Pillar 3 Report

2024

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Declaration and Risk Statement

Declaration

The Bank is exposed to various risks and the management of these risks is an integral part of the Bank's operations. The Bank has focused on building up a responsible internal risk culture among the Bank's employees although the Board of Directors is Íslandsbanki's supreme governing body and has the final word on risk management. The Board defines and communicates the acceptable level of risk through the Bank's Risk Appetite Statement and risk management policies that are reviewed at least annually, and the CEO is responsible for ensuring that risks are managed within those limits.

The Board hereby declares that the Bank's risk management arrangements are satisfactory in relation to the Bank's profile and strategy.

Risk Statement

Íslandsbanki's objective is to be a force for good, and the corporate vision is to create value for the future, with excellent service. Íslandsbanki is a universal bank, offering a full range of banking services to personal and corporate customers in Iceland. Outside Iceland, the Bank's operations are limited to the extension of credit to a small number of corporate clients. This means that the Bank's core business is taking on risk through the extension of credit and the rendering of other financial services to its customers.

Risk assessment and the prudent evaluation and pricing of risk are key elements in Íslandsbanki's operations and value creation, and the business strategy is well within with the risk appetite as set by the Board. The Board of Directors reviews the risk appetite and the risk management framework at least once a year. The risk management and internal control framework is based on the three lines of defence model and aims for informed decision-making and strong risk awareness throughout the Bank. The framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial disclosures, as well as compliance with law, regulations, supervisory requirements and the Bank's internal rules and decisions. Íslandsbanki promotes a strong risk culture as an important part of an effective risk management and internal control framework. Emphasis is placed on transparency, acknowledgement, responsiveness, and respect for risk throughout the Bank and open communication regarding risk is encouraged. All business decisions and the resulting risks are initiated and owned by a business unit and undergo a clearly defined review and control process. The level of authority needed to approve each business decision depends on the size, complexity and risk involved.

The Bank has a healthy and well-diversified funding base and a strong capital framework based on the regulatory Standardised Approach. At year-end the Bank's total capital ratio was 23.2%, which is 3.5 percentage points above the regulatory overall capital requirement. The Bank expects CRR 3 to be enacted into Icelandic law in 2025, which will lead to approximately 5% reduction in the Bank's Risk Exposure Amount. The Bank plans to optimise its capital structure before year-end 2025. Íslandsbanki aims to have a management buffer of 1.0 – 3.0 percentage points in addition to the total regulatory requirement in order to cover volatility in risk exposure amount and earnings.

The leverage ratio was 13.2% at the end of 2024 compared to 13.4% at year-end 2023, indicating low leverage.

The Bank is predominantly a **credit risk** operation with credit risk accounting for almost 90% of the Bank's REA. *The Credit Risk Policy* aims for a modest credit risk profile resulting in a well-diversified loan book with conservative collateralisation. The Bank has a long-standing, conservative credit risk culture and is shifting most retail products to digital channels with data driven decision-making bringing significant risk management benefits. The Risk Appetite Statement includes tolerance thresholds for credit quality, a limit on non-primary lending activity and limits on concentration risk.

The share of loans with significant increase in credit risk (Stage 2) reduced to 3.1% and the non-performing loans ratio (Stage 3) lowered slightly to 1.6%.

Market risk accounts for a small proportion of the Bank's REA but is carefully managed through limits, in particular for interest rate risk and inflation risk in the banking book, and equity risk that arises from a small portfolio of strategic equity investments and market making activities.

The Bank manages its **liquidity risk** in accordance with the *Liquidity Risk Policy* and has internal limits for Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and the encumbrance ratio. Throughout 2024 the Bank maintained a strong liquidity position and all key metrics were well above their respective limits.

Operational risk, which covers business, process, outsourcing, reputational, legal, ICT & security, model, conduct, and compliance risks, is managed in accordance with the *Operational Risk Policy* and several supplementary policies and guidelines.

The Bank monitors and manages operational risk through Risk and Control Self-Assessment and Key Risk Indicators for non-financial risk factors, process for new products and significant changes, and follows up of all significant operational risk events in the Loss Event Database.

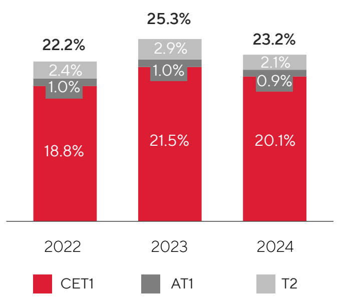
The Bank is constantly seeking ways to strengthen its operational risk framework to prevent deviations in its operations and is Information Security Management System is ISO/IEC 27001:2013 certified.

Sustainability risk is managed in accordance with the Bank's *Sustainability Policy*, risk management framework and risk appetite. The Bank has conducted ESG risk assessments for over 90% of its corporate customers and will continue to analyse sustainability risk in its operations.

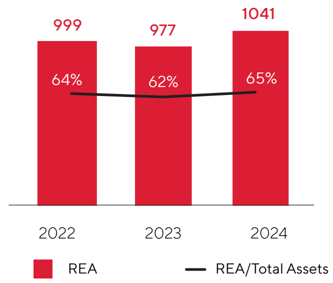
Board of Directors
13 February 2025

Key Metrics

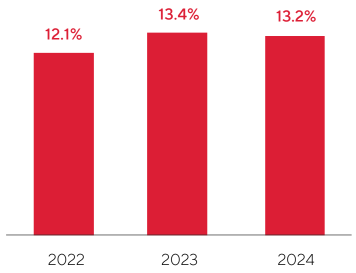
Capital ratios



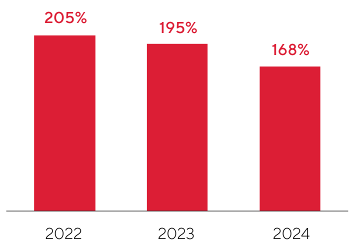
Risk Exposure Amount (ISK bn)



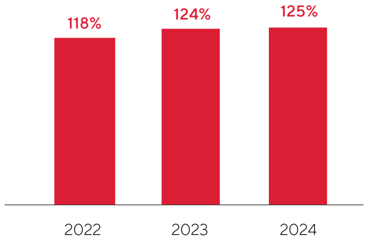
Leverage Ratio



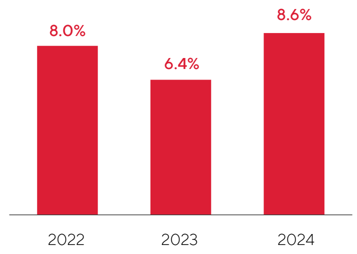
Liquidity Coverage Ratio (LCR)



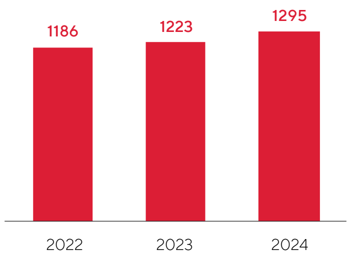
Net Stable Funding Ratio (NFSR)



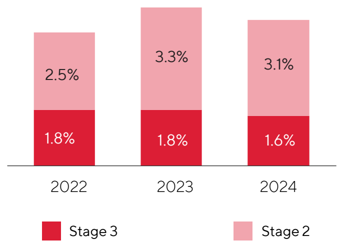
Market risk as a percentage of total capital base, year-end



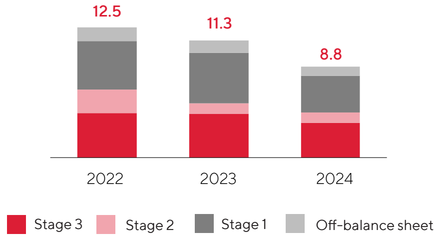
Loans to customers (ISK bn)



Loans to customers: Share in stage 2 and 3



Loans to customers: Impairment allowance account (ISK bn)



1 Introduction

Íslandsbanki's Pillar 3 Report contains information on risk management, risk measurement, material risk exposures, capital adequacy and liquidity adequacy, in accordance with Icelandic law and European Regulation. The report should provide market participants and other stakeholders with information that facilitates a better understanding of the Bank's risk profile and capital adequacy.

1.1 Regulatory Background

The EU Capital Requirements Directive and the EU Regulation on Prudential Requirements for Credit Institutions and Investment Firms (CRR), hereafter referred to together as CRD, have been transposed into Icelandic law by amendments made to the Act on Financial Undertakings and incorporated into the European Economic Area (EEA) Agreement.

The European Union has introduced regulatory changes effective from January 2025 to finalise the implementation of the Basel III framework. These changes, known as CRR 3, are expected to be incorporated into Icelandic regulations through the EEA Agreement later this year.

The scope of the CRD is broken into the following components:

Pillar 1 – Rules for risk coverage, calculation of the capital requirements, quality of capital and minimum leverage ratio. Pillar 1 sets the minimum capital requirements for credit, market and operational risk.

For each of the Pillar 1 risk factors, the CRD permits various methods for calculating the minimum capital requirements and thereby risk exposure amount (REA). For credit risk, market risk and operational risk, the Bank employs the Standardised Approach to determine the capital requirements. The minimum capital requirements under Pillar 1 are set at 8% of REA.

Additionally, the Bank must maintain regulatory capital buffers to absorb losses during periods of financial stress.

Pillar 2 – Supervisory Review and Evaluation Process (SREP) and framework for banks' Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP).

Pillar 2 sets out total regulatory requirements for the Bank, in view of its risk profile, by means of additional capital requirements for risk factors not addressed or not adequately covered under Pillar 1. The Bank's internal capital adequacy assessment is subsequently reviewed by the Central Bank through the Supervisory Review and Evaluation Process (SREP).

Global liquidity standard and supervision monitoring
Rules on minimum liquidity (LCR) and stable funding (NSFR) requirements.

The SREP also includes a review of the Bank's liquidity adequacy assessment and if the Bank adequately identifies and measures its liquidity risk, maintains adequate liquidity in relation to its risk profile, and employs sound risk management systems and processes to support it.

Pillar 3 – Market discipline through disclosure requirements.

The Pillar 3 Report is in accordance with Commission Implementing Regulation (EU) 2021/637 on disclosure requirements under Part Eight of the CRR. The Implementing Technical Standards on prudential disclosures concerning Environmental, Social, and Governance (ESG) risks, as stipulated by Article 449a of the CRR, have been implemented in Iceland and are included in this report. This Pillar 3 Report contains information in accordance with the disclosure requirements in the form of standardised tables and templates. They are available in an Excel file on the Bank's website and will hereafter be referred to as the Additional Pillar 3 Disclosure.

Additional Pillar 3 Disclosure

The Pillar 3 Report is intended to allow market participants to assess key information on capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution.

1.2 Consolidation

The Pillar 3 Report includes figures for the consolidated group, hereafter referred to as Íslandsbanki or the Group. When figures are shown for the parent company, it is specifically noted by referring to the Bank or parent. Further details on the Bank's subsidiaries can be found in LI3 in the Additional Pillar 3 Disclosure.

1.3 Disclosure and Communication Policy

Íslandsbanki has in place a formal Disclosure and Communication Policy approved by the Board of Directors (BoD). The policy outlines the governing principles and framework for external disclosure and communication.

Risk and capital management disclosure aims at giving a true and fair view of the Bank's capital structure and adequacy, material risk exposures and risk assessment processes and governance. Íslandsbanki may choose not to disclose information that is considered immaterial. Additionally, the Bank will not disclose information deemed proprietary or confidential. The classification of proprietary and confidential information is based on relevant Icelandic laws and regulations as well as the Bank's own assessment.

The main channels for Íslandsbanki's risk and capital management disclosure are through the Pillar 3 Report, the Annual and Sustainability Report, Consolidated Financial Statements, and investor presentations. All these documents are available on the Bank's website. The Pillar 3 Report is published annually in conjunction with the Annual Report and the Consolidated Financial Statements. The Additional Pillar 3 Disclosure, published in an Excel sheet on the Bank's website, is partially updated quarterly and semi-annually. If there are significant changes in material risk exposures between reporting periods, Íslandsbanki can choose to disclose information more frequently.

1.4 Verification

The Pillar 3 Report has not been audited by external auditors and does not form a part of Íslandsbanki's audited financial statements. However, it has been appropriately verified internally and includes information from the audited Consolidated Financial Statements 2024.

The Pillar 3 Report has been prepared in accordance with the CRD, not in accordance with International Financial Reporting Standards (IFRS). This may cause some discrepancies between the financial information in the Consolidated Financial Statements and the information in the Pillar 3 Report, see LI2 in the Additional Pillar 3 Disclosure. In some sections, figures are only available or relevant, at the parent level and are clearly marked as such.

1.5 Disclaimer

The Pillar 3 Report is informative in nature and should under no circumstances be interpreted as a recommendation to take, or not to take, any particular investment action. Íslandsbanki holds no obligation to update, modify, or amend this report in the event that any matter contained herein changes or subsequently becomes inaccurate. Nothing in this report should be interpreted as an offer to customers, nor is it intended to constitute a basis for entitlement of customers. Íslandsbanki accepts no liability whatsoever for any direct or consequential loss arising from the use of this publication or its contents.

Exhibit 1.1. List of disclosures in the Additional Pillar 3 Disclosures.

Overview of risk management, key metrics and risk-weighted assets	Additional Pillar 3 Disclosure	Format	Frequency of Disclosure	Reference in Pillar 3 Report
EU OV1: Overview of RWA	OV1	Template	Quarterly	Chapter 3
EU KM1: Key metrics template	KM1	Template	Quarterly	Key Metrics
EU KM2: Key metrics for MREL	KM2	Template	Semi-annual	Chapter 3
EU OVA: Institution risk management approach	OVA	Table	Annual	Chapter 2
EU OVB: Disclosure on governance arrangements	OVB	Table	Annual	Chapter 2
EU OVC: ICAAP information	OVC	Table	Annual	Chapter 3
Composition of capital				
EU CC1: Composition of regulatory own funds	CC1	Template	Semi-annual	Chapter 3
EU CC2: Reconciliation of regulatory own funds to balance sheet in the audited financial statements	CC2	Template	Semi-annual	Chapter 3
EU CCA: Main features of regulatory own funds instruments and eligible liabilities instruments	CCA	Table	Annual	Chapter 3
EU TLAC1: MREL and TLAC capacity and composition	TLAC1	Template	Annual	Chapter 3
EU TLAC3: Creditor ranking	TLAC3	Template	Annual	Chapter 3
Countercyclical capital buffer				
EU CCyB1: Geographical distribution of credit exposures relevant to the calculation of the countercyclical buffer	CCyB1	Template	Semi-annual	Chapter 3
EU CCyB2: Amount of institution-specific countercyclical capital buffer	CCyB2	Template	Semi-annual	Chapter 3
Scope of application				
EU LI1: Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories	LI1	Template	Annual	Chapter 3
EU LI2: Main sources of differences between regulatory exposure amounts and carrying values in financial statements	LI2	Template	Annual	Chapter 4
EU LI3: Outline of the differences in the scopes of consolidation	LI3	Template	Annual	Chapter 1
EU LIA: Explanations of differences between accounting and regulatory exposure amounts	LIA	Table	Annual	Chapter 3
EU LIB: Other qualitative information on the scope of application	LIB	Table	Annual	Chapter 3
Credit risk				
EU CRA: General qualitative information about credit risk	CRA	Table	Annual	Chapter 4
EU CRB: Additional disclosure related to the credit quality of assets	CRB	Table	Annual	Chapter 4
EU CR1: Performing and non-performing exposures and related provisions	CR1	Template	Semi-annual	Chapter 4
EU CR1-A: Maturiy of exposures	CR1-A	Template	Semi-annual	Chapter 4
EU CR2: Changes in stock of non-performing loans and advances	CR2	Template	Semi-annual	Chapter 4
EU CQ1: Credit quality of forborne exposures	CQ1	Template	Semi-annual	Chapter 4
EU CQ3: Credit quality of performing and non-performing exposures by past due days	CQ3	Template	Annual	Chapter 4
EU CQ4: Quality of non-performing exposures by geography	CQ4	Template	Semi-annual	Chapter 4
EU CQ5: Credit quality of loans and advances by industry	CQ5	Template	Semi-annual	Chapter 4
EU CQ7: Collateral obtained by taking possession and execution processes	CQ7	Template	Semi-annual	Chapter 4
EU CRC: Qualitative disclosure requirements related to credit risk mitigation techniques	CRC	Table	Annual	Chapter 4
EU CR3: Credit risk mitigation techniques – overview	CR3	Template	Semi-annual	Chapter 4
EU CRD: Qualitative disclosure requirements on institutions' use of external credit ratings under the Standardised Approach for credit risk	CRD	Table	Annual	Chapter 4
EU CR4: Standardised approach – credit risk exposure and Credit Risk Mitigation (CRM) effects	CR4	Template	Semi-annual	Chapter 4
EU CR5: Standardised approach	CR5	Template	Semi-annual	Chapter 4

Exhibit 1.1. List of disclosures in the Additional Pillar 3 Disclosures (continued).

Counterparty credit risk	Additional Pillar 3 Disclosure	Format	Frequency of Disclosure	Reference in Pillar 3 Report
EU CCRA: Qualitative disclosure requirements related to counterparty credit risk	CCRA	Table	Annual	Chapter 4
EU CCR1: Analysis of the counterparty credit risk (CCR) exposure by approach	CCR1	Template	Semi-annual	Chapter 4
EU CCR2: Transactions subject to own funds requirements for CVA risk	CCR2	Template	Semi-annual	Chapter 4
EU CCR3: Standardised approach – CCR exposures by regulatory portfolio and risk.	CCR3	Template	Semi-annual	Chapter 4
EU CCR5: Composition of collateral for CCR exposures	CCR5	Template	Semi-annual	Chapter 4
EU CCR6: Credit derivatives exposures	CCR6	Template	Semi-annual	Chapter 4
EU CCR8: Exposures to central counterparties	CCR8	Template	Semi-annual	Chapter 4
Operational risk				
EU ORA: Qualitative information on operational risk	ORA	Table	Annual	Chapter 7
EU OR1: Operational risk own funds requirements and risk-weighted exposures amounts	OR1	Template	Annual	Chapter 7
Market risk				
EU MRA: Qualitative disclosure requirements related to market risk	MRA	Table	Annual	Chapter 5
EU MR1: Market risk under standardised approach	MR1	Template	Semi-annual	Chapter 5
Leverage ratio				
EU LR1: LRSum: Summary reconciliation of accounting assets and leverage ratio exposures	LR1	Template	Semi-annual	Chapter 3
EU LR2: LRCom: Leverage ratio common disclosure	LR2	Template	Annual	Chapter 3
EU LR3: Split-up of on balance sheet exposures	LR3	Template	Semi-annual	Chapter 3
EU LRA: Disclosure of Leverage ratio qualitative information	LRA	Table	Annual	Chapter 3
Liquidity ratio				
EU LIQ1: LCR disclosure template, on quantitative information of LCR	LIQ1	Template	Quarterly	Chapter 6
EU LIQA: Liquidity risk management	LIQA	Table	Annual	Chapter 6
EU LIQB: On qualitative information on LCR, which complements template EU LIQ1	LIQB	Table	Quarterly	Chapter 6
EU LIQ2: Net stable funding ratio (NSFR)	LIQ2	Template	Semi-annual	Chapter 6
Remuneration				
EU REMA: Remuneration policy	REMA	Table	Annual	Chapter 9
EU REM1: Remuneration awarded for the financial year	REM1	Template	Annual	Chapter 9
EU REM2: Special payment to staff whose professional activities have a material impact on institutions´risk profile (identified staff)	REM2	Template	Annual	Chapter 9
EU REM3 : Deferred remuneration	REM3	Template	Annual	Chapter 9
EU REM4 : Remuneration of 1 million EUR or more per year	REM4	Template	Annual	Chapter 9
EU REM5: Information on remuneration of staff whose professional activities have a material impact on institutions' risk profile	REM5	Template	Annual	Chapter 9
Asset encumbrance				
EU AE1: Encumbered and unencumbered assets	AE1	Template	Annual	Chapter 6
EU AE2: Collateral received and own debt securities issued	AE2	Template	Annual	Chapter 6
EU AE3: Sources of encumbrance	AE3	Template	Annual	Chapter 6
EU AE4: Accompanying narrative information	AE4	Table	Annual	Chapter 6
Interest rate risk of non-trading book activities				
EU IRRBBA: Qualitative information on interest rate risks of non-trading book activities	IRRBBA	Table	Annual	Chapter 5
EU IRRBB1: Interest rate risk of non-trading book activities	IRRBB1	Template	Semi-annual	Chapter 5

Exhibit 1.1. List of disclosures in the Additional Pillar 3 Disclosures (continued).

