- 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
- Although the high uncertainty inherent in exchange rate forecasts should be noted, ISB Research assumes that the ISK exchange rate will be 8-9% stronger by 2H 2024 than it was at the beginning of 2022
- The real exchange rate in terms of relative consumer prices will then be similar to that in 2018

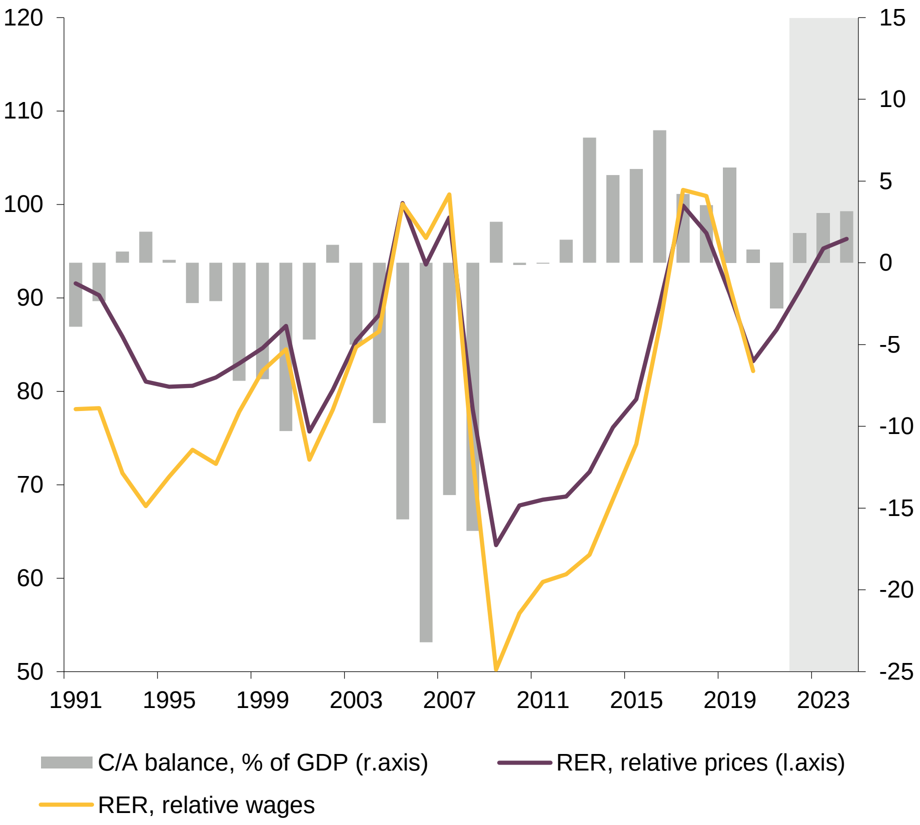
ISK exchange rate and CBI FX market intervention

EUR m (left) and EURISK (right)



Real exchange rate and current account balance

Index and % of GDP



Sources: Statistics Iceland, The Central Bank of Iceland, ISB Research

The Ukraine war increases uncertainty to the downside

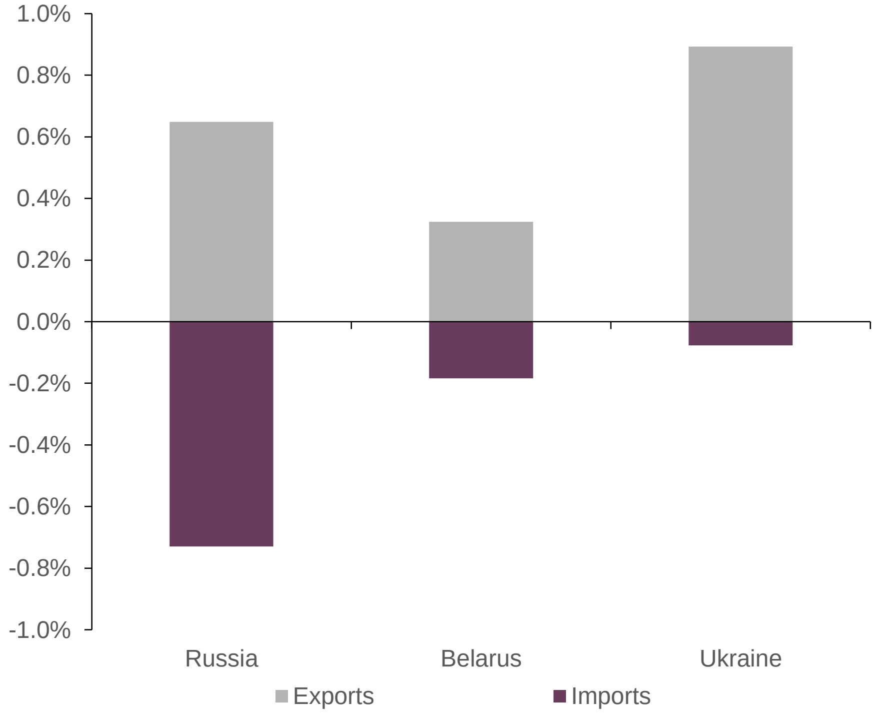
Impact likely to be moderate compared to peers with closer ties to Ukraine and Russia