Disclosure on ESG risks	Additional Pillar 3 Disclosure	Format	Frequency of Disclosure	Reference in Pillar 3 Report
Table 1: Qualitative information on Environmental risk	Table 1	Table	Annual	Chapter 8
Table 2: Qualitative information on Social risk	Table 2	Table	Annual	Chapter 8
Table 3: Qualitative information on Governance risk	Table 3	Table	Annual	Chapter 8
Template 1: Banking book - Climate Change transition risk: Credit quality of exposures by sector, emissions and residual maturity	Template 1	Template	Annual	Chapter 8
Template 2: Banking book - Climate change transition risk: Loans collateralised by immovable property - Energy efficiency of the collateral	Template 2	Template	Annual	Chapter 8
Template 3: Banking book - Climate change transition risk: Alignment metrics	Template 3	Template	Annual	Chapter 8
Template 4: Banking book - Climate change transition risk: Exposures to top 20 carbon-intensive firms	Template 4	Template	Annual	Chapter 8
Template 5: Banking book - Climate change physical risk: Exposures subject to physical risk	Template 5	Template	Annual	Chapter 8
Template 6: Summary of GAR KPIs	Template 6	Template	Annual	Chapter 8
Template 7: Mitigating actions: Assets for the calculation of GAR	Template 7	Template	Annual	Chapter 8
Template 8: GAR (%)	Template 8	Template	Annual	Chapter 8
Template 9: Mitigating actions: BTAR	Template 9	Template	Annual	Chapter 8
Template 10: Other climate change mitigating actions that are not covered in the EU Taxonomy	Template 10	Template	Annual	Chapter 8

2 Risk Management and Internal Control

Risk assessment and the prudent evaluation and pricing of risk are key elements in Íslandsbanki's operations. In turn, an efficient risk assessment framework forms the foundation of the Bank's risk and capital management strategy. Íslandsbanki's risk governance is based on a three lines of defence framework and aims for informed decision-making and strong risk awareness throughout the Bank.

2.1 Risk strategy

Íslandsbanki offers universal banking services to domestic individuals, companies, and public entities with a strong emphasis on lending. The Bank aims for a modest credit risk profile and takes on credit risk through a clearly defined authorisation framework, and a conservative credit risk culture. This results in a diversified and well collateralised loan portfolio, broadly reflecting the Icelandic economy, and a modest international seafood portfolio. The Bank has a strong and diversified funding base and an ample liquidity buffer, and a robust capital framework based on CRD standardised approach. The interest rate risk strategy is in the short term to stabilise net interest income, including indexation and fair value changes, while minimising fluctuations in the economic value of equity.

The risk management and internal control framework is based on the three lines of defence model, as referred to in the EBA Guidelines, and aims for informed decision-making and strong risk awareness throughout the Bank.

2.2 Risk Governance and Organisation

Íslandsbanki is exposed to various risk factors and managing these risks is an integral part of the Bank's operations. Íslandsbanki emphasises sound governance principles. The risk management and internal control framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with the relevant laws, regulations, supervisory requirements and the Bank's internal rules and decisions.

2.2.1 Three Lines of Defence Model

The first line of defence consists of the Bank's business and support units. The business units take on risk through the extension of credit, through proprietary trading, and by providing other services to the Bank's customers. The primary responsibility for managing these risks lies with the business units. Each business unit shall have in place effective processes to identify, measure or assess, monitor, mitigate and report on the risks taken on by the unit. Support units, whose decisions have an impact on the Bank's operational risk and sustainability risk, are subject to the same requirements for risk identification and management as the Bank's business units.

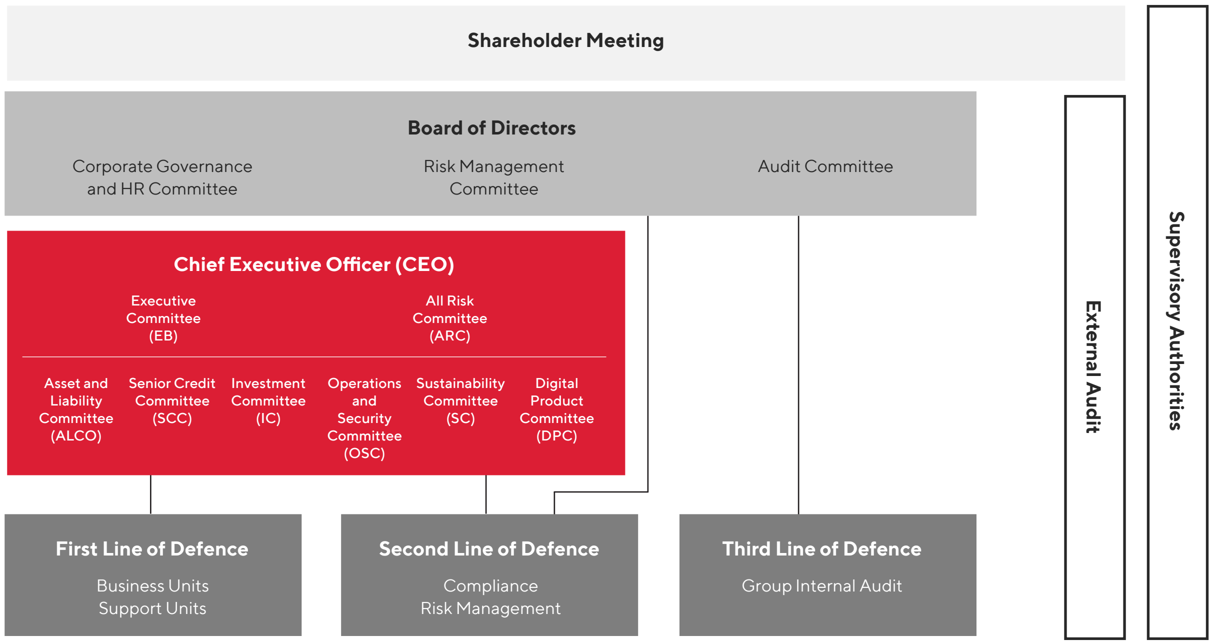
The second line of defence comprises the Bank's risk management function and the compliance function. They are responsible for developing and maintaining an efficient internal framework to facilitate adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported or disclosed, and compliance with the relevant laws, regulations, supervisory requirements and the Bank's internal policies and procedures.

The third line of defence provides independent assurance to management and the Board of Directors of the effectiveness and completeness of the internal control framework, including both the first and the second line of defence. The third line of defence duties are performed by Group Internal Audit.

2.2.2 Organisational Hierarchy

The Bank's management body has a dual structure. The Board of Directors has a supervising role in setting and monitoring the execution of policies, the sound control of accounting and financial management and ensuring that group internal audit, compliance and risk management are effective. The Chief Executive Officer (CEO), the Chief Risk Officer (CRO) and other members of the senior management committees are responsible for implementing risk management practices and internal control in accordance with Board authorisation. Exhibit 2.1 provides an overview of the Group's risk management and internal control governance.

Exhibit 2.1. Íslandsbanki's risk management and internal control governance.



2.3 Roles and Responsibilities

2.3.2 Board of Directors

The Board of Directors is Íslandsbanki's supreme governing body and has the final word on risk management within the Bank. The Board determines the outlines of the Bank's risk management and internal control framework, sets the risk appetite, and decides on the principles according to which risk shall be managed within the Bank.

2.3.2 Board Committees

To advice the Board and to prepare for decisions to be taken by the Board, the Board has formed three subcommittees, the Risk Management Committee, the Audit Committee and the Corporate Governance and Human Resource Committee. Further information on the roles, composition and frequency of meetings of these Board's subcommittees can be found in the Bank's corporate governance statement, in an unaudited appendix to the Consolidated Financial Statements.

2.3.3 Chief Executive Officer

The CEO is responsible for the day-to-day operations of the Bank, implements the risk management and internal control framework and facilitates control mechanisms to ensure adherence to the risk appetite and risk management principles defined by the Board of Directors. The CEO is accountable to the Board for the execution of these arrangements.

The CEO appoints the Chief Risk Officer, Chief Compliance Officer, and other Executive Committee members, as well as members of senior management committees

2.3.3 Chief Risk Officer

The CRO heads Risk Management and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for monitoring the risk management framework at Íslandsbanki and verifying that the Bank has the appropriate resources and organisation to manage its risks efficiently.

The CRO is selected and appointed by the CEO, subject to Board confirmation. The CRO reports directly to the Board and the Board Risk Committee on the overall risk profile of the Group and cannot be removed without the Board's prior approval. The removal or appointment of the CRO shall be publicly disclosed and the Central Bank informed about the reasons.

The CRO is independent from the business units. The CRO chairs the All Risk Committee (ARC), is a member of the Executive Board and reports directly to the CEO. The CRO provides an independent view on the Group's exposure to risk. The CRO has the right but not the responsibility to escalate certain risk-taking decisions of the Bank's business committees if an internal control unit considers the proposed risk inconsistent with the Bank's risk appetite, policies or procedures.

2.3.4 Chief Compliance Officer

The CCO heads the Compliance function, which sits within the second line of defence and acts independently within the Bank. The CCO is responsible for defining the daily tasks of the department and assessing the adequacy of its professional skills. The CCO is responsible for monitoring the compliance risk framework and providing comprehensive and understandable information regarding compliance risk to the Board and senior management.

The CCO reports directly to the CEO, is a member of the Executive Committee and the All Risk Committee, as well as having an advisory role in relevant business committees. The CCO is appointed by the CEO, subject to Board confirmation, and cannot be removed from the post without the Board's prior approval. The Central Bank shall be notified of the dismissal or departure of the CCO.

2.3.5 Chief Audit Executive

The CAE is appointed by the Board, reports directly to the Board and directs Group Internal Audit with a mandate from the Board. The CAE is responsible for internal audit matters within the Group.

2.3.6 Managing Directors in Business Units

The managing directors for individual business units are responsible for the risks taken on by their units and for earning an acceptable level of return on these risks. This entails the responsibility for ensuring the necessary resources and training of employees for identifying, understanding, measuring or assessing, continuously monitoring and reporting on these risks.

Managing directors for individual business units can be assigned authorisations for assuming risk on the Bank's behalf through the extension of credit and the provision of other financial services. For business decisions exceeding the authorisations of managers at individual business units, further authorisation must be requested from the relevant senior management committee.

2.3.7 Managing Directors in Support Units

The managing directors of individual support units are responsible for the implementation of the technical and operational infrastructure necessary to fulfil internal and external requirements for the identification, continuous monitoring and reporting on the risks assumed by the business units.

The responsibility for managing individual risk factors that are owned by a business unit can only be transferred to a support unit through clear documentation, mandate letters, product descriptions, service level agreements or some other formal manner.

2.3.8 General Counsel

The General Counsel heads the legal department and reports directly to the CEO. The General Counsel provides legal advice to senior management, including the Board of Directors, and manages the Bank's legal department that provides comprehensive legal advice to the Bank's business and support units.

2.3.9 All Employees

Each employee is responsible for understanding the risk related to their day-to-day work, for knowing and understanding the respective internal and external rules and procedures, for using the alert procedures in the event of possible fraudulent activities and for conducting business in accordance with the Bank's code of conduct.

2.3.10 Internal Control Functions

The Bank's internal control functions are responsible for developing and maintaining an efficient internal control framework to facilitate adequate risk management, prudent conduct of business, reliability of financial

Exhibit 2.2. Risk Management organisation.

and non-financial information reported or disclosed, and compliance with the relevant laws, regulations, supervisory requirements and the Bank's internal policies and procedures.

Risk Management

The Bank has an independent risk management function, Risk Management, headed by the CRO.

Risk Management is responsible for ensuring efficient implementation of the Bank's risk strategy and policies, for verifying that the Bank has in place efficient risk management processes and that each key risk that the Bank faces is identified and properly managed by the relevant function.

Risk Management is mandated to identify, understand, measure and monitor the risks that the Group is exposed to. It provides independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by senior management and business or support units as to whether they are consistent with the risk appetite and risk policies set by the Board.

Risk Management is organised into four divisions, Risk Assessment & Modelling, Risk Monitoring & Governance, Risk Data & Reporting, and Security & Resilience.

In addition, a special risk product team, which is formally part of Digital and Data but works closely with Risk Management, is responsible for enhancing and maintaining risk management's digital structure and its assets. This includes building a cross data domain aggregation and derived data generation platform as well as automated models, data pipelines and software critical for modelling, monitoring and reporting.

Emphasis is made on actively involving Risk Management at an early stage in elaborating the Bank's risk strategy and in all material risk management decisions, especially when offering new products or making material changes to the Bank's operations.

Where necessary, Risk Management makes recommendations to senior management and the Board for revisions to the risk appetite, the risk strategy and the risk management framework to further clarify risk policies, procedures and limits.

Risk Management provides senior management and the Board with all relevant risk-related information to enable them to define the Bank's risk appetite and maintain oversight over the Bank's overall risk profile. Risk Management takes an active part in developing the Bank's business strategy by ensuring that risks are appropriately and timely considered and that targets, which include credit ratings and rates of return on equity, are plausible and consistent. However, accountability for the business and pricing decisions taken remains with the business and support units and ultimately the senior management and the Board.

Compliance

The Compliance function's day to day role is to advise and assist management as well as employees of the Bank, which can be for example in its training capacity, supporting in development of relevant policies and procedures or as being part of the product approval process. It also plays a key role when it comes to regulatory change processes within the Bank.

Monitoring is a key role of Compliance, both ongoing surveillance and regular and ad-hoc testing of specific operations or business practices. The Compliance function monitors that the Bank's business and operation is conducted in compliance with law, regulations, and supervisory requirements, where effective controls and internal policy and procedures are essential to the Banks appropriate conduct.

Compliance has extensive reporting obligations, where its focus is on compliance findings and actions as well as all significant issues that have risen between reports. Compliance annual report is shared with the Central Bank of Iceland.

2.3.11 Group Internal Audit

Group Internal Audit is an independent function headed by the CAE and is responsible for assessing the effectiveness and efficiency of the Group's risk management, internal control framework and governance processes.

Group Internal Audit is not responsible for internal control or its implementation, but provides the Group with independent, objective assurance and consulting services designed to add value and improve the Group's operations. It helps the Board and senior management to evaluate and improve the effectiveness of the risk management, controls, and governance processes.

Group Internal Audit evaluates the compliance of the Bank's operations to internal policies and procedures. Group Internal Audit also assesses whether existing policies and procedures remain adequate and whether they comply with the relevant legal and regulatory requirements.

Group Internal Audit verifies the integrity of the processes ensuring the reliability of the Bank's methods and techniques, assumptions and sources of information used in risk models and accounting measurements. Group Internal Audit is, however, not involved in the design or selection of models or other risk management tools.

The work of Group Internal Audit is performed in accordance with a risk-based audit plan, which is approved by the Board Audit Committee. Group Internal Audit is furthermore responsible for internal investigations on suspected fraudulent activities.

Group Internal Audit reports directly to the Board on its findings and suggestions for material improvements to internal controls. All audit recommendations are subject to a formal follow-up procedure by the appropriate levels of management to ensure and report their resolution.

2.3.12 External Audit

As is provided for in the Articles of Association, the Group's external audit firm is elected at the Annual General Meeting (AGM). External audit is responsible for the auditing of the annual accounts in accordance with accepted auditing standards and rules set by the Central Bank.

2.3.13 Senior Management Committees

The Bank's committee structure is divided into two categories, executive committees and business committees. There are two executive committees, the Executive Committee and All Risk Committee (ARC). They are responsible for overseeing the implementation of the business strategy, risk appetite and policies. The business committees are six in total, the Asset and Liability Committee (ALCO), the Senior Credit Committee (SCC), the Investment Committee (IC), Operations and Security Committee (OSC), Sustainability Committee and Digital Product Committee. They are responsible for the approval of business proposals and the Bank's operational framework subject to internal rules and guidelines issued by the executive committees and the Board.

The members of all senior management committees are appointed by the CEO, and each committee's mandate and rules of procedure is documented in a charter. The organisation of the Bank's committees is shown in Exhibits 2.1 and 2.3.

Executive Committee

The Executive Committee, chaired by the CEO, is responsible for implementing the Board-approved business strategy, maintaining oversight for and coordinating the Bank's operations and human resources. The Executive Committee also coordinates key aspects of the Bank's activities and holds decision-making power in matters entrusted to it by the CEO in accordance with the Bank's strategy, policies and risk appetite.

All Risk Committee

The All Risk Committee (ARC) is responsible for reviewing and overseeing the implementation of risk management and internal control policies issued by the Board. ARC translates the Board-approved risk policies into risk limits or guidelines for individual business units, desks or portfolios and approves methods and assumptions used for calculating risk measures, capital and liquidity requirements and targets, impairment, and internal and external pricing.

Exhibit 2.3. The Bank's senior committees and the number of meetings in 2024. In addition, the Credit Committee which is a sub-committee of the Senior Credit Committee had 120 meetings discussing credit proposals for lower exposure.

Committee	Role	Number of meetings
Executive Committee	Business strategy, finances, IT strategy, marketing, governance and human resources	46
All Risk Committee	Risk strategy and risk appetite	20
Asset and Liability Committee	Funding and liquidity, market risk, capital management and internal and external pricing	57
Senior Credit Committee	Credit proposals	87
Investment Committee	Investment proposals	17
Operations and Security Committee	Product approval, operations, security and business continuity	27
Sustainability Committee	Review's sustainability related matters and business opportunities	21
Digital Product Committe	Reviews and implements the Bank's digital strategy	9

The committee reviews and confirms proposals regarding risk assessment, impairments and capital and liquidity requirements prior to submission to the Board of Directors for approval.

Business Committees

The business committees decide on individual business proposals in accordance with the rules and procedures issued by the Executive Committee, ARC and the Board. All business proposals discussed in the business committees are initiated and owned by a business or support unit and although authorisation has been given by a committee, the business decision itself is made and owned by the relevant unit.

Representatives from Risk Management attend all meetings of business committees. Their attendance is intended to ensure effective communication of risk in the decision-making process, to ensure that the risks inherent in individual proposals are adequately addressed by the business units and to give an independent view on the risk inherent in the proposals and whether the risk is in line with the Bank's risk appetite.

The Risk Management representatives do not take part in the final decision of the business committees but have the right but not the obligation to veto or escalate certain risk decisions if they are considered inconsistent with the Bank's risk appetite, policies or procedures.

2.4 Risk Culture

The Bank promotes strong risk culture as an important part of an effective risk management and internal control framework. The Bank's risk culture is reflected in the Bank's values and human resources strategy and is developed and maintained through the training of staff regarding policies, procedures and their responsibilities for risk. Emphasis is placed on transparency, acknowledgement, responsiveness and respect for risk throughout the Bank and open communication regarding risk is encouraged.

2.4.1 Ownership, Transparency and Accountability

A key feature of a strong risk culture is that every member of the organisation knows and understands their responsibilities relating to risk management. The *Risk Management and Internal Control Policy*, the *Risk Appetite Statement* along with other risk management policies outline these roles and responsibilities at Íslandsbanki.

All business decisions and the resulting risks are initiated and owned by a business unit and go through a clearly defined review and control process. As part of that process, the business units are responsible for identifying and describing the risks inherent in their proposals and for ensuring that all information regarding these risks is made available in a clear and comprehensive format before proposals are presented to the relevant authority within the Bank.

The business units are also responsible for ensuring that all information regarding risk exposures is correctly registered in the Bank's information systems to facilitate complete transparency, oversight and correct reporting of the Bank's overall risk exposures.

The meetings of business committees provide a formal platform for the communication of risk before a final decision is reached regarding individual business proposals.

The managing directors are responsible for ensuring that their employees have the necessary knowledge, resources and systems to monitor and manage their respective risk positions within the approved risk limits. All breaches of risk limits are reported through a formal limit breach process.

The principle of segregation of duties is integral to the Bank's risk management and internal control framework. This principle is implemented to mitigate conflicts of interest, prevent fraud, and reduce the likelihood of errors. It ensures that no single individual has control over all aspects of any critical transaction, process, or significant decision-making activity.

2.4.2 Training and Incentives

The Bank's performance and talent management aims at encouraging and reinforcing risk awareness and a healthy risk culture. The Bank has in place a comprehensive training programme managed by the Human Resources Department. The programme includes mandatory training on the Bank's internal policies and procedures tailored to the responsibilities of individual employees.

In 2024, the Bank recorded almost 10,000 registrations for over 200 different in-house training courses, on-demand courses and live online courses. This amounts to an average of 13 courses per employee. All employees are required to read and confirm their knowledge of the Bank's operational procedures, code of conduct, security policies and rules on measures against money laundering. The ratio of confirmation is monitored by the Bank's Human Resources Department and lack of participation is escalated to the appropriate managing directors.

2.4.3 Incident Reporting

The Bank has implemented a framework to capture both actual and potential operational risk losses. The Bank emphasises a "no-blame" culture and encourages employees to register all mistakes or failures, irrespective of financial losses, into the Bank's operational risk database. All registered events are analysed and recorded, and the information used for continuous improvements to the Bank's operations and control framework.

2.4.4 Internal Alert Procedures

The Bank has an independent reporting channel enabling employees to report anonymously suspicion of fraudulent activities or actual breaches of regulatory or internal requirements. This reporting channel, referred to as a whistleblowing service, is provided by an external partner to ensure anonymity and whistle-blower protection. Information stored in the system is only accessible to the Bank's Group Internal Audit Fraud Investigation Team.

2.5 Risk Management Framework

The Bank's risk policies, rules and procedures, limits and reports form the Bank's risk management framework. The policies apply to the Bank and are implemented throughout the Group as applicable.

As described before, all business decisions and the resulting risks are initiated and owned by a business unit and go through a clearly defined internal review and control process. The level of authority needed to approve each business decision depends on the size, complexity and risk involved. The responsibilities regarding such decisions are outlined in the Bank's risk policies and investment policies and for material decisions summarised in the Bank's *Matrix for Material Bank Actions*.

2.5.1 Risk Appetite Statement

The Board defines the Bank's risk appetite, tolerance, and financial targets in the *Risk Appetite Statement*. The *Risk Appetite Statement* is intended to support the Bank's business strategy by defining high-level limits and targets for core factors in the Bank's risk profile and operations. The Risk Appetite Statement defines thresholds for both financial and non-financial risk. The measures include target return on equity, target capitalisation level and capital composition, maximum credit losses, concentration limits, maximum amounts at risk for market risk and target liquidity ratios. Exhibit 2.4 shows the risk types and corresponding metrics in the Risk Appetite Statement.

2.5.2 Risk Policies and Limits

The *Risk Appetite Statement* is further implemented through risk policies, approved by the Board, and other rules, procedures and limits approved by ARC which provide more details specific to each risk type. In addition, the *Risk Assessment Framework* and the *Stress Testing Framework*, approved by the Board, describe the processes for identifying and assessing the risks inherent in the Bank's operations.

The risk policies, such as the *Credit Risk Policy*, the *Market Risk Policy*, the *Liquidity Risk Policy*, the *Operational Risk Policy* and the *Compliance Policy*, outline in further detail the Bank's strategy for risk identification, management, and control within the three lines of defence framework. Finally, the risk appetite is translated into limits on individual desks, portfolios, or risk positions and a Key Risk Indicator (KRI) framework for non-financial risks.

The risk policies are all subject to an annual review managed by Risk Management. The policy review process focuses on changes in the regulatory environment, changes in the Bank's operations and gaps that have been identified after an assessment of policy effectiveness.

2.5.3 Risk Identification

Identification of risks in the Bank's operations is made both bottom up, through the process for new products and material changes, the risk and control self-assessment process, and approval of individual

Exhibit 2.4. Risk types and corresponding metrics in the Risk Appetite Statement.

Type of risk	Metrics
Profitability	Long-term rate of return on capital Cost-to-income ratio Target dividend ratio
Capital adequacy	CET1 Capital ratio Total Capital target MREL ratio threshold
Credit risk	Average annual credit losses Non-primary lending activity Leveraged transactions Concentration risk
Market risk	Market risk as a ratio of the Groups total capital Market value of listed and unlisted equities Equity and bond underwriting exposures
Liquidity risk	Liquidity coverage ratio Net stable funding ratio Encumbrance ratio
Operational risk	Operational losses as a percentage of capital Key risk indicators for material sub-categories of operational risk
Compliance risk	Key risk indicators
Sustainability risk	Alignment with Sustainability Principles

transactions or portfolio and desk limits; and top-down through the annual risk assessment procedure as part of the Internal Capital Adequacy Assessment Process (ICAAP). The process for new products and material changes and approval of individual transactions, or portfolios, is intended to ensure early detection and full oversight of risks in the Bank's operations. Each business unit is responsible for identifying the risks inherent in their operations and the products and services they offer.

The *New Products, Material Changes and Product Governance Policy* delineates the coordination, product governance, review, and control processes essential for the effective introduction of new products and material changes. The main objective is to ensure that the implementation of products and operations complies with the Bank's policies and the relevant legal requirements.

In addition, as a part of the ICAAP, a formal and comprehensive assessment of the risks inherent in the Group's operations is made annually. This review is described in the *Risk Assessment Framework* which is approved by the Board of Directors.

Risk Management is responsible for managing the annual risk assessment process. The assessment is done at the business unit level and then consolidated throughout the Group. The results from the risk assessment process are compared to the Bank's business strategy and risk appetite and used as input to the annual review of the Risk Appetite Statement.

For the key risk types identified through the assessment, a specific risk policy is defined and approved by the Board of Directors. The need for a specific risk policy is based on the assessment of the proportionality of the respective risk factors to the Bank's operations and business strategy.

The following six risk types have been defined as key to the Group's operations and business strategy according to the Bank's Risk Taxonomy, with Compliance risk being elevated to this status in 2023. Their assessment, management, mitigation techniques, and overall limits are defined in specific policies:

- Credit risk (Chapter 4)
- Market risk (Chapter 5)
- Liquidity risk (Chapter 6)
- Operational risk (Chapter 7)
- Compliance risk (Chapter 7)
- Sustainability risk (Chapter 8)

Concentration risk is considered in the *Credit Risk Policy*, the *Market Risk Policy*, and the *Liquidity Risk Policy*. Anti-money laundering is considered a part of compliance risk in this context.

Risk types that are not covered in separate risk policies are assessed through the annual ICAAP process based on the Bank's Risk Taxonomy and addressed in other risk policies and management reports in accordance with their nature and importance.

2.5.4 Risk Monitoring and Reporting

Risk Management provides a holistic view on risk and compliance to limits, to internal and external stakeholders, and ensures an appropriate escalation in the event of limit breaches. Business and support units are, however, responsible for maintaining their independent view on the risks inherent in their operations, implementation of controls and other mitigating actions where needed, and reporting to senior management any present or foreseeable breaches from limits, policies or strategic direction. Exhibit 2.5 provides an overview of the risk governance framework.

The strategic targets are further defined in the Group's business plan, approved by the Board of Directors. The business plan gives a 5-year view of the development of the Group's operations and provides a basis for stress testing and capital planning.

The ICAAP / ILAAP aims at identifying and assessing the risk inherent in the Group's operations and for integrating the Bank's business strategy and business plan on one hand and its risk profile and risk appetite on the other hand. This is to ensure that the Bank holds enough capital and liquidity to support its risk profile and business strategy.

Íslandsbanki's *Risk Assessment Framework* outlines the Bank's framework for identifying the risks inherent in its operations and assessing its capital and liquidity adequacy. The scope of the Bank's risk assessment framework encompasses all material risks to which the Bank and its subsidiaries are exposed.

2.5.5 Liquidity and Capital Contingency Plan

The Bank's *Liquidity and Capital Contingency Plan* describes the process for assessing the liquidity risk and capital adequacy position according to three different levels of severity called contingency stages. The main purpose of the contingency plan is to provide the Bank's management with an instrument that identifies actions and contingency options to restore financial strength and viability of the Bank in case it should come under capital or liquidity stress. Moreover, it defines the internal roles and responsibilities at each contingency stage and the contingency options the Bank may take at each stage in order to return to normal business conditions. The plan also defines the management of internal and external disclosure, communication and reporting at each contingency stage. The Liquidity and Capital Contingency Plan is tested regularly and findings from the tests are used to improve the contingency plan if needed.

2.5.6 Recovery Plan and Resolution Planning

The Bank has implemented a comprehensive framework to ensure the viability of its operations in the unlikely event of significant financial stress. In accordance with Icelandic law, the Bank has in place a *Recovery Plan* setting out the relevant measures to be taken by the Bank to restore its financial position after a significant deterioration in capital or liquidity. The Recovery Plan contains several recovery options that have been tested against different stress scenarios to ensure that the Bank is able to recover under different circumstances and return its core business lines and critical functions to business as usual.

The activation of recovery options can include extraordinary measures subject to the Board's or even the shareholder's approval. The status of the Bank's contingency indicators and contingency stages is reported monthly to the All Risk Committee and the Board of Directors as a part of the Risk Dashboard. The Board is responsible for the approval and submission of the Recovery Plan to the Central Bank.

The Board also approves the Master playbook that is a comprehensive guide outlining procedures and strategies in the run-up to and during resolution.

2.5.7 Internal Reporting

The Bank aims to have clearly defined and efficient reporting lines to ensure compliance with the approved risk limits and targets. Timely and accurate reporting on material risk factors is an essential part of the risk management and internal control governance.

Risk Management is responsible for providing ARC, the Board's Risk Management Committee and the Board with comprehensive and understandable information on the overall risk profile of the Group, including a comparison with the approved policies and limits. Exhibit 2.6 provides an overview of risk reporting and frequency to the ARC and the Board of Directors. In addition, risk positions are reported to various business committees like the Asset and Liability Committee, Operations and Security Committee and the Sustainability Committee.

2.5.8 External Reporting

The Group publishes financial information mainly through the Annual and Sustainability Report, Consolidated Financial Statements, the Pillar 3 Report and in investor presentations. These are all available on the Bank's website.

The Group's financial accounts are prepared in accordance with International Financial Reporting Standards (IFRS). Regulatory reports are prepared based on CRD along with discretionary rules and requirements set by the Central Bank of Iceland.

Exhibit 2.5. Íslandsbanki's risk governance framework.

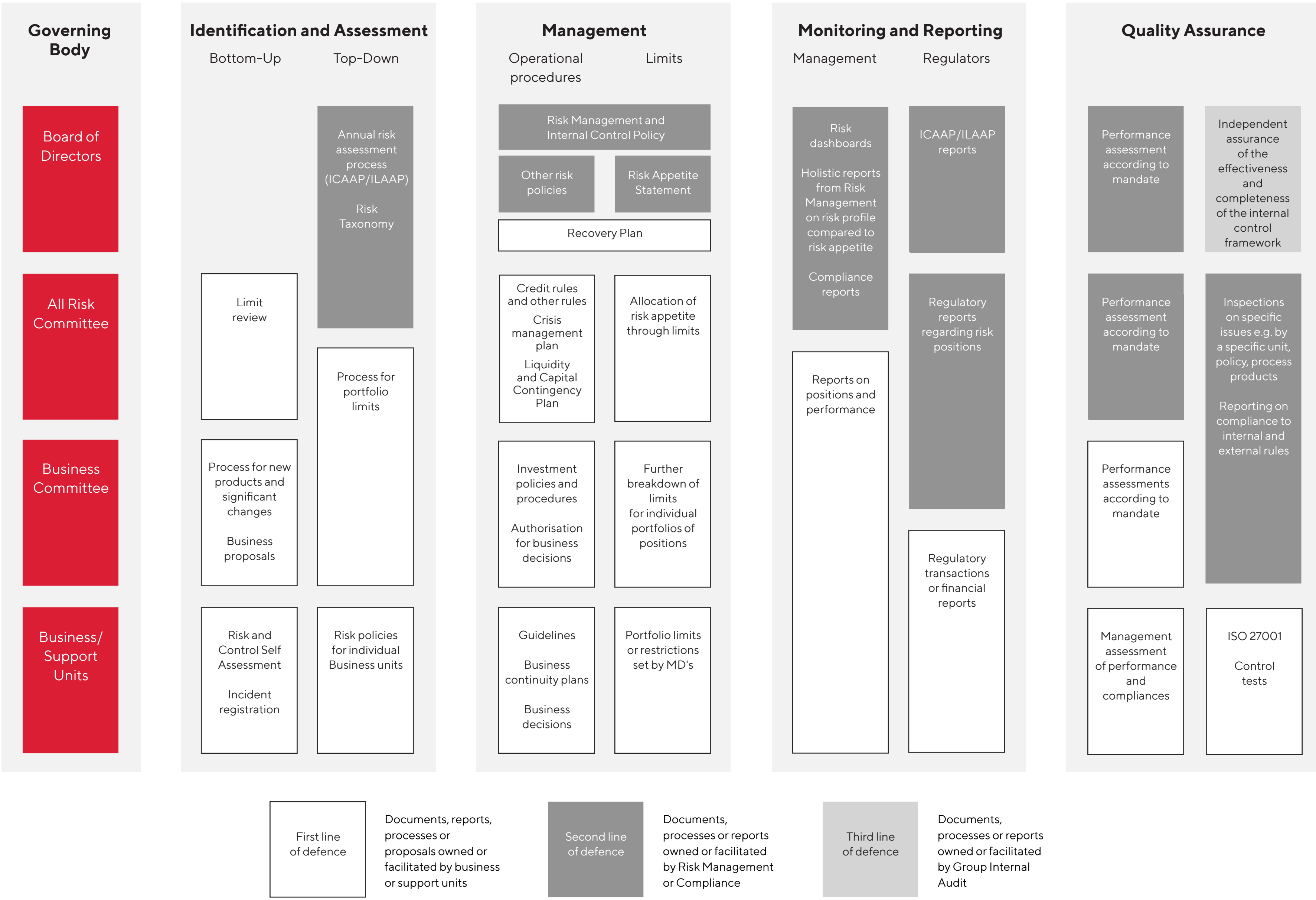


Exhibit 2.6. Risk reporting and frequency to the Board of directors, Board´s Risk Committee and All Risk Committee.

Reporting	Details	Frequency
Risk dashboard	The report provides a review of risk measures that summarise the main risk positions as compared to the risk appetite, internal tolerance and regulatory limits. This includes utilisation of limits set by the Board or Executive and Business Committees. The report also includes the status of the Bank's contingency indicators. On a quarterly basis the report includes an assessment of capital adequacy in light of changes in risk profile (ICAAP review).	Monthly
Compliance report	The report provides an overview of the main supervisory tasks of the compliance unit, identified deficiencies and reactions. .	Annual
ICAAP report (Internal Capital Adequacy Assessment Process)	The ICAAP report includes a detailed description of how the Bank identifies, measures and assesses its capital adequacy in relation to its risk profile and business model. The scope of the assessment encompasses all material risks to which the Bank and its subsidiaries are exposed.	Annual
ILAAP report (Internal Liquidity Adequacy Assessment Process)	The ILAAP report includes a detailed description of how the Bank identifies, measures and assesses its liquidity adequacy in relation to its risk profile. The report also includes a forward looking analysis based on contractual inflows and outflows, planned issuance and new lending according to the Bank's business plan.	Annual
Recovery plan	The document provides a comprehensive recovery plan for the Bank that sets out measures to be taken for the recovery of the Bank's financial position after a significant deterioration to restore financial stability.	Annual

In addition, the Group works and reports according to the guidelines issued by Nasdaq Iceland for listed companies, since Íslandsbanki is an issuer of listed securities both on Nasdaq Iceland and on the Euronext Dublin Stock Exchange. The framework for public disclosure regarding the Bank's risk and financial positions is described in the *Disclosure and Communication Policy* approved by the Board.

3 Capital Management

The Bank continued its journey to optimise its capital base and repurchased over ISK 9 billion of its own shares during the year. As a result, the capital ratio was reduced from 25.3% to 23.2% and is now more aligned with the Bank's targets, while still exceeding regulatory requirements. The CET1 ratio was 20.1%, well above 15.4% overall capital requirement.

The capital management strategy is to aim for the long-term target of CET1 while satisfying various conditions set by the risk framework. This underpins the Bank's commitment to optimise the capital structure by adjusting the share of AT1 or Tier 2 capital through further issuance and lowering CET1 through dividend payments or similar methods such as the share repurchase programme.

3.1 Strategy, Organisation, and Responsibility

Banks' capital is intended to provide a buffer for unexpected losses or volatility in earnings and thereby provide protection for depositors and other creditors as well as promoting stability of the financial system. The eligible capital for calculating the capital ratio is defined by law and further outlined in relevant rules and regulations. The applicable Icelandic laws define both the type of eligible capital and restrictions to the reliance on specific instruments. The Bank's capital management framework is based on CRD as transposed into Icelandic law.

The Board of Directors is responsible for the Bank's capital management framework and for ensuring that the Bank's capitalisation is adequate in relation to the risk inherent in the operations considering the Bank's business strategy and operating environment. The Board defines the capital governance framework and the adequate capitalisation through the *Risk Management and Internal Control Policy*, the *Risk Appetite Statement, Risk Assessment Framework*, and the *Capital Management and Pricing Policy*.

In addition to the current internal requirement of adequate capitalisation, the Board has defined a long-term capital target as a part of the business strategy.

The All Risk Committee (ARC) governs the capital management of the Bank in accordance with the risk appetite set by the Board and reviews proposals to the Board regarding issues related to capital management, including the dividend policy.

The Asset and Liability Committee (ALCO) is responsible for capital allocation to the business units within the framework set by the Board. ALCO reviews and approves the contingency stage assessment as a part of the Bank's Liquidity and Capital Contingency Plan (LCCP) and reviews information about the capital adequacy position of the Bank with respect to business targets and risk limits.

Risk Management is responsible for internal and external reporting on the Bank's capital adequacy. Risk Management is also responsible for the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and for the calculations of the allocated capital to individual business units.

Treasury is responsible for the management of the Bank's capital in accordance with the targets set by the Board. Finance is responsible for reporting on the risk-adjusted performance down to individual business units.