Highlights

- Russia's invasion of Ukraine and the economic sanctions imposed on Russia in response will doubtless have a tangible impact on economic developments in Iceland
- The inflation outlook has deteriorated, and short-term uncertainty increased
- The sudden spike in imported goods prices has a negative impact on the current account, all else being equal, due to deteriorating terms of trade
- However, price increases in Iceland's main export commodities have a partially offsetting impact on the C/A balance
- Exports to Ukraine, Russia and Belarus totaled around 2% of total exports in 2021, mostly pelagic fish products
- Uncertainty for the tourism sector has increased but so far, the impact has been minimal
- Private consumption impact milder than peers as households' utility costs remain stable
- Worsening inflation outlook could prompt more monetary tightening by the CBI but weaker GDP growth and increased near-term uncertainty may weigh in the opposite direction
- Most probably, the economic recovery will continue, although it may hit a rocky patch as a result of the war

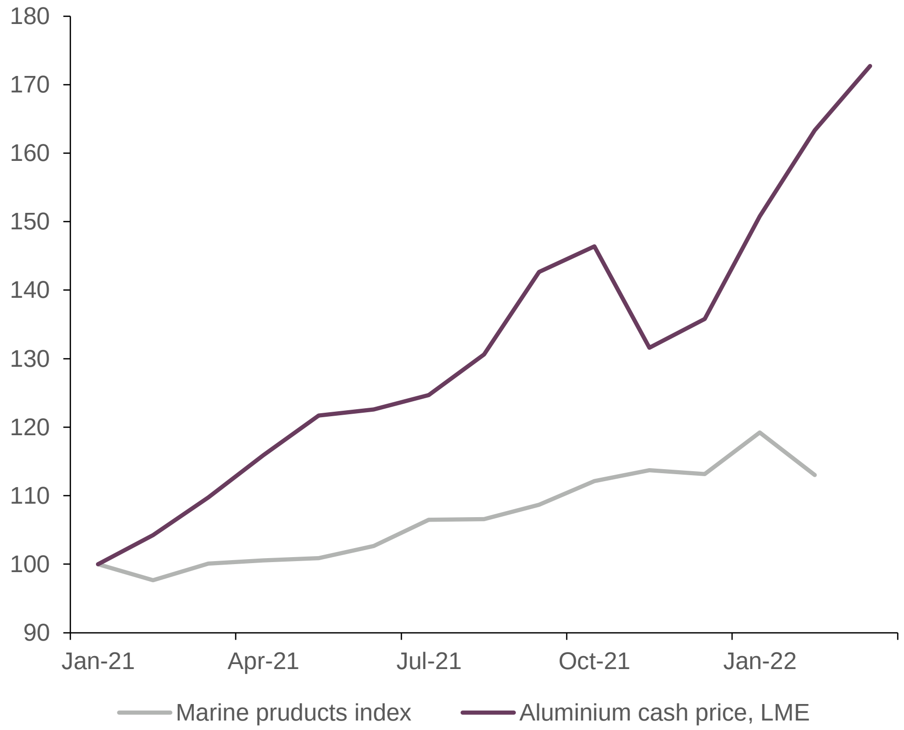
Trade in goods and services with selected countries