3.2 Total Capital and Capital Ratios

At year-end 2024, the Bank's common equity Tier 1 capital (CET1) amounted to ISK 209bn, unchanged from year-end 2023. The ISK 24bn profit for the year, from which the 50% target dividend payment is deducted from the capital base, contributed to an increase in CET1. However, this was offset by the Bank's ISK 9bn repurchase of its own shares during the year.

The Annual General Meeting (AGM) of Íslandsbanki hf., held on 21 March 2024, authorised the Board of Directors to acquire on behalf of the Bank up to 10% of issued share capital of the Bank. The Central Bank has furthermore granted permission for the Bank to acquire, through buybacks, share capital of the Bank equivalent to ISK 10bn in addition to the previously approved ISK 5bn, which is within the 10% authorisation from the AGM. At year-end 2024, ISK 11bn of buybacks had been executed, leaving ISK 3.6bn of the approved buyback being deducted from CET1 capital.

The Bank's Tier 2 capital reduced from ISK 28bn to ISK 24bn during the year. The Bank exercised the option to call Tier 2 notes that were due June 2029, amounting to SEK 500m (ISK 6.5bn).

The capital requirements and capital ratios are presented in terms of the Risk Exposure Amount (REA) that is determined by multiplying the capital requirements for market risk and operational risk by 12.5 (the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of the risk weighted assets for credit risk (see more in Section 3.4).

The Bank's minimum capital requirements and the corresponding risk exposure amounts are shown in Exhibit 3.2, and the resulting capital ratios in Exhibit 3.3. Details regarding the Bank's capital requirements can be found in Section 3.4.

Exhibit 3.1. Breakdown of the capital base at year-end 2024 and 2023 (ISK m).

Capital	31.12.2024	31.12.2023
Capital instruments and the related share premium accounts	64,473	64,898
Reserves	7,102	5,083
Retained earnings	155,781	154,713
Intangible assets	(2,070)	(1,922)
Tax assets	(164)	(122)
Foreseeable dividend payment and approved buyback	(15,760)	(14,990)
Fair value changes due to own credit standing	135	1,827
Insufficient coverage for non-performing exposures	(17)	(4)
Common equity Tier 1 Capital	**209,479**	**209,483**
Additional Tier 1 capital	9,371	10,019
Tier 1 Capital	**218,849**	**219,502**
Tier 2 capital	22,324	28,135
Total capital base	**241,174**	**247,637**

Exhibit 3.2. Pillar 1 capital requirements and REA at year-end 2024 and 2023 (ISK m).

	31.12.2024		31.12.2023	
Íslandsbanki's capital requirements and REA	**Minimum capital requirements**	**REA**	**Minimum capital requirements**	**REA**
Credit risk	73,803	922,533	69,261	865,758
Market risk	848	10,606	829	10,360
Credit valuation adjustment	57	714	54	677
Operational risk	8,570	107,119	8,019	100,237
Total	**83,278**	**1,040,972**	**78,163**	**977,032**

Exhibit 3.3. REA and capital ratios at year-end 2024 and 2023.

	31.12.2024		31.12.2023	
	ISK m	**% of REA**	**ISK m**	**% of REA**
REA	**1,040,972**		**977,032**	
CET1 capital	209,479	**20.1%**	209,483	**21.4%**
Tier 1 capital	218,849	**21.0%**	219,502	**22.5%**
Capital base	241,174	**23.2%**	247,637	**25.3%**

The REA increased by ISK 64bn during the year and the main components contributing to changes can be seen in Exhibit 3.4. Changes in the loan portfolio contributed an ISK 48bn increase. The average risk weight of the loan portfolio remained unchanged at 64%. Further breakdown of the credit risk exposure in risk weights and exposure classes can be found in template CR5 in the Additional Pillar 3 Disclosures.

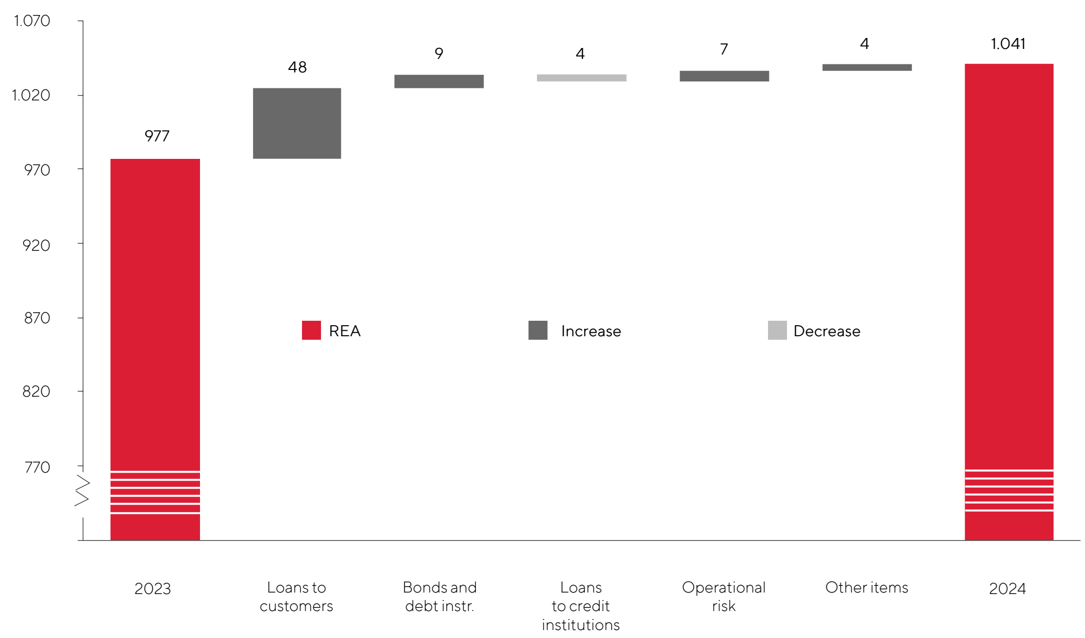
3.3 Internal Capital Adequacy Assessment Process

The internal capital adequacy assessment process (ICAAP) aims at identifying and assessing the risk inherent in the Bank's operations and for integrating the Bank's business strategy and business plan on one hand and the risk profile on the other hand to ensure that the Bank holds enough capital to support its risk profile and business strategy through a period of severe stress.

The Board of Directors is actively involved in the ICAAP process and signs the report. The process is carried out by Risk Management with active participation of the business and support units through risk identification and appropriate review of the capital adequacy assessment and stress testing results.

In an annually revised 5-year business plan, the Bank's risk strategy is aligned with the business strategy, and the financial targets are translated into a base case projection of the financial results under normal business conditions. The business plan forms the basis for pro forma financial statements that allow for a comprehensive business and strategic stress testing whereby the impact of all relevant risk drivers is assessed.

Exhibit 3.4. Changes in risk exposure amount (ISK bn).



3.4 Capital Requirements

The Board of Directors sets minimum capital thresholds for the Bank, expressed as the ratio between capital and risk exposure amount. The minimum capital thresholds are intended to reduce the likelihood that the regulatory overall capital requirement is ever breached. The minimum is based on the results from ICAAP, the views expressed by the regulator through the Supervisory Review and Evaluation Process (SREP), implementation and announced changes of the capital buffers, and other factors such as uncertainties in the operating environment or other external factors. The following sections describe each component in more detail.

3.4.1 Pillar 1 Minimum Capital Requirements

The first pillar of the CRD defines the minimum capital requirements for credit risk, market risk, and operational risk. The minimum capital requirement under Pillar 1 is 8% of the risk exposure amount. For each of the Pillar 1 risk factors, the CRD allows for different methods to be used for calculating the minimum capital requirements and thereby REA.

Credit risk

The Bank uses the Standardised Approach for credit risk by which the REA risk is derived by assigning a risk weight, in the range of 0–150%, to the Bank's assets depending on the creditworthiness of the counterparty, the underlying collateral, and the type and term of the exposure.

CRR 3 will enhance the risk sensitivity of the Standardised Approach, particularly for loans secured by real estate collateral. The Bank has prepared for this change by aligning its product offerings with the new regulation. This includes a clearer distinction between real estate that is under construction, used for own operations, or rented out. Overall, the change is expected to lead to a capital relief. For further discussion, please refer to Chapter 4.

Market risk

For traded debt instruments, the capital requirement is generally in the range of 0–12% of the net exposure, based on the creditworthiness of the issuer and the term of the instrument. For traded equity instruments, the capital requirement is 16% of the net exposure. For foreign exchange (FX) risk, the minimum capital requirement is 8% of the maximum of the Bank's total long and total short positions in foreign currencies.

The CRR 3 will not change the approach to market risk in 2025 since the EU has postponed the implementation of market risk rules to preserve the international level playing field.

Operational risk

The Bank uses the Standardised Approach to calculate capital requirements for Pillar 1. The minimum capital requirement for operational risk varies by business lines and equals 12-18% of the average over three full calendar years of the sum of net interest income, net fee and commission income, and net other financial income in that business line.

Under CRR 3, all institutions will adopt a uniform approach that consider both turnover and interest-bearing assets and business indicator component. This is expected to lead to a capital relief for Íslandsbanki due to the size of the Banks operations.

3.4.2 Pillar 2 Required Add-On (Pillar 2-R)

In addition to the minimum capital requirements for credit risk, market risk and operational risk under Pillar 1, financial institutions are required to make their own assessment of the overall capital requirements in the ICAAP process. These additional capital requirements, taking into account the risk profile of the institution, are referred to as Pillar 2-R capital requirements. The sum of Pillar 1 and Pillar 2-R is referred to as total SREP capital requirement (TSCR).

In the ICAAP 2024, the main factors contributing to additional capital requirements under Pillar 2-R were:

- **Additional capital requirements for risk factors underestimated under Pillar 1:** Credit risk and market risk.
- **Additional capital requirements for risk factors not addressed under Pillar 1:** Credit concentration risk, interest rate risk in the banking book (IRRBB), market risk arising from equities in the banking book, and the inflation imbalance.

The Pillar 2-R capital requirements are presented as a proportion of REA and come as an addition to the regulatory capital minimum of 8% under Pillar 1. The Bank's Pillar 2-R results are reviewed by the Central Bank through the SREP. Based on the 2024 SREP, the additional capital required for Íslandsbanki under Pillar 2-R was 1.8% of REA, a decrease of 0.6 percentage points from 2023. The breakdown of the Pillar 2-R capital and the total SREP capital requirements can be seen in Exhibit 3.5.

Exhibit 3.5. Breakdown of the total SREP capital requirement.

SREP capital requirement	2024	2023
Pillar 1	**8.0%**	**8.0%**
Credit risk	7.1%	7.1%
Market risk	0.1%	0.1%
Operational risk	0.8%	0.8%
Pillar 2-R	**1.8%**	**2.4%**
Credit risk	0.9%	1.0%
Market risk	0.8%	1.4%
Operational risk	0.1%	1.0%
Total SREP capital requirement	**9.8%**	**10.4%**

3.4.3 Combined Capital Buffer Requirement

Capital buffers are additional capital requirements for financial institutions in excess of minimum capital requirements. They are intended to counteract the problems that could occur when economic shocks and increased expectations of losses on financial institutions' assets cause those institutions to reduce the supply of credit excessively in order to safeguard their own solvency. These buffers are flexible and less stringent than minimum capital requirements, allowing institutions to smooth out credit supply fluctuations despite economic shocks.

The capital buffers that have been implemented in Iceland are as follows: systemic risk buffer, capital buffer for systemic importance, countercyclical capital buffer, and capital conservation buffer.

The size of the capital conservation buffer is fixed by law at 2.5% while the size of the other capital buffers is stipulated in rules issued by the Central Bank.

The Financial Stability Committee of the Central Bank of Iceland (FSN) decided to increase the countercyclical capital buffer (CCyB) from 2% to 2.5%, effective from March 2024.

The FSN further decided, in December 2024, to lower the systemic risk buffer rate from 3% to 2%, on the grounds that it considers systemic risk to have subsided since the buffer was first introduced in 2016. As the systemic risk buffer only applies to domestic exposures, the effective risk buffer rate is calculated by multiplying the proportion of the domestic credit risk exposure by the domestic systemic risk buffer rate.

On the same meeting in December, the FSN decided to increase the capital buffer for systemic important financial institutions (O-SII buffer) from 2% to 3%. This increase aims to capture the risk facing the economy because of the size and scope of the systemically important financial institutions.

The institution-specific countercyclical capital buffer rate applies to institution-wide total REA. The institution's specific buffer add-on amount is calculated as the weighted average of the countercyclical capital buffer rate applicable in jurisdictions in which an institution has private sector credit exposures, multiplied by the total risk exposure amount.

The calculation of the institution specific countercyclical capital buffer rate is displayed in sheet CCyB2 in the Additional Pillar 3 Disclosures. Exhibit 3.6 shows combined buffer requirement for Íslandsbanki at year-end 2024 and 2023.

Exhibit 3.6. Combined capital buffer requirement.

	31.12.2024	31.12.2023
Capital conservation buffer	2.50%	2.50%
Countercyclical capital buffer	2.46%	1.97%
O-SII buffer	3.00%	2.00%
Systemic risk buffer	1.94%	2.89%
Combined buffer requirement	**9.90%**	**9.36%**

The sum of Pillar 1, Pillar 2-R and the combined capital buffers forms the overall capital requirement.

Pillar 2-G (Guidance for stressed conditions)

The Pillar 2-G is based on future risk and is subject to the regulators' assessment of stress tests performed on the financial institutions (supervisory stress testing). The Central Bank can add the Pillar 2-G as a capital reference if the results from the supervisory assessment indicate that a financial institution might not be able to meet the total SREP capital requirements over the projected economic cycle. Currently no Pillar 2-G is applicable for the Bank.

3.4.5 Management Buffer

The Bank aims at managing its capital position and the corresponding capital ratios at a comfortable margin above the overall regulatory capital requirement. This margin is referred to as the management buffer in the Bank's capital management framework. The size of the management buffer is based on factors such as views from the regulator through the SREP, volatility in the Bank's REA due to currency fluctuation, volatility in the Bank's REA due to uneven asset growth, the Bank's target rating, competitive issues, funding terms, uncertainty in the operating environment not accounted for in the ICAAP, and uncertainty in the regulatory environment. Currently the management buffer is 1-3%. as defined in the Risk Appetite Statement set by the Board of Directors.

3.4.6 Capital Composition

According to the CRR, the following restrictions apply to the composition of Pillar 1 capital:

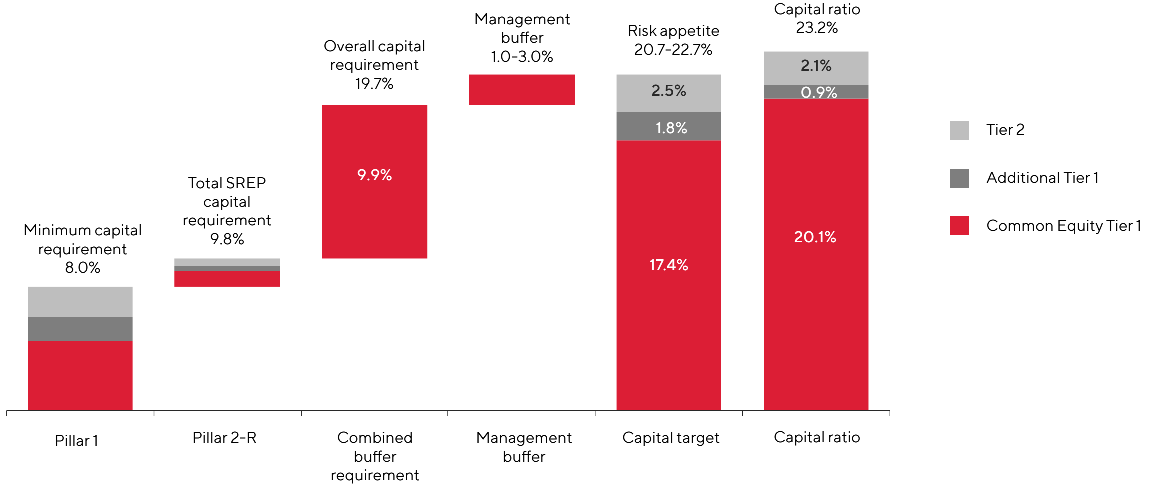
- CET1 at a minimum 4.5% of REA
- Tier 1 capital including Additional Tier 1 (AT1) at a minimum 6.0% of REA
- A total capital ratio including Tier 2 debt at a minimum 8.0% of REA

The capital held under Pillar 2-R is subject to the same proportional restrictions as capital held under Pillar 1, while the capital buffers shall be comprised of CET1 capital only. Exhibit 3.7 shows the composition of the overall capital requirement.

Exhibit 3.7. Composition of the regulatory capital requirements at year-end 2024.

SREP capital requirement	CET1	AT1	Tier 2	Total
Pillar 1	4.5%	1.5%	2.0%	8.0%
Pillar 2	1.0%	0.3%	0.5%	1.8%
Combined buffer requirement	9.9%	-	-	9.9%
Overall capital requirement at year-end 2024	**15.4%**	**1.8%**	**2.5%**	**19.7%**

Exhibit 3.8. Regulatory requirements compared with Íslandsbanki's risk appetite as well as the composition of the Bank's current capital ratio.



3.4.7 Capital Target

The Bank's risk management framework stipulates a management buffer of 1–3% above of the overall capital requirement resulting from the SREP. Based on the most recent SREP results, this translates to capital thresholds of 20.7 –21.7% with the composition of the capital satisfying the constraints presented above.

The capital management strategy is then to aim for the long-term target of CET1 while satisfying the conditions set by the risk framework. This can lead to an optimisation of the capital structure by adjusting the share of AT1 or Tier 2 capital though further issuance and lowering CET1 through dividend payments or similar canals.

3.5 Expected changes to REA and Capital Ratios with the introduction of CRR 3

In 2025, the regulatory landscape for banks within the European Union will undergo significant changes with the revision of the Capital Requirements Regulation (CRR 3). This new framework aims to enhance the robustness and stability of the financial system by better aligning the internal ratings based approach and the standardised approach for calculating REA.

The implementation of CRR 3 is expected to have a notable impact on the Bank's REA and capital ratios. The revised regulation will mostly introduce changes to the standardised approaches for credit and operational risk. The changes in the Standardised Approach for credit risk are designed to increase the risk sensitivity of that approach and to ensure that banks hold sufficient capital to withstand periods of severe financial stress. To provide comparability between banks, all existing approaches for calculating the operational risk capital requirements have been replaced by a single non-model-based method referred to as the new Standardised Approach.

Exhibit 3.9. An estimation of the effects of the CRR 3 capital requirements for the Group, based on year-end amounts.

Risk exposure amount	Foreseeable CRR requirements	Current CRR requirements
Due to credit risk	896,371	922,264
Due to market risk	10,606	10,606
Due to credit valuation adjustment	714	714
Due to operational risk	85,944	107,119
Total risk exposure amount	**993,635**	**1,040,703**
CET1 ratio	21.1%	20.1%
Tier 1 ratio	22.0%	21.0%
Total capital ratio	24.3%	23.2%

As part of the preparation for the upcoming regulatory changes, the Bank has conducted a comprehensive assessment of the expected impact of CRR 3 on its REA and capital ratios. This section provides an overview of the anticipated adjustments to risk-weighted assets and the corresponding effect on capital adequacy metrics. By proactively addressing these changes, the Bank aims to maintain a strong capital position and continue to support its strategic objectives while complying with the new regulatory requirements. Further details on credit risk REA are in Chapter 4 and on operational risk REA in Chapter 7.

3.6 Stress Testing

Íslandsbanki's stress testing framework aims at detecting the sensitivity of the Bank's operations to changes in the operating environment and to ensure that the Bank holds sufficient available capital and liquid funds to meet minimum requirements, even under stressed operational conditions.

The main types of stress tests performed at Íslandsbanki are:

1. Sensitivity analysis provides information about key risks and enhances understanding about concentrations in one or several risk factors. Sensitivity analysis stresses one risk driver, with different degrees of severity, to assess the sensitivity of the Bank's operations to that particular risk driver.

2. Reverse stress test consists of defining a significant and pre-defined negative outcome and then identifying causes and consequences that could lead to such an outcome. The purpose is to identify possible combinations of events and risk concentrations that might not be included in other stress tests performed within the Bank. Thus, the reverse stress test could reveal weaknesses in the Bank's operations that might otherwise be overlooked.

3. Scenario analysis can be defined as multiple sensitivity analyses performed at the same time which assess the resilience of an institution. A stress scenario is supposed to be forward looking and identify possible events or changes in market conditions that could adversely impact the Bank. The scenario should address the main risk factors that the Bank may be exposed to. The scenario should be severe but plausible and at the same time be consistent internally as well as economically.

4. Specific events focus on current or imminent situations that could have an extensive impact on its operations, the risk mitigating actions that can be taken to reduce the likelihood of these events materialising and to minimise the impact for the Bank.

5. Reputational risk stress test is a qualitative test performed by experts from across the Bank. The experts come up with a scenario that could damage the Bank's reputation and analyse how the scenario affects the Bank's reputation, the impact it has on different stakeholders, the likelihood of the effect and discuss possible countermeasures. The discussions are documented and summarised in the Bank's ICAAP Stress Testing Results.

The key assumptions for a scenario analysis and other significant stress tests are developed in cooperation with the Bank's Chief Economist, business units, ARC and the Board. The results from stress tests are compared with the Bank's capital target, other risk appetite measures and risk limits. If the results indicate a breach in the Bank's capital targets or other risk appetite or strategic measures, remedial actions may be suggested, depending on the severity and likelihood of such a breach.

3.7 Leverage Ratio

The leverage ratio is a measure supplementing the risk-based capital requirements. The leverage ratio is calculated by dividing Tier 1 capital by the sum of total assets and adjusted off-balance sheet exposures. According to law, the minimum leverage ratio is 3%. The leverage ratio is monitored monthly through the Risk dashboard. The level of the Bank's overall requirement as well as the current RWA density deter excessive leverage.

The leverage ratio was 13.2% at year-end 2024, compared to 13.4% at year-end 2023. Larger balance sheet explains the change leverage ratio. Template LR2 of the Additional Pillar 3 Disclosures shows the components of the leverage ratio calculations.

3.8 Minimum Requirements for Own Funds and Eligible Liabilities

In addition to the previously discussed capital requirements, which are intended to ensure that the Bank holds sufficient capital to support its risk profile and business strategy through a period of severe stress, regulatory requirements are forming with the intention to ensure that the Bank maintains a minimum amount of equity and debt to support an effective resolution. These are called Minimum Requirements for Own Funds and Eligible Liabilities (MREL).
With the implementation of the Bank Recovery and

Resolution Directive (BRRD), credit and financial institutions in the EU are required to hold a certain amount of bail-in-able resources to fulfil the minimum requirement for own funds and eligible liabilities. The purpose of the MREL is to ensure that institutions can absorb potential losses and be recapitalised without recourse to public funds.

In 2021, the Icelandic Resolution Authority published its MREL policy for Icelandic banks and in October 2024 the Resolution Authority announced that a resolution plan had been approved for Íslandsbanki as well as the MREL requirement based on the MREL policy.

The resolution plan stipulates that the MREL requirement for Íslandsbanki is the sum of the Loss absorption amount (LAA) and Recapitalisation amount (RCA), both equal to the total SREP capital requirement of 9.8%, resulting in an MREL requirement of 19.6% of REA. Note that no market confidence charge is applied in Iceland. The requirement can be met with the total capital base in addition to senior non-preferred and senior preferred debt with some conditions, such as having more than one year to maturity. This debt is referred to as eligible liabilities. Since any CET1 capital that is maintained to meet the combined buffer requirement (CBR) is excluded, the effective requirement can be monitored as 29.5% of REA. The Bank's effective MREL ratio was 33.4% at year-end 2024, 4 percentage points above the requirement.

Exhibit 3.10. Minimum requirement for own funds and eligible liabilities (MREL) and Own fund and eligible liabilities at year-end 2024 and 2023.

	31.12.2024		31.12.2023	
Minimum Requirements for Own Funds and Eligible Liabilities	**ISK m**	**(%REA)**	**ISK m**	**(%REA)**
MREL	204,031	19.6%	203,223	20.8%
Combined buffer requirement	103,020	9.9%	91,435	9.4%
MREL including CBR	**307,050**	**29.5%**	**294,658**	**30.2%**

	31.12.2024		31.12.2023	
Own funds and eligible liabilities	**ISK m**	**(%REA)**	**ISK m**	**(%REA)**
Own funds	241,174	23.2%	247,637	25.3%
Eligible liabilities	106,878	10.3%	155,531	15.9%
Own funds and eligible liabilities	**348,052**	**33.4%**	**402,986**	**41.2%**

4 Credit Risk

The Bank undertakes credit risk by offering loans, guarantees and other credit products. Credit risk is the primary risk factor in the Bank's operations, and taking on credit risk is a core activity of the Bank. The Bank has policies and procedures for accepting, measuring and managing credit risk. The objective of credit risk management is to achieve an appropriate balance between risk and return while minimising potential adverse effects of credit risk on the Bank's financial performance.

By the end of 2024, the Bank's regulatory credit risk exposure amount was ISK 1,635bn, a rise from ISK 1,622bn at year-end 2023. The loan portfolio grew by 5.9% in 2024, an acceleration compared to the 3.2% increase in the previous year. Over the past year, inflation steadily declined, resulting in a reduction in interest rates in the last quarter. However, interest rates remain relatively high from a historical perspective. Seismic activity continues to pose a threat to residents and businesses in the town of Grindavík, however, the majority of residential properties has been acquired by the government-owned real estate company Þórkatla. As a result, the share of loans with significant increase in credit risk lowered slightly to 3.1%, from 3.3% the year before. Furthermore, the non-performing loans ratio fell to 1.6% from 1.8% in the previous year. Credit risk accounted for 89% of capital requirements under Pillar 1 and credit risk, and credit concentration risk accounted for 83% of the total capital requirements, as determined in the SREP.

This chapter provides a description of the Bank's credit process, risk assessment models and a detailed breakdown of the loan portfolio that gives an indication of credit concentration and credit quality.

4.1 Strategy, Organisation and Responsibility

Credit risk is defined as the current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any contract with the Bank.

Credit concentration risk is the increase in risk that is driven by common underlying factors, such as sector, economy, geographical location, type of financial instrument, or due to connections or relations among counterparties. This includes large individual exposures to parties under common control and significant exposures to groups of counterparties whose probability of default is driven by common underlying factors.

The Board defines the credit risk governance framework and the acceptable level of credit risk through the *Risk Management and Internal Control Policy*, the *Risk Appetite Statement* and the *Credit Risk Policy*.

The Bank's strategy is to maintain a modest credit risk profile and it aims to have long-term average annual credit losses less than 0.9% of the loan portfolio, excluding the liquidity portfolio and the qualified retail mortgage portfolio. This risk appetite is reflected in the credit risk limit structure and guided through the use of credit risk assessment models.

Credit risk activities are controlled through exposure limits applied to counterparties, countries, sectors and products.

As the second line of defence, Risk Management monitors the adherence to credit risk limits and reports on credit risk to the All Risk Committee and to the

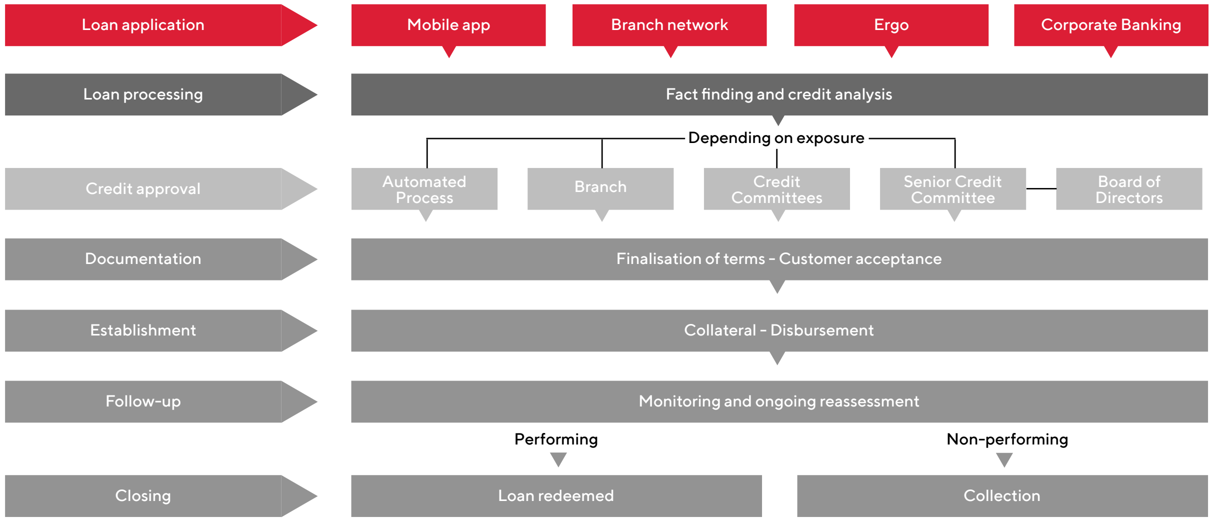
Board of Directors, including current and prospective risk position compared to the risk appetite.

The Bank's credit process, shown in Exhibit 4.1, is based on a committee structure where the Senior Credit Committee has the authority to approve credit proposals within authorisation limits set by the Board of Directors. The Senior Credit Committee then appoints and allocates credit authorisation limits to its subcommittees and to individual employees such as branch managers and credit managers. Credit authorisation limits can have reference to the risk class of the counterparty or to specific credit products. Credit decisions for certain retail products, such as mortgages, overdrafts and credit cards to individuals, are partially based on an automated approval process.

The All Risk Committee approves frameworks for rule-based and automated approval processes. The frameworks include appropriate control mechanisms, continuous monitoring and reporting, assessment of the risk associated with the process, and mitigating actions. To further strengthen the quality of frameworks for rule-based or automated approval processes, they shall be reviewed annually with the results presented to the Board of Directors. Automated approval processes do not relieve the business units granting the credit of their responsibilities regarding credit quality or accountability.

The Bank's Credit Rules outline the principles governing loans, guarantees and other products that expose the Bank to credit risk. Trust between the Bank and its customers is a prerequisite for all lending, along with the customer's ability and willingness to repay in a timely manner. Sufficient collateral alone cannot justify lending to customers with insufficient payment capacity. The Bank's *Sustainability Policy* mandates that sustainability and ESG risk is evaluated in the credit granting and risk assessment process.

Exhibit 4.1. Schematic overview of the Bank's credit process. Loan applications can be received through the Bank's Call Centre as well as the Bank's mobile and online banking platforms.



To mitigate risk, the Bank requires collateral that is appropriate for the product offered. For some products, such as relatively small overdrafts to individuals, no collateral is required, given that the customer's creditworthiness meets the Bank's criteria. Since the Bank does not seize collateral unless a borrower faces serious repayment difficulties, the valuation of collateral focuses on its future expected value at the time of default. The Bank has appointed a Collateral Council that reviews and proposes guidelines for the valuation of collateral and pledged assets. The objective is to ensure that the valuation of collateral is coordinated throughout the Bank.

As the first line of defence, the business units continuously monitor their loan portfolio and periodically re-assess customers' performance, based on both internal and external data. Collection procedures are set to be agile and swift to keep arrears at minimum. Loan covenants are monitored, and appropriate actions are taken to protect the Bank's interests if there are covenant breaches.

Customers that show signs of financial difficulties are placed on an internal watchlist and monitored carefully. When restructuring measures are more appropriate than collection procedures, the Bank can offer several measures and restructuring frameworks for customers in financial difficulties. Forbearance measures include temporary payment holidays, extension of loan terms, capitalisation of arrears, and waiving of covenants. In cases when these measures are not sufficient, they may serve as precursors to a more formal restructuring process. Formal legal collection and liquidation of collateral is the final step of the collection process if other measures are not successful.

4.2 Measurement and Monitoring

Portfolio credit risk is measured both in terms of current events and possible future events. Current events include non-performing ratios, the scope of forbearance agreements and impairment allowance for defaulted facilities, while possible future events are captured by measurements such as the probability of default and the impairment allowance for non-defaulted facilities.

To ensure that the Bank charges an adequate interest rate and that it has sufficient capital reserves to ensure long-term sustainability, the Bank estimates expected and unexpected losses of its loan portfolio.

The long-term expected credit loss on the loan portfolio is covered by a part of the interest rate margin. Due to various underlying factors, the observed annual losses can fluctuate significantly around the long-term average, sometimes up to an order of magnitude. To be able to cover these unexpected losses at any time, the Bank holds a substantial capital buffer against these fluctuations. An adequate return on this capital buffer also needs to be covered by the interest rate margin.

The annual expected credit loss (ECL) for a single obligor depends on the probability that the obligor defaults within the horizon of one year (PD), the expected exposure at time of default (EAD), and the loss given default (LGD), expressed as a fraction of the exposure at default:

$$ECL = PD \cdot LGD \cdot EAD$$

Under IFRS 9, all loans are required to carry an impairment allowance of either 12-month expected credit loss or, in case of a significant increase in credit risk since origination, lifetime expected credit loss. This impairment allowance is calculated using several different scenarios for the future economic development and the final result is the probability-weighted average of the ECL in these scenarios. The calculation of the impairment allowance under IFRS 9 is further discussed in Note 64.3 in the Consolidated Financial Statements.

The main drivers for the unexpected portfolio loss are correlations between obligor defaults within the portfolio. These correlations may be due to common dependencies on macro-economic factors or due to business relations between individual obligors.

4.2.1 Definition of Default

The Bank's definition of default has been designed so that it simultaneously satisfies the requirements in the definition of Stage 3 according to IFRS 9, the definition of default according to Article 178 of CRR, and the definition of non-performing exposure used in FINREP. Defaults are defined on the obligor level rather than the facility level. Obligors are considered to be in default according to the current definition if (a) it is the opinion of the Bank that it is unlikely that they will fulfil the terms of their contracts or (b) they have been more than 90 days past due on material credit obligations.

The assessment under point (a) is based on a defined set of triggers, some of which are fully objective, while others are based on subjective evaluation. The general rule is that if any one of these triggers is activated, the customer is deemed to be in default. Furthermore, customers are required to actively demonstrate that there is no longer any reason for the Bank to consider them in default.

The triggers that activate default include when the customer's revenues do not sustain their level of indebtedness, when the customer is in serious breach of covenants in their loan contracts, when the Bank has initiated serious collection measures, when the customer has been given a serious registration on an internal watchlist, and when there are certain registrations on an external credit bureau watchlist.

Triggers that indicate that a customer is no longer in default include maintaining normal repayments over a certain period, completing a period of probation, and experiencing a change due to an event such as a merger or acquisition that significantly improves their financial position.

4.2.2 Probability of Default

The way an obligor's probability of default (PD) is assessed depends on the obligor type. Exhibit 4.2 shows the methods used to assess the risk for different obligor types, as well as the number of obligors and the relative size of exposure for each obligor type.

The Bank uses internal rating models to assess the PD for companies and individuals. The rating of large

Exhibit 4.2. Methods used to assess the default risk of different obligor types, approximate number of obligors and relative size of on-balance-sheet exposure at year-end 2024.

Obligor type	PD assessment	Number of obligors	Exposure
		(approx. count)	(%)
Individuals	Statistical model	91,000	41.0%
Small companies	Statistical model	10,000	6.2%
Large companies	Hybrid model	500	34.0%
Credit institutions	Expert model	100	6.0%
Regional governments	Expert model	20	1.3%
Sovereigns	Expert model	10	11.5%

Exhibit 4.3. Average long-term PD levels per risk class for the different rating models at end of year 2024.

Risk group	Risk class	Large companies	Small companies	Individuals
		(%)	(%)	(%)
Low	1	0.3	0.2	0.1
	2	0.4	0.4	0.4
	3	0.8	0.8	0.9
	4	1.3	1.6	1.4
Medium	5	2.3	2.7	2.1
	6	4.1	4.2	3.1
Increased	7	7.1	7.3	5.4
	8	12.5	15.3	11.9
High	9	21.8	37.1	35.4

companies is a hybrid model based on a company's most recent financial statements, together with a qualitative assessment of its management, market position and industry sector. The model assigns each obligor to one of ten risk classes. Risk class 10 is reserved for obligors in default and risk classes 1–9 for other obligors.

For individuals and small companies, the Bank uses two different statistical rating models. These models are behavioural scoring models and use information about a customer's payment history, amount of debt and deposits and demographic variables to assess the probability that a customer will default on any of their obligations within 12 months of the rating assessment.

4.2.3 Observed Default Frequency

The Bank's PD models predict the long-term average of the one-year default rate while the observed default frequency (ODF) depends on the current state of the economy.

In 2024 there were a handful of observed defaults for large companies in the Bank's portfolio, which translates to a 1.2% default frequency compared to a predicted default probability of 4.5%. The defaults were so few that a meaningful comparison of the observed default frequency and the predicted probability of default per risk class is not possible.

For individuals and small companies, however, the number of defaults allow for a meaningful breakdown by risk classes, as shown in Exhibits 4.4 and 4.5. Risk classes 1 through 4 are grouped together due to few defaults in those classes. The mapping from PD to risk classes for the years 2022 to 2024 differ from those of previous years, both for individuals and small companies, due to a recalibration of the corresponding rating models at year-end 2021.

Despite high interest rates and persistent inflation for the past few years, households and businesses have demonstrated greater resilience after COVID-19 than has been observed historically. Thus, a discrepancy between ODF and predicted default rates is not necessarily a cause for concern. The ODF was 1.5% compared to the 3.2% predicted probability of default for individuals, while corresponding rates were 3.1% and 8.8% for small companies, respectively.

4.2.4 Loss Given Default

The loss given default (LGD) represents the percentage of exposure expected to be lost if an obligor defaults. The LGD mostly depends on collateralisation and other credit mitigants. However, in many cases defaulted customers become performing again without the need to seize collateral. To take historically observed loss experience into account, while also allowing for

Exhibit 4.4. Observed default frequency (dots) and the range of the predicted through-the-cycle probability of default (vertical lines) by risk class for individuals in 2024, results from other years shown for comparison. Logarithmic scale.