% of total exports/imports. Goods trd 2021 and services trd 2020



Price of main export commodities

Indices, global price. Jan-2021=100

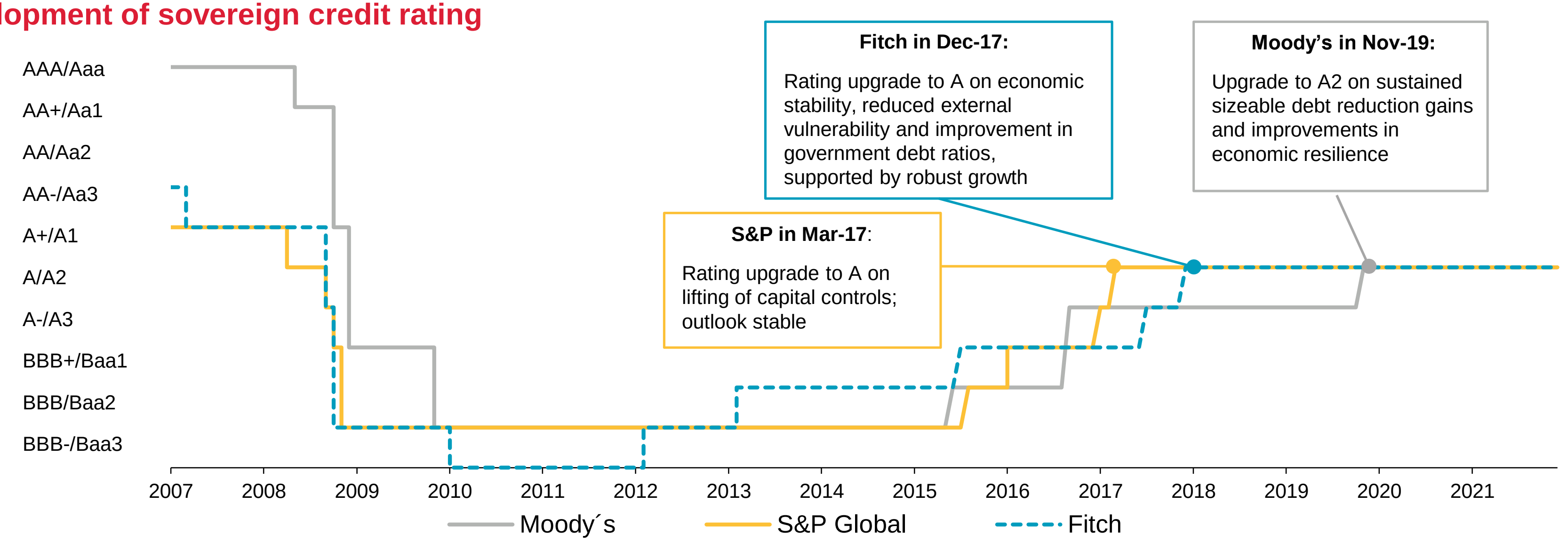


Sources: Government of Iceland, Statistics Iceland, Reuters Eikon

Iceland's credit rating has remained at A

Setbacks in the tourist sector have not affected the sovereign ratings

Development of sovereign credit rating



MOODY'S IN AUGUST 2021

- "Iceland's credit strengths include the economy's flexibility, wealth, competitiveness and favourable demographics, all of which support its long-term growth prospects and help it to absorb shocks."
- "In our baseline scenario we expect the recovery to gather pace into next year, helped by the authorities' strong and swift policy action, high wealth buffers and stronger-than-expected resilience of Iceland's other key industries.

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 NOVEMBER 2021

- "The economic recovery has been stronger than S&P Global Ratings expected"
- "Despite risks to the tourism recovery, we believe the medium-term growth trajectory will be strong, and supported by a public investment program."
- "Iceland's stable institutional framework and effective policymaking also support the ratings."