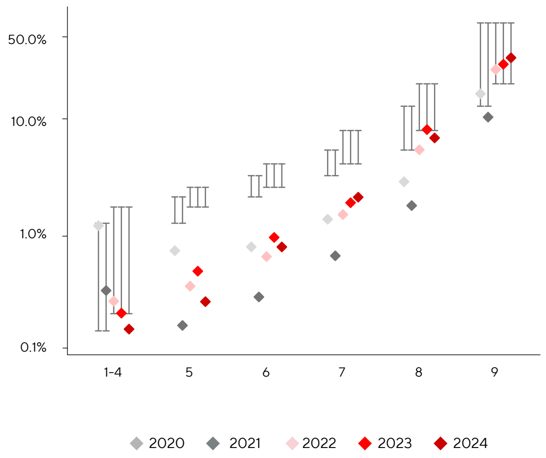
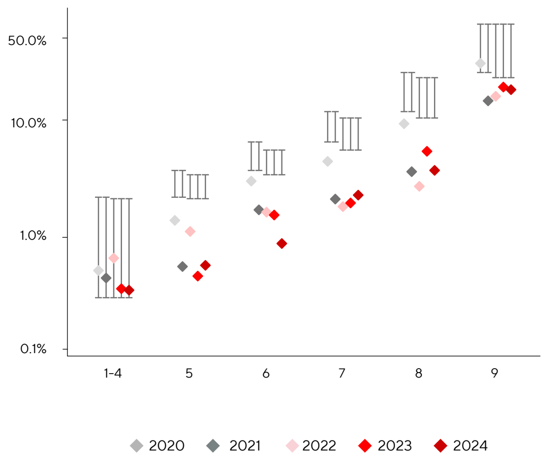


Exhibit 4.5. Observed default frequency (dots) and the range of the predicted through-the-cycle probability of default (vertical lines) by risk class for small companies in 2024, results from other years shown for comparison. Logarithmic scale.



a risk-sensitive differentiation of the portfolio, LGD is modelled using loss severity in several different scenarios. One of the scenarios considered is that the facility becomes performing again without intervention by the Bank and the probability of that scenario is the so-called cure rate. The other scenarios assume that recoveries are based on the seizing of collateral and apply different haircuts according to the type of collateral and scenario. The haircuts are applied to the most current and appropriate valuation of the pledged collateral and take into account cost of sale, depreciation of value and discounting of recovery cash flows. The resulting amounts are allocated to eligible exposures by maximising the total collateralisation of the exposure amount subject to constraints imposed by the collateral agreements.

In 2024, the Bank began utilising an LGD model specifically for uncollateralised consumer loans belonging to individuals, namely credit cards and overdrafts. This model was trained on historical loss experience for these types of loans. For facilities and obligors, where collateral is generally not pledged, the estimate of LGD may be based on a specific assessment.

During 2024, components of the LGD model were recalibrated, including a part that evaluates cure rate for facilities belonging to customers that are in default and haircuts of specific asset types. These calibrations and the utilisation of the above mentioned LGD model for uncollateralised consumer loans for individuals resulted in a reversal of the impairment allowance.

4.2.5 Exposure at Default

To model exposure at default (EAD), the Bank currently applies the supervisory credit conversion factors (CCF) stipulated by CRR to unutilised amounts:

$$EAD = Drawn\ amount + CCF \cdot Undrawn\ amount$$

The Bank has developed models for exposure at default that take the expected amortisation schedule into account and these models are used in calculations of both the 12-month and lifetime expected credit losses in IFRS 9. The EAD shown here is, however, the one found for capital requirement purposes and not for IFRS 9.

4.3 Credit Concentration

The Bank monitors credit concentration risk which arises from the unequal and granular distribution of exposure to borrowers, industry sectors and geographic regions. The portfolio concentration is monitored and constrained by limits set in the *Risk Appetite Statement.*

4.3.1 Borrower Concentration

The Bank actively seeks to limit large exposures. A large exposure is defined as an exposure to a group of connected clients that is 10% or more of the Bank's Tier 1 capital. The exposure is evaluated both before and after application of eligible credit risk mitigating effects according to relevant rules. When assessing the exposure, both on-balance sheet items and off-balance sheet items from all types of financial instruments are included. The Bank has internal criteria where groups of connected clients are defined in line with Icelandic law and EBA guidelines.

At year-end 2024, the Bank had two large exposures after eligible credit risk mitigating effects that amounted to 20.9% of the Bank's Tier 1 capital. This is a reduction compared to the two large exposures that amounted to 25% of the Bank's Tier 1 capital at year-end 2023.

The Bank seeks to limit borrower concentration risk and has an internal limit on the aggregated exposures to the 20 largest groups of connected clients.

4.3.2 Industry Sector Concentration

The Bank defines industry sectors as groups of entities that have similar primary activities, underlying risk factors and behaviour characteristics. The sector classification is generally based on information from the tax authorities although the Bank has the possibility to reclassify customers internally based on a "see-trough principle" when another sector is more descriptive of the underlying risk.

In the case of real estate companies, this can be appropriate if the real estate is specialised, and the credit risk depends more on the operations located in the building than general real estate or rental prices.

The Bank has limits on both the exposure to any single economic industry sector as well as the aggregated exposure to the three largest economic industry sectors as a percentage of the Bank's total credit exposure. Exposure to individuals, as an economic industry sector, is also considered separately.

The tourism industry is an important economic sector in Iceland but due to the nature of tourism, its effects are not limited to hotels, car rentals and tour guides. The Bank therefore monitors the tourism industry internally as a quasi-sector instead of a new separate sector.

4.3.3 Geographic Concentration

Country risk is the risk of losses that may occur, for example, due to economic difficulties or political unrest in countries to which the Bank has exposures. Country risk includes political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, i.e., economic factors that could have significant influence on the business environment.

Specific geographical limits are established to manage country risk. The geographical limits apply to the country from where the credit risk arises. Iceland is considered to be a home market and is as such not subject to geographical limits.

Most of the Bank's activities are in Iceland although the Bank maintains a certain level of international activities. The overseas strategy is built on a heritage of servicing the key industries in Iceland with increasing focus on infrastructure and leverage finance projects. The strategy focuses on the North Atlantic region and Europe.

4.3.4 Product Concentration and Collateral Concentration

The Bank regularly monitors product concentration and collateral concentration but neither type is currently considered to be material.

Credit exposure that is not a part of the Bank´s principal lending activity is limited in the Bank's *Risk Appetite Statement*. Primarily, this includes lending to holding companies collateralised by shares in operating companies.

4.4 Settlement Risk

Settlement risk is the risk that a party will fail to deliver on the terms of a contract at the time of settlement. Settlement loss can occur because of a default or liquidity event at settlement and because of any timing differences in settlement between two parties. The amount at risk or the potential loss is the principal of the transaction.

To mitigate settlement risk on counterparties, the Bank utilises the services of clearing houses and applies the general rule of delivery versus payment. If such a rule is not applicable due to the nature of the business relationship, a settlement limit is assigned to the counterparty to limit the risk.

4.5 Counterparty Credit Risk

Counterparty credit risk (CCR) is the risk arising from the possibility that the counterparty may default on amounts owed on a derivative transaction.

The Bank takes on CCR when entering into derivative transactions. This includes, but is not limited to, interest rate swaps, cross-currency swaps, equity and bond forwards and foreign exchange forwards and swaps.

Customers enter into derivative contracts with the Bank either to take on speculative positions or to hedge risk for the customer's own risk mitigation purposes. Derivative contracts with customers are generally done on margin where customers post collateral to the Bank. The Bank's objective in setting margin requirements is to have adequate collateral to absorb any losses that the position could suffer before the Bank is able to close the position. Margin requirements are decided based on the underlying product and its characteristics, such as volatility and liquidity. In addition to cash, the Bank accepts selected stocks and bonds as collateral posted for margin trades. Non-cash collateral is subject to haircuts depending on risk characteristics such as the issuer and duration in the case of bonds and volatility and liquidity in the case of stocks. The Bank uses netting across contracts of the same counterparty to allow profits in one contract to offset collateral requirement in another contract. To mitigate wrong-way risk, the Bank generally does not accept collateral that is correlated with the asset underlying the respective customers' derivative contracts. The Bank may waive collateral requirements where the purpose of the derivative contract is to mitigate the customer's own risk, subject to certain conditions, including an approved credit limit based on the customer's creditworthiness. Limits are also set to manage the concentration risk towards single issuers or instruments and thus to manage the risk of the instruments becoming illiquid.

The Bank actively uses derivatives to hedge currency, interest, and inflation exposures. Such derivative contracts are generally subject to ISDA master agreements with a Credit Support Annex, or similar terms, with collateral in the form of cash and eligible bonds. Counterparties in these contracts are also subject to approved credit limits.

When setting credit limits for counterparties in derivative contracts, the Bank follows the same process as for other credit exposure and, as for credit concentration risk in general, credit limits for counterparties are constrained by various concentration limits, many of which are defined in terms of the Bank's capital base. This is discussed further in Section 4.3.

Information on CCR exposures, broken down by various characteristics, is provided in CCR1, CCR2, CCR3, CCR5, and CCR6 in the Additional Pillar 3 Disclosures.

4.6 Credit Risk Exposures

Credit risk exposure comprises both on-balance sheet and off-balance sheet items. Exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the Consolidated Financial Statements, see Template LI1 in the Additional Pillar 3 Disclosures. The exposure for off-balance sheet items is the amount that the Bank might have to pay out against financial guarantees and loan commitments, less the impairment the Bank has made for these items, but before applying credit conversion factors. The regulatory exposure amount under the credit risk framework for capital requirement purposes does not reconcile with the carrying amount in the Consolidated Financial Statements mostly due to the contribution of off-balance sheet items, see Template LI2 in the Additional Pillar 3 Disclosures for details on the difference.

Exhibit 4.6. The main sources of credit risk.

Item	Obligor type	Description
Loans to customers	Individuals and households	Loans to individuals derive from lending activities to individuals and households. The largest product type is mortgages, but it also includes term loans, car loans and leasing agreements, credit cards and overdrafts.
	Companies, municipalities, public-sector entities	Loans to companies as well as municipalities and public-sector entities. This includes long-term facilities, leases and asset-based financing, working capital facilities and other short-term financing, project finance, and financing of income producing real estate.
Cash and balances with Central Bank and loans to credit institutions	Financial institutions and Central Bank	Mandatory reserve deposits and other balances with the Central Bank as well as other exposures to international banks and financial institutions, for example as part of the Bank's liquidity management.
Bonds and debt instruments	Government entities, issuers of listed bonds approved by the Bank's credit committees	The Bank is exposed to credit risk due to investment in debt instruments, for example as part of the Bank's liquidity management.
Derivatives	Qualified counterparties with defined credit limits at the Bank	Derivatives and other financial instruments that involve contingent exposures.
Shares and equity instruments		Shares and equity instruments in the banking book mainly consist of strategic equity investments to support the Bank's operations. the Bank's equity investment desk.
Other assets		Account receivables, property and equipment, non-current assets and disposal groups held for sale.
Off-balance sheet items	Same as loans to customers	This includes unused overdrafts and credit card limits, undrawn amounts in credit agreements and project finance agreements, letters of credit, and export documentary credits.

Exhibit 4.7. The main sources for credit risk at year-end 2024 and 2023. Exposure for off-balance sheet items is the nominal amount, otherwise it is the carrying amount (ISK bn). Consolidated.

	31.12.2024		31.12.2023	
Credit risk	**Exposure**	**Regulatory exposure amount under the credit risk framework**	**Exposure**	**Regulatory exposure amount under the credit risk framework**
Loans to customers	1,295.4	1,295.4	1,223.4	1,223,4
Cash and balances with Central Bank and loans to credit institutions	116.2	116.2	161.0	161.0
Bonds and debt instruments	142.6	135.0	161.3	155.5
Derivatives	12.6	9.2	5.8	11.2
Shares and equity instruments	29.0	8.7	17.3	7.6
Other assets	19.2	12.9	13.9	10.6
Off-balance sheet items	192.2	57.6	197.9	53.2
Total	**1,807.2**	**1,635.0**	**1,780.6**	**1,622.6**

For capital requirement purposes, credit conversion factors (CCF) are applied to guarantees and undrawn commitments. For derivative contracts, the exposure is calculated according to the simplified standardised method by adding potential future credit exposure to the replacement cost of the contract. The Bank currently has no direct credit exposure to securitisation.

Exhibit 4.6 summarises and describes the main sources of credit risk, while Exhibit 4.7 shows the main sources for credit risk at year-end 2024 and 2023.

4.6.1 Cash and Balances with Central Bank and Loans to Credit Institutions

Cash and balances with Central Bank and loans to credit institutions can fluctuate considerably between periods due to liquidity management. Exhibit 4.8 shows a breakdown of these exposures at year-end 2024 and 2023.

Cash and balances with the Central Bank include CB deposits, minimum reserve requirements, and other balances with the Central Bank.

Exhibit 4.8. Cash and balances with the Central Bank and loans to credit institutions at year-end 2024 and 2023, by risk weights (net carrying amount, ISK bn). Consolidated.

Type of institution	31.12.2024	31.12.2023
Central Bank	65.7	87.5
Domestic credit institutions	2.9	1.2
Foreign credit institutions	47.6	72.2
thereof in risk weight 20%	45.8	70.0
thereof in risk weight 50%	1.8	2.2
thereof in risk weight 100%	-	-
Total	**116.2**	**161.0**

The Bank has exposures to domestic and foreign credit institutions, mostly in the form of money-market deposits and nostro accounts.

Exposures are only granted to credit institutions that have been allocated a credit limit by the Senior Credit Committee. When applying for a credit limit for a specific credit institution, a thorough analysis of the institution is presented to the committee, including credit ratings from rating agencies, as appropriate.

Exhibit 4.9. Bonds and debt instruments at year-end 2024 and 2023, by risk framework (net carrying amount, ISK bn). Consolidated.

Bonds and debt instruments	31.12.2024	31.12.2023
Subject to the credit risk framework	**135.2**	**155.5**
Icelandic government	96.4	72.8
Foreign government bills	7.2	82
Foreign credit institutions	18.2	0.7
Domestic credit institutions	8.3	-
Domestic corporates - government guaranteed	5.1	-
Subject to the market risk framework	**3.5**	**5.8**
Icelandic government	2.5	1.5
Domestic credit institutions	0.9	0.6
Domestic corporates	0.0	0.0
Economical hedging bonds	4.4	3.7
Total	**138.6**	**161.3**

4.6.2 Bonds and Debt Instruments

The Bank is exposed to credit risk as a result of investing in bonds and debt instruments, primarily as part of its liquidity management activities.

Exhibit 4.10. Off-balance sheet items at year-end 2024 and 2023, by product type. Consolidated.

	31.12.2024			31.12.2023		
Product type	**Maximum exposure to credit risk**	**After CCF**	**Effective CCF**	**Maximum exposure to credit risk**	**After CCF**	**Effective CCF**
	(ISK bn)	(ISK bn)		(ISK bn)	(ISK bn)	
Undrawn loan commitments	170.9	46.1	27%	176.2	42.6	24%
Financial guarantees	21.4	11.4	54%	20.9	10.6	51%
Total	**192.2**	**57.6**	**30%**	**197.1**	**53.2**	**27%**

4.6.3 Derivatives

The Bank uses derivatives to hedge currency, interest and inflation exposure. Exposure under the credit risk framework for derivatives amounted to ISK 11.9bn at year-end 2024 compared to ISK 9.2bn the year before. See Templates CRR1-CRR5 in the Additional Pillar 3 Disclosures for further breakdown.

4.6.4 Off-Balance Sheet Items

The Bank's maximum exposure to credit risk deriving from off-balance sheet items totalled ISK 192bn at year-end 2024 compared to ISK 197bn the year before, see Exhibit 4.10. For regulatory purposes a credit conversion factor (CCF) is applied to calculate the exposure under the credit risk framework. Calculated in this way, the regulatory credit exposure deriving from off-balance sheet items totalled ISK 57.6bn at year-end 2024 compared to ISK 53bn at year-end 2023.

4.6.5 Country Risk Exposure

Exposure to countries other than Iceland amounted to ISK 93.8bn at year-end 2024 compared to ISK 187bn the year before. This exposure relates mainly to the management of the Bank's foreign liquidity reserves. The Bank has no retail lending activities outside of Iceland but maintains a modestly sized portfolio of lending to companies outside its home market. The exposure to companies within this portfolio was ISK 14.5bn at year-end 2024.

4.7 Loans to Customers

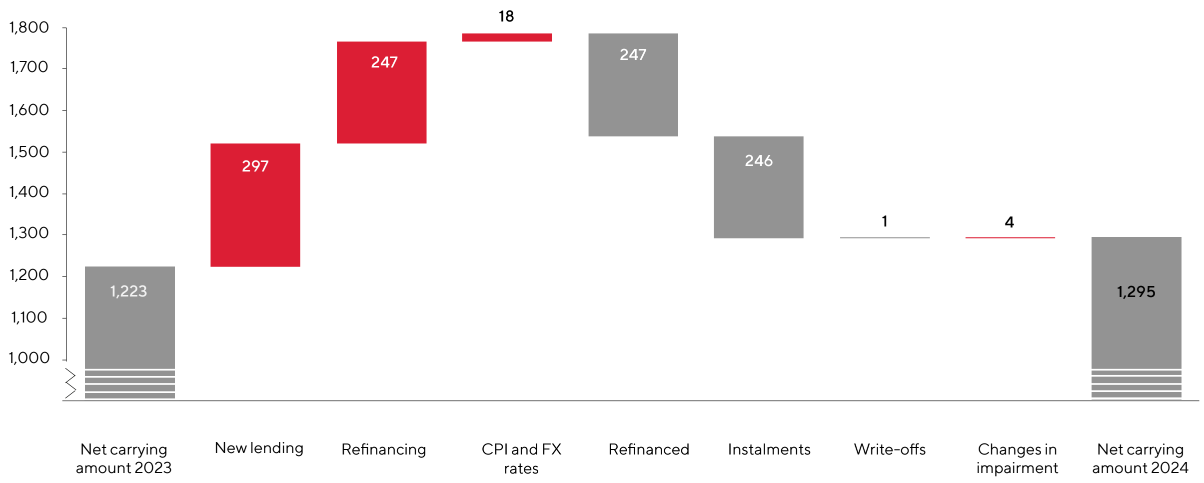
Loans to customers, both individuals and companies, represent the largest part of the Bank's credit risk exposure. This section describes the portfolio of loans to customers and its development.

4.7.1 Development of the Loan Portfolio

At year-end 2024 the net carrying amount of the portfolio of loans to customers was ISK 1,295bn, having grown from ISK 1,224bn at year-end 2023. This growth of 5.8% is mainly due to the increase in the mortgage portfolio which grew by ISK 33bn on the back of ISK 544bn in lending, a part of which was due to strong growth in the housing market and partly due to refinancing of outstanding mortgages.

Exhibit 4.11 shows the development of the loan portfolio through 2024.

Exhibit 4.11. The main sources of changes in the net carrying amount of loans to customers from year-end 2023 to year-end 2024. Outstanding loans that are refinanced within the Bank are shown both as an increase and a decrease in the net carrying amount. Regular instalments, pre-payments and loans that are fully repaid are all shown as instalments in this chart. (ISK bn). Consolidated.



4.7.2 Currency Composition of Loans to Customers

As a principle, the Bank aims to have the currency composition of loans to customers aligned with customer needs. In particular, loans to customers whose income is predominantly in ISK should be denominated in ISK. The Bank has in place rules regarding lending in foreign currency, ensuring management of this risk. Exhibit 4.12 shows a breakdown of loans to customers by industry sectors and currency types. Loans to customers are categorised into three currency types, Non-indexed ISK, Consumer Price Index (CPI) linked ISK and Foreign currency (FX).

Exhibit 4.12. Currency composition of loans to customers at year-end 2024 (net carrying amount, ISK bn). Consolidated.

Industry sector	Non-indexed	CPI-linked	Foreign currency	Total
Individuals	272.2	352.9	0.1	625.2
Commerce and Services	139.4	27.2	18.5	185.2
Construction	79.3	16.4	-	95.7
Energy	4.0	6.9	1.0	11.9
Financial services	0.7	-	-	0.7
Industrials and Transportation	54.4	4.2	23.9	82.5
Investment companies	24.7	7.4	10.8	43.0
Public sector and non-profit organisations	19.4	1.0	-	20.3
Real estate	64.9	85.3	4.7	154.9
Seafood	4.0	0.3	72.3	76.6
Total	**663.0**	**501.6**	**131.3**	**1,295.9**
Total as %	51.2%	38.7%	10.1%	100.0%
Total % at year-end 2023	56.9%	33.2%	10.0%	100.0%

4.7.3 Loans to Individuals

Loans to individuals amounted to ISK 625bn at year-end 2024 compared to ISK 595bn the year before. New loans and refinancing amounted to ISK 131bn.

Loans to individuals derive from lending activities to individuals and households. They can be categorised into five product types, i.e., mortgages, term loans, credit cards, overdrafts, and leasing. Each product type serves a different purpose and has unique features to cater to the varied financial needs of individuals and households.

The largest part of loans to individuals is in the form of residential real estate mortgages. Mortgages are granted to individuals to buy or refinance real estate for their own use. The Bank utilises a fully digital and automatic credit score evaluation for mortgages. With the customer's permission, the Bank gathers information from third parties, such as other financial institutions and tax authorities, and provides a credit score within three minutes. The loan application process is fully automated, from the customer's selection of a property, through the selection of a loan structure and to the submittal of loan application. Applicants can track the status of their application and most signatures in the process are electronic.

Mortgages are secured by the first lien on the residential real estate or consecutive liens from and including the first lien. The Bank actively manages the mortgage portfolio, making payment processing effortless with automatic transfers and timely initiation of collection procedures if payments are late.

Term loans to individuals are often secured with residential real estate but do not meet all the requirements needed to be classified as mortgages. These loans may have a non-standard term structure, or the purpose of the loan may not have been to acquire the underlying property. Term loans are generally not as well collateralised as mortgages. Some term loans are uncollateralised consumer loans granted by an automated process through the Bank's app. The last group of term loans are loans provided to individuals for purchases of vehicles, mostly cars and campers. These loans are usually well collateralised.

Credit cards and overdrafts to individuals are usually uncollateralised short-term consumer loans. They are used to meet fluctuations in cash flows and the outstanding amounts per customer are typically low. It is expected that future earning-ability of individuals is sufficient for repayment without a formal collateral. In CRR 3, credit cards and overdrafts that satisfy certain conditions will qualify as transactors and will be subject to a 45% risk weight.

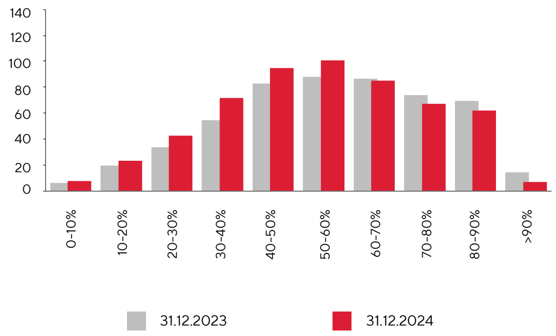
Leasing agreements are provided to individuals for purchases of vehicles, mostly cars and campers. These agreements are usually well collateralised. For credit risk purposes these leasing agreements are very similar to loans provided for the same purpose.

The loan-to-value (LTV) ratio is an important factor when measuring the risk of a mortgage portfolio. The LTV for a single mortgage is the current net carrying amount of the loan divided by the value of the property. The value of residential real estate (RRE) is usually taken as the estimate from a statistical pricing tool provided by a third party, which is based on market transaction data and estimates the market value of the property on a monthly basis. However, for newly granted mortgages, the purchase price of the property can be used as a valuation while it is considered more accurate. For other types of real estate, the value of the property is usually the tax value obtained from Registers Iceland or the purchase price if it is recent. For mortgages that are not on the first lien, the cumulative loan-to-value (CLTV) is the sum of the current carrying amount of the loan under consideration and the outstanding balance of all previous liens, divided by the value of the property. For a portfolio of mortgages, however, the LTV can be represented in various ways depending on the intended usage. Here, two such representations are presented.

The first representation is from the property point of view. To find the average LTV of a mortgage portfolio, each property is assigned the maximum CLTV value of the Bank's mortgages on that property and that value is weighted with the total carrying amount of the Bank's loans on the property. The weighted average LTV, calculated in the manner described, was 54% at year-end 2024 compared to 57% at year-end 2023.

Exhibit 4.13 shows the LTV distribution by categorising the total carrying amount of the Bank's loans on each property in the mortgage portfolio by the maximum

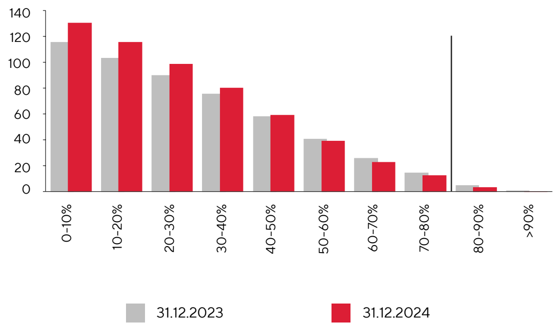
Exhibit 4.13. Breakdown of the mortgage portfolio by the LTV calculated for each property, year-end 2024 and 2023 (net carrying amount, ISK bn). Consolidated.



CLTV for that property. Note that the calculation is based on available data at year-end and for newly granted mortgages there is a few weeks lag in the official lien registration. The classification for loans with over 90% CLTV is temporary and not descriptive for long-term collateralisation.

Another way to represent the LTV of a mortgage portfolio is to consider how each part of the loan amount is distributed in LTV bands. In the breakdown, each part of the loan amount is categorised according to its ranking in the total debt on the property. The first band represents the part of the portfolio that falls in the 0–10% LTV band, the second represents the part that falls in the 10–20% LTV band and so on. Exhibit 4.14 shows how the mortgage portfolio is distributed in LTV bands defined in this way.

Exhibit 4.14. Breakdown of the mortgage portfolio by LTV bands, year-end 2024 and 2023 (net carrying amount, ISK bn). See main text for further explanation. Consolidated.



For capital requirement assessment purposes, residential real estate mortgages to individuals are divided into two segments, the part that is covered up to 80% LTV and the amount that exceeds 80% LTV. The part with an LTV below 80% is potentially eligible for a 35% risk weight when calculating the capital requirements as compared to 75% for the remaining part. One of the benefits of the representation shown in Exhibit 4.14 is that the part of the mortgage portfolio that is potentially eligible for a 35% risk weight is on the left side of a vertical line drawn at 80% LTV in Exhibit 4.14, this amount cannot be inferred from Exhibit 4.13. With the introduction of CRR 3, the risk weights of residential real estate mortgages will be adjusted. Specifically, the portion of a loan with an LTV below 55% will be potentially eligible for a 20% risk weight, while the remaining portion will continue to be subject to a 75% risk weight. The representation in Exhibit 4.14 enables an estimation of the effect of this regulatory change to the REA.

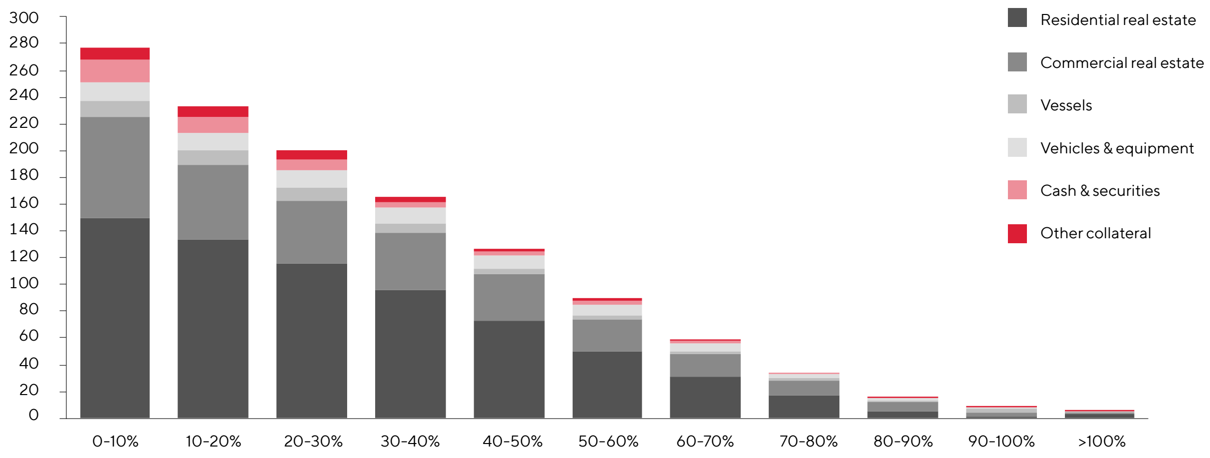
4.7.4 Loans to Companies

The category *loans to companies* includes loans to companies as well as municipalities and public sector entities. These loans comprise a significant part of the Bank's balance sheet and operation. Loans to companies amounted to ISK 670bn at year-end 2024 compared to ISK 629bn at year-end 2023. New loans and refinancing of outstanding loans amounted to ISK 412bn in 2024.

Credit policies are in place to ensure that companies have the capacity to repay their loans. The Bank also takes collateral to minimise loss in case of default.

Note 48 in the Consolidated Financial Statements show the maximum credit risk exposure for loans to companies, broken down by industrial sectors, and the type of collateral held against these exposures.

Exhibit 4.15. The continuous LTV distribution of the portfolio of loans to customers by type of underlying asset at year-end 2024 (ISK bn). Consolidated.



4.8 Loans Covered by Collateral

Collateral and other credit risk mitigants vary between types of obligors and credit facilities. Loans to eligible credit institutions are usually unsecured. For loans to individuals, the principal collateral pledged is residential property against mortgages. Unsecured loans to individuals are mostly short-term consumer loans such as overdrafts and credit cards. In the case of large companies, pledged collateral includes real estate, fishing vessels, cash and securities, as well as other collaterals such as accounts receivable, inventory, vehicles and equipment. Loans to government entities and municipalities are generally unsecured. The measured credit risk exposure of loans is not affected by the pledged collateral.

In some cases, the Bank uses guarantees as credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not represent a reduction in exposure to credit risk although they may strengthen its quality. The guarantees which the Bank accepts are from parties which have some association with the obligor, e.g., direct ownership. Thus, the Bank does not use general credit derivatives to mitigate credit risk. Covenants in loan agreements are also an important credit enhancement though they do not reduce credit exposure.

Valuation of collateral is based on market price, an official valuation from Registers Iceland, statistical models, or the expert assessment of the Bank's employees, depending on availability. In the case of fishing vessels, the assigned fishing quota is included in the valuation, based on a valuation by the Bank's Collateral Council. Valuations can only be valid for a certain amount of time and must therefore be reassessed regularly. Since the price volatility differs between asset classes it is interesting to consider how the LTV distribution of the portfolio is split between these classes. This LTV distribution is shown in Exhibit 4.15.

4.9 Risk Profile

As described in Section 4.2.2, each obligor is assigned a risk class depending on how likely they are considered to default in the next 12 months. Note 49 in the Consolidated Financial Statements shows the breakdown of loans to customers, off-balance sheet loan commitments, and financial guarantees into risk

Exhibit 4.16. Loans individuals by risk groups and stage at year-end 2024 (net carrying amount, ISK bn). Consolidated.

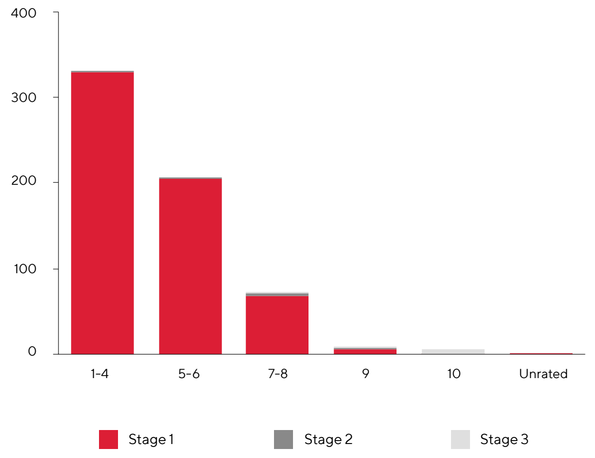
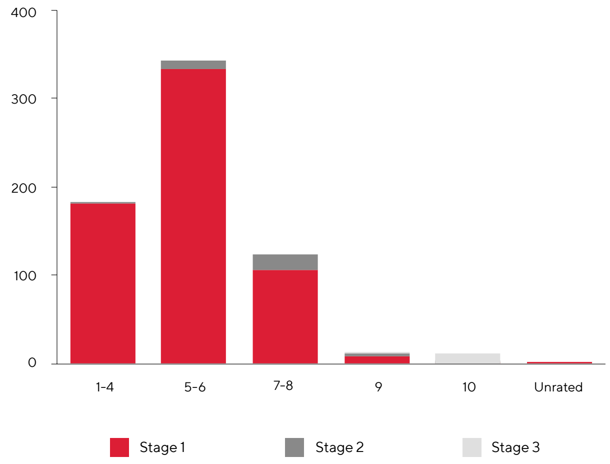


Exhibit 4.17. Loans companies by risk groups and stage at year-end 2024 (net carrying amount, ISK bn). Consolidated.



With the introduction of CRR 3, significant changes will be made to the risk weights assigned to loans secured by real estate. While the distinction between residential real estate (RRE) and commercial real estate (CRE) remains, the new regulation introduces further categorisation in the Standardised Approach based on the specific use of the real estate.

Acquisition, Development, and Construction (ADC):
This new category encompasses properties that are under construction. Loans in the ADC category will typically carry higher a higher risk weight of 150% due to the added uncertainty and risk associated with properties under development.

Income-Producing Real Estate (IPRE):
This category is for exposures that are materially dependent on cash flows generated by the property, typically because the underlying real estate is being rented out. The risk weight will depend on the LTV using the whole loan approach (as opposed to the loan-splitting approach). The risk weight also depends on whether this is residential (from 30% to 105%) or commercial real estate (from 70% to 110% risk weight).

General Real Estate: This category includes exposures that do not materially depend on cash flows generated by the property, usually because it is used as the primary residence by the borrower in the case of residential real estate or used for the borrower's own business operations in the case of commercial real estate. The risk weights for general real estate exposures will depend on the LTV ratio but using the loan-splitting approach as shown in Exhibit 4.14. The portion of the loan with LTV up to 55% will be subject to a 20% risk weight for residential real estate and 60% risk weight for commercial real estate.

The new regulation is expected to lead to an overall reduction in REA. However the technical standards that define the criteria for the assignments of risk weights for ADC exposures have not been finalised. The technical standards that define the criteria for ADC exposures have not been finalised yet.

Exhibit 4.18. Migration of risk classes in 2024 (net carrying amount, ISK bn). Consolidated.

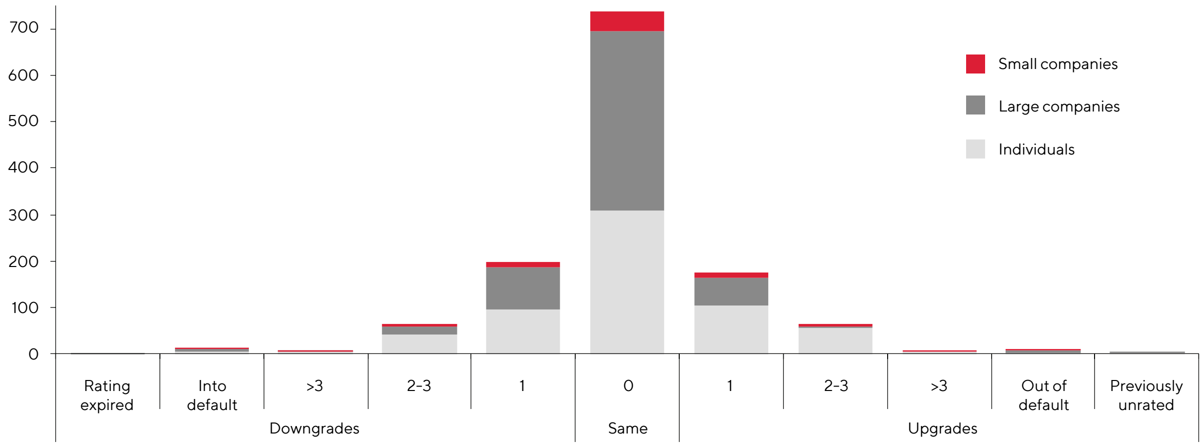


Exhibit 4.19. The expected credit loss for loans to customers at year-end 2024. Consolidated.

Stage	Gross carrying amount	PD	LGD loss rate	LGD loss severity	Effect of lifetime loss	ECL
	(ISK bn)	(%)	(%)	(%)	(%)	(%)
Stage 1	1,240.7	4	34	21	100	0.3
Stage 2	41.1	13	39	22	210	2.4
Stage 3	21.5	100	76	20	100	15.6

Exhibit 4.20. The expected credit loss for loans to customers at year-end 2023. Consolidated.

Stage	Gross carrying amount	PD	LGD loss rate	LGD loss severity	Effect of lifetime loss	ECL
	(ISK bn)	(%)	(%)	(%)	(%)	(%)
Stage 1	1,172.5	4	44	22	100	0.4
Stage 2	40.4	13	56	33	288	6.8
Stage 3	22.3	100	66	29	100	18.9

Exhibit 4.21. The Bank's definition of non-performing assets indicated by the highlighted cells.

Asset classes	Exposure	Cross default	Non-performing criteria
(can choose many)	(choose one)	(choose one)	(can choose many)
Loans to customers	Gross carrying amount	Per facility	90 days past due
Loans to Credit institutions	Net carrying amount	Per customer	Unlikeliness to pay
Off-balance sheet items	Payment in arrears	Per group of connected clients	Probation period
Other financial assets			Forbearance

class groups and stages. Exhibits 4.16 and 4.17 show the breakdown of loans to customers graphically where in addition, exposure to individuals and exposure to companies are shown separately. Exhibit 4.18 shows the migration of customers between risk classes in 2024.

According to IFRS 9, the impairment allowance, i.e. the difference between the gross and the net carrying amount, is the expected credit loss (ECL). Exhibits 4.19 and 4.20 show the breakdown of the ECL for loans to customers by IFRS 9 stages. The columns show the contribution to the ECL from the probability of default (PD) and the loss given default (LGD). For facilities in Stage 3, the PD does not apply since default has already occurred. Additionally, the LGD contribution is divided into the probability that the default will not cure, and thus lead to an economical loss (loss rate), and the expected size of the eventual economic loss (loss severity). Finally, for facilities in Stage 2, the loss allowance is equal to the expected loss for any events occurring during the lifetime of the facility, the contribution of this is shown in the column Effect of lifetime loss.

The Bank carefully monitors the non-performing loans (NPL) ratio. The NPL ratio used by the Bank, depicted in Exhibit 4.21, is based on the gross carrying amount of loans to customers that are in default (i.e., Stage 3), see Section 4.2.1 for further details on the Bank's definition of default. It's important to note that the NPL ratio may not be comparable between banks unless they use the exact same definition. The exposure amounts used to calculate the NPL ratio can be found in Note 49 in the Consolidated Financial Statements. The Bank's NPL ratio decreased to 1.6% at year-end 2024, from 1.8% at year-end 2023.

4.10 Seismic activity on the Reykjanes peninsula

In November 2023, a Phase of Emergency was declared in the town of Grindavík by the Civil Protection and over 3,000 residents were evacuated to safe areas due to the formation of a magma dike under the town centre. Since then, several volcanic eruptions have occurred right outside the town and future habitability of the area is currently uncertain.

Due to the significant increase in credit risk, loans to individuals residing in Grindavík and local businesses in the area have generally been transferred to Stage 2 in accordance with IFRS 9. Additionally, a higher haircut is applied to the value of collaterals, along with temporary management overlay to the modelled ECL. In February 2024, a government-owned real estate company Þórkatla, was established in accordance with Act no.16/2024 on the Purchase of Residential Property in Grindavík. With its establishment residence were offered to sell their residential property at 95% of their fire insurance value. In parallel, the Bank derecognised the loans and recognised a claim on Þórkatla instead. The Bank's claim on Þórkatla is classified as bonds and debt instruments measured at fair value, through profit and loss, and does therefore not contribute to the impairment allowance. As a result, the credit exposure moved to Stage 2 decreased from ISK 5.2bn (0.4% of loans to customers) at year-end and is now around ISK 1.3bn (0.1% of loans to customers).

4.11 Exposures in Default and Exposures with Forbearance

The Bank's definition of default is described in detail in Section 4.2.1. Details on exposure amounts in default can be seen in Note 49 of the Consolidated Financial Statements where Stage 3 corresponds to amounts in default. Furthermore, Templates CR1, CQ4, and CQ5 of the Additional Pillar 3 Disclosures show these amounts broken down by asset class, geographic region and industry sector.

Template CR2 of the Additional Pillar 3 Disclosures shows the development of impairment amounts and the stock of defaulted loans throughout the year.

Forbearance measures can be granted to customers facing temporary challenges or financial difficulties. For a loan to be considered as forborne, two conditions need to apply: (1) the Bank has agreed to changes to the terms of the loan that would normally not be offered to the customer and (2) the customer was in financial difficulties, making it hard for them to uphold the loan contract at the time the terms were changed. Such forbearance measures include temporary payment holidays, capitalisation of arrears, extension of loan terms, and waiving of covenants. Generally, forbearance measures are less severe than recovery actions for defaulted exposures and they do not lead to economic loss for the Bank. When the restructuring of loans corresponds to an economic loss then the obligor is classified as in default and any subsequent forbearance actions are classified as forbearance on non-performing facilities.

For households, forbearance measures are used to accommodate temporary changes in household income, for instance due to illness or unemployment. Temporary changes in terms are also granted to companies when needed, for example to meet adverse changes in the operating environment, which affect revenue and cash flows or to meet necessary but unforeseen capital expenditures. The customer is

Exhibit 4.22. Breakdown of estimated changes to REA under credit risk due to CRR 3 (ISK bn).

Exposure class	Changes to risk weights in CRR 3	Exposure	REA before		REA after		Change
		(ISK bn)	(ISK bn)	(%)	(ISK bn)	(%)	(ISK bn)
Central governments or central banks	No change	172	2	1%	2	1%	0
Regional governments or local authorities	No change	21	4	20%	4	20%	0
Public sector entities	No change	0	0	50%	0	50%	0
Institutions	Risk weight for certain credit ratings lowered from 50% to 30%.	59	13	22%	14	24%	1
Covered bonds	No change	22	4	16%	4	16%	0
Corporates	Exposure with collateral in real estate moved to another line	380	360	95%	355	93%	-5
Equity	No change for now	7	8	116%	8	116%	0
Retail exposures	Risk weight of 45% for transactors	151	88	59%	100	66%	12
Secured by mortgages on immovable property	RRE with a 20% RW up to 55% LTV (loan splitting)	537	192	36%	124	23%	-68
	CRE with a 60% RW up to 55% LTV (loan splitting)	36	24	67%	25	70%	1
	IPRE with risk weight based on the LTV (whole loan approach)	123	113	91%	100	81%	-13
	ADC with risk weight of 150%	82	77	94%	122	150%	45
Exposures in default	No change	18	24	130%	24	130%	0
Collective investment undertakings	No change	2	1	74%	1	74%	0
Other items	No change	13	13	100%	13	100%	0
Total		**1.623**	**923**	**57%**	**896**	**55%**	**-27**

expected to resume normal repayments after the concession period. Furthermore, when covenants are waived due to minor difficulties of customers then it may be classified as a forbearance measure. Note 50 in the Consolidated Financial Statements provides a summary of the Bank's forborne assets.

4.12 Capital Requirements

The Bank reports its Pillar 1 capital requirements for credit risk according to the standardised approach of the CRD. Template CR5 of the Additional Pillar 3 Disclosures shows exposure amounts, risk weights and corresponding risk-exposure amounts for the different portfolios at year-end 2024.

The capital add-on for credit risk under Pillar 2-R is estimated in the annual ICAAP process. This add-on includes credit concentration risk and underestimation of credit risk under Pillar 1.

For the purpose of the impending enforcement of CRR 3 in Iceland, Exhibit 4.22 provides an overview of credit risk products whose risk weights will be affected at Íslandsbanki, along with the estimated changes to REA. Note that the lines CRE, IPRE and ADC are shown under the exposure class 'Secured by mortgages on immovable property' in Exhibit 4.22 to anticipate the CRR 3 changes, however, currently they belong under the line 'Corporates' and therefore an exposure amounting to ISK 241bn has been moved between lines compared to Template CR5 in the Additional Pillar 3 Disclosures.

5 Market Risk

The Central Bank lowered its policy rate twice in 2024 in response to stabilising inflation, decreasing the key interest rate from 9.25% to 8.5%. Inflation constantly remained above the 2.5% Central Bank's target in 2024 as the Consumer Price Index rose by 4.8% and the ISK appreciated by 3.8% based on the Central Bank main trade-weighted ISK index. The domestic stock market rose by 18.8% in 2024 according to the stock market index OMXI15GI.

Market risk accounted for 14.6% of the Bank's total SREP capital requirement, compared to 15.4% in the previous process. Market risk as percentage of total capital base increased in 2024, mainly due to higher CPI risk.

5.1 Strategy, Organisation and Responsibility

Market risk is defined as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those resulting from changes in interest rates, inflation, equity prices and foreign exchange rates.

Market risk has been identified as one of the key risk factors in the Bank's operations. As part of its business strategy, the Bank engages in activities that involve market, aiming to maintain a moderate market risk profile in line with the Board's approved risk appetite. The objective of the Bank's market risk management framework is to manage and control market risk exposures efficiently, ensuring that the risk profile remains within the established risk appetite limits.

Market risk at Íslandsbanki originates from two areas: the trading book and the non-trading book (hereafter called the banking book).

- In the banking book, market risk arises from mismatches in assets and liabilities with respect to currencies, interest rate reset dates and CPI-indexation. It also encompasses risk related to exposures in instruments held in the long-term, positions in unlisted securities, and holdings in subsidiaries or affiliates.
- The trading book consists of market risk exposures related to short-term trading in securities, currencies, other capital market instruments, and derivatives. These positions are primarily undertaken as part of the Bank's flow trading activities and to hedge against customers' derivative contracts.

The Bank's strategy is divided into distinct approaches for the trading book and the banking book, each tailored to address their unique objectives and risk profiles:

- In the trading book, the primary objective is to maximise short-term profitability while contributing to the liquidity and efficiency of Iceland's securities market. The Bank also aims to take advantage of market opportunities through active trading, positioning itself as a key participant in promoting market depth and facilitating transactions.
- In contrast, the focus of the banking book is to stabilise net interest income, including indexation and fair value changes (NII) in the short term, while minimising fluctuations in the economic value of equity (EVE) over the long term. The Bank seeks to mitigate risks arising from changes in the yield curve, maintaining a conservative approach to protect against adverse shifts in interest rates.

The Board of Directors defines the market risk governance framework and the acceptable level of market risk through the *Risk Management and Internal Control Policy*, the *Risk Appetite Statement* and the *Market Risk Policy*.

The All Risk Committee (ARC) is responsible for the review and implementation of the *Market Risk Policy* and the market risk appetite. The Asset and Liability Committee (ALCO) makes decisions on individual proposals for assuming and pricing market risk on behalf of the Bank, ensuring these are within the appetite and limits approved by the Board and ARC. The CFO and the managing director of Corporate & Investment Banking are responsible for the market risk taken on or owned by their units and for earning an acceptable level of return on these risks. The directors of business units that take on market risk on behalf of the Bank are responsible for identifying and managing the risk in their portfolios within limits approved by the Board, ARC or ALCO.

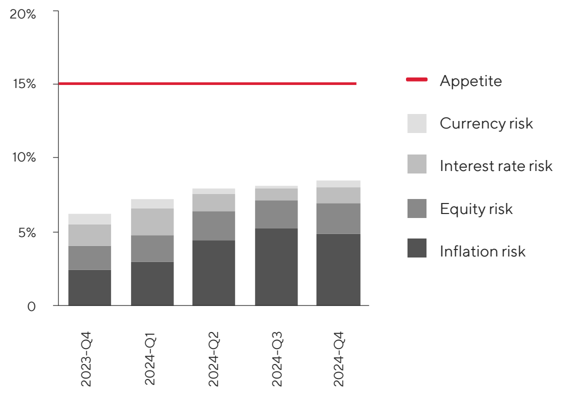
5.2 Measurement and Monitoring

The Bank uses various tools to measure, monitor and limit market risk exposures. These tools include conventional risk measures, limits on notional and sensitivity measures. The Bank's overall market risk exposure is measured according to the Bank's *Market Risk Measurement Framework* (MRMF) and the *Risk Appetite Statement* mandates that the Bank's market risk shall not exceed 15% of the Bank's capital base. The MRMF uses stress tests to calculate potential losses from extreme but plausible market events for each risk exposure, both for the current position of each portfolio, as well as the maximum position within the limits for the given portfolio. Limits are also set to manage the concentration risk towards single issuers or instruments, as well as to manage trading liquidity risk. The Bank is also exposed indirectly to market risk through customers' derivative positions. Those positions are subject to strict margin and monitoring requirements.

Exhibit 5.1. Main types of market risk within Íslandsbanki.

Risk type	Description	Origination	Main limit types
Interest rate risk	Current or prospective risk to earnings or capital arising from adverse movements in interest rates. Main sources of interest rate risk are as follows: **Gap risk:** Arising from mismatches in the timing of cash flows of assets and liabilities in the banking book and the resulting effects of changes in the yield curve (change in slope and shape of the yield curve). **Basis risk:** Arising from changing rate relationships among yield curves that affect the Bank's activities. **Optionality risk:** Arising from interest rate related options embedded in the Bank's products. **Price risk:** Arising from price changes of bonds due to changes in interest rates.	- Loans and deposits - Bonds and debt instruments - Interest rate derivatives	- BPV (basis point value) - Total position in individual securities - Supervisory Outlier Tests on Economic Value of Equity and Net Interest Income
Credit spread risk	The risk that earnings or capital may be negatively affected from adverse movements in the risk premium (credit spread or liquidity premium) for a bond's issuer.	- Bonds and debt instruments	- Issuer-specific notional limits
Inflation risk	The risk that earnings or capital may be negatively affected from unexpected changes in inflation.	- Inflation-linked loans and deposits - Inflation-linked bonds and debt instruments - Inflation-linked derivatives	- Size of the inflation imbalance relative to a neutral position
Currency risk	The risk that earnings or capital may be negatively affected from the fluctuations of foreign exchange rates, due to transactions in foreign currencies or holding assets or liabilities in foreign currencies.	- Spot positions in currencies - Foreign exchange derivatives - Foreign-currency-denominated loans and deposits	- Total currency imbalance - Total open position per currency - Total notional in underlying derivatives
Equity risk	The risk that earnings or capital may be negatively affected from the changes in the price level or volatility of equity instruments.	- Equities	- Total position in equities - Total position in individual securities

Exhibit 5.2. Market risk exposure and market risk appetite as a percentage of total capital base, average positions. Consolidated.



The business units, as the first line of defence, are responsible for:

- Continuous monitoring of the market risk inherent in their operations
- Maintaining their view on these risks
- Notifying senior management of any foreseeable breaches of limits, policies or strategic direction.

Risk Management, as the second line of defence:

- Monitors the overall market risk profile of the Group
- Ensures proper escalation of limit breaches
- Provides an independent view on all market risk taken on by the Group.

5.2.1 Credit Spread Risk in the Banking Book (CSRBB) as a part of the EBA's guidelines on Interest-Rate Risk in the Banking Book (IRRBB)

In 2023, the European Banking Authority (EBA) published updated Guidelines and Regulatory Technical Standards (RTS) on Interest Rate Risk in the Banking Book (IRRBB). These revisions applied from June 30, 2023 and were discussed in section 5.2.1 in the last Pillar 3 report.

However, the implementation date for the parts on CSRBB were delayed to December 31, 2023. Notably, EBA was directed to outline criteria for assessing and monitoring the CSRBB. Unlike IRRBB, the assessment methodology for CSRBB largely remains within the discretion of individual banking institutions.

From early 2024, the Bank started evaluating and monitoring CSRBB on a monthly basis, with a scope restrained to the non-customer asset side of the banking book, i.e. on bonds and debt instruments held for liquidity. The Bank's integration of CSRBB into its risk management framework is further discussed in the Credit Spread Risk section (5.3.2).

5.3 Market Risk Exposure

Market risk, as measured by the MRMF, increased in 2024. This was mainly due to an increase in CPI risk, mitigated by a lower currency risk and interest rate risk in the banking book. The increase in inflation risk is due to an increased demand for indexed loans. The overall market risk remains low and well within the Group's risk appetite, as seen in Exhibit 5.2.

5.3.1 Interest Rate Risk

In line with the new EBA guidelines on IRRBB, the Bank has integrated the Supervisory Outlier Tests (SOT) into its risk management framework. These tests extend analytical capabilities beyond the conventional parallel shock scenarios, enabling the Bank to comprehensively evaluate its exposure to interest rate risk under a variety of stress conditions. Furthermore, the SOT on NII provides a more granular and forward-looking assessment of IRRBB.

Exhibit 5.3. Quarter-end development of interest rate risk in 2024. Presented as the change in fair value that results from a 100 basis points parallel upward shift in yield curves (100 BPV in ISK m). Consolidated.

The Bank applies modelling assumptions, notably on Non-Maturity Deposits (NMD) for providing a more accurate measure of interest rate risk in the banking book. Non-maturing deposits are savings and current accounts that do not have a contractual term, making their cash flows uncertain. By using statistical models, the Bank can gain insights into deposit behaviour and optimise its risk management strategies. The practice of using NMD modeling to measure interest rate risk is a widely accepted practice, with EBA providing guidelines.

To manage interest rate risk, the Bank also uses sensitivity measures like basis point value (BPV). The BPV measures the effect of a 0.01 percentage point (1 basis point) parallel upward shift in the yield curve on the fair value of the underlying position. As observable from Exhibit 5.3, interest rate risk remained at a low level throughout 2024. Adjustments to the composition of the banking book during the year enabled the Bank to better cope with the expected reduction in ISK interest rates.

Interest Rate Risk in the Trading Book

All positions in the trading book are subject to BPV or duration limits, both intraday and end-of-day limits. In addition to BPV limits, there are limits on the total short and long positions in underlying bonds. The interest rate risk in the trading book was stable at a low level in 2024.

The maximum interest rate risk, measured as the absolute value of the effect of a 100 basis points parallel adverse shift in yield curves, was ISK 247m in 2024 compared to ISK 246m in 2023. An overview of the Bank's interest rate risk in the trading book is provided in Note 56 in the Consolidated Financial Statements.

Interest Rate Risk in the Banking Book

Interest rate risk in the banking book (IRRBB) arises from core banking activities. It represents the risk of loss from fluctuations in future cash flows or fair value of financial instruments as market rates change over time, reflecting the fact that the Group's assets and liabilities are repricing or maturing at different times, in addition to be priced relative to different interest rate curves. The interest rate risk in the banking book is mostly sensitive to fixed rate mortgage loans, covered bond debts and fixed-term deposits, where the longer duration creates some sensitivity.

Interest rate risk in the banking book is managed by setting limits on the sensitivity of the fair value of the Bank's assets and liabilities to market rate changes. All interest-bearing assets and liabilities are bucketed according to their next interest rate reset date, and the effect of a 100 basis points parallel upward shift on the Bank's interest rate exposure is measured.

Sensitivity calculations are based on the duration of the underlying assets and liabilities but exclude non-performing loans, as their valuation depends on expected recovery rather than changes in interest rates. An overview of the Bank's interest rate risk in the banking book is provided in Note 56 in the Consolidated Financial Statements.

In addition to a parallel shift in yield curves, the Group measures the effect of a weighted adverse shift in yield curves. This approach applies different weights to shift each yield curve in a way that results in a loss for the Group, with the individual effects combining into a single total amount. The weights are defined as 100 bp for non-indexed ISK, 40 bp for CPI-indexed ISK, 20 bp for EUR and JPY, 40 bp for other currencies.

The development of the interest rate risk in the banking book in 2024 based on the weighted adverse shifts is shown in Exhibit 5.4. Measured this way, interest rate risk in the banking book decreased in 2024, as the gap between non-index-linked assets and liabilities narrowed. Additionally, the interest rate sensitivity for index-linked assets and liabilities decreased in absolute terms; by the end of the year, the banking book was liability-heavy with regard to interest rate risk.

The introduction of a behavioural model allows for a duration extension of the Non-Interest Sensitive component of certain eligible client deposits. The maximum repricing term of NMDs is five years, with a weighted average maturity of 0.4 years. The effect of NMDs on the potential maximum loss observed under the six regulatory shock scenarios on the economic value of equity (EVE) and two parallel regulatory shock scenarios on the net interest income (NII) is displayed on Exhibit 5.5. Note that a large decline is defined at a -15% threshold for the SOT on EVE and -5% for the SOT on NII.

Exhibit 5.4. Quarter-end development of interest rate risk in the banking book in 2024 (weighted adverse shifts in ISK m). Consolidated.

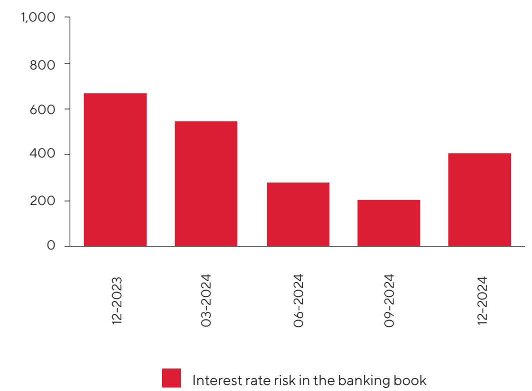
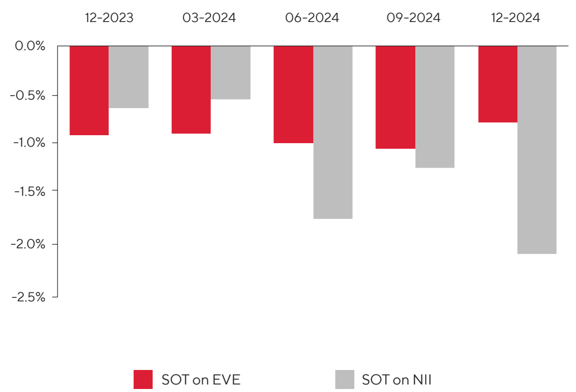


Exhibit 5.5. Quarter-end development of the SOTs in 2024 (in % of Tier 1 Capital).



5.3.2 Credit Spread Risk in the Banking Book

The Bank has refined its approach for the modelling of the Credit Spread Risk in the Banking Book (CSRBB), in accordance to the EBA guidelines (section 5.2.1) defined as any spread risk of credit risky instruments that is not explained by IRRBB and by the expected credit jump-to-default risk. Specifically, CSRBB captures a combination of two elements: (a) The changes to the "market credit spread", representing the credit risk premium required by market participants for a given credit quality; and (b) the changes of the "market liquidity spread", representing the liquidity premium that sparks market appetite for investments and presence of willing buyers and sellers.

It is the Bank's interpretation that, to