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 CBI - FSA

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 such 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 CBI - FSA 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 after satisfying certain criteria
Collateral type	Mortgage loan receivables, public sector assets and substitute assets recorded in the cover register
LTV limit	Market value LTV Limits dependent on 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 outstanding covered bonds against the issuer. On a net present value (NPV) basis, cover assets, including derivatives, must always exceed the corresponding value of the interest and principal of outstanding covered bonds, taking into account the effects of stress-test scenarios on interest and currency risk set by the FME. The issuer shall ensure that cash flows with respect to cover assets and derivative agreements are such that payment obligations towards holders of covered bonds and counterparties in derivatives agreements can always be met
Substitute assets maximum %	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 risk 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 issuer can adhere to a self-imposed OC level for structural enhancement, as the ICBA protects any OC in the cover pool in the event of issuer insolvency
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)
Collateral type	– Residential mortgage loans – Mortgage loans backed by industrial, office or commercial properties – Mortgage loans backed by farms and real estate used for agricultural purposes – Public sector loans	– Residential mortgage loans – Commercial mortgage loans – Public sector loans – Shipping loans – Aircraft loans	– Residential mortgages – Commercial mortgages – Loans secured by other registered assets – Public sector loans – Assets in form of derivative agreements (in accordance with regulation)	– Residential mortgages – Commercial/office mortgages (max. 10% pool) – Mortgages backed by properties intended for agricultural use – Site-leasehold right and tenant-owner right – Public sector loans
Segregation of collateral	Ring fenced on the issuer's balance sheet via a cover register	Ring fenced on the issuer's balance sheet	Ring fenced on the issuer's balance sheet via a cover register	Ring fenced on the Issuer's balance sheet via a cover register
Repayment	Soft Bullet	Soft bullet	Hard and soft bullet	Hard and soft bullet
LTV limits	– 80% of the value for real estate – 70% of the value for real estate intended for agricultural use (some restrictions apply) – 60% of the value for real estate, where the property is intended for office or commercial use	– 60% % of mortgage lending value	– 75% for residential mortgage loans – 60% for mortgages backed by holiday/leisure properties and commercial mortgages	– 75% for real estate, site-leasehold rights and tenant-owner rights where the property is intended for residential use – 70% for agricultural real estate – 60% for real estate, site-leasehold rights and tenant-owner rights where the property is intended for office or commercial use
Substitute collateral	Up to 20% of the cover pool; FME can approve an increase up to 30%	Up to 10% of outstanding covered bonds may consist of exposures against CSQ1 credit institutions	Up to 20% of the cover pool; the FSA can approve an increase up to 30%	Up to 20%; the SFSA can approve an increase up to 30%
Protection against mismatching	Nominal value and NPV of assets at least equal to outstanding covered bonds; payment obligations covered by inflows	Nominal value and NPV of assets at least equal to outstanding covered bonds; 180-day liquidity covered via liquid assets	Nominal value of assets at least equal to 102% outstanding covered bonds	Nominal value and NPV of assets at least equal to outstanding covered bonds; payment obligations covered by inflows
Mandatory OC	No mandatory OC requirement	2% Net Present Value	2% Nominal	2% Nominal
Voluntary OC is protected	Yes – up to limit approved by FME	Yes	Yes	Yes
Fulfils UCITS 52(4)	Yes	Yes	Yes	Yes
ECB CBPP3 eligibility	No	Yes, depending on assets	No	No

Source: ECBC Factbook 2021, does not reflect EU Covered Bond Directive transposition, with the exception of Germany

Covered bond framework comparison – cont’d

	Iceland	Finland	Denmark		
Name of instrument	Sértryggð skuldabréf	Finnish Covered Bonds	Særligt Dækkede Obligationer	Særligt Dækkede Realkreditobligationer	Realkreditobligationer
Supervision	Icelandic Financial Supervisory Authority (FME)	Finnish Financial Supervisory Authority (FSA)	Danish Financial Supervisory Authority (FSA)		
Collateral type	– Residential mortgage loans – Mortgage loans backed by industrial, office or commercial properties – Mortgage loans backed by farms and real estate used for agricultural purposes – Public sector loans	– Residential mortgage loans – Commercial mortgage loans – Public sector loans	– Residential mortgage loans – Public sector loans – Shipping loans	– Residential mortgage loans – Public sector loans	– Residential mortgage loans – Public sector loans
Segregation of collateral	Ring fenced on the issuer’s balance sheet via a cover register	Ring fenced on the issuer’s balance sheet via a cover register	Cover assets held on the issuer’s balance sheet and assigned to individual capital centers (mortgage banks) or registers (commercial banks)		
Repayment	Soft Bullet	Hard and soft bullet	Hard and soft bullet		
LTV limits	– 80% of the value for real estate – 70% of the value for real estate intended for agricultural use (some restrictions apply) – 60% of the value for real estate, where the property is intended for office or commercial use	– 70% for residential mortgage loans – 60% for commercial mortgage loans	– 75/80% for residential loans – 75% for holiday property – 60% for agricultural or commercial property	– 75/80% for residential loans – 75% for holiday property – 60% for agricultural or commercial property	– 80% for residential loans – 75% for holiday property – 70% for agricultural property – 60% for commercial property
Substitute collateral	Up to 20% of the cover pool; FME can approve an increase up to 30%	Up to 20% of the cover pool	Up to 15% of the cover pool		
Protection against mismatching	Nominal value and NPV of assets at least equal to outstanding covered bonds; payment obligations covered by inflows	Nominal value of assets at least equal to outstanding covered bonds; interest received on cover assets in any 12-month period more than interest outstanding covered bonds	Balancing principle for mortgage banks; strict et of asset-liability management (ALM) rules for commercial banks		
Mandatory OC	No mandatory OC requirement	2% Net Present Value	No mandatory OC		
Voluntary OC is protected	Yes – up to limit approved by FME	Yes	Yes		
Fulfils UCITS 52(4)	Yes	Yes	Yes		
ECB CBPP3 eligibility	No	Yes	No		

Source: ECBC Factbook 2021, does not reflect EU Covered Bond Directive transposition

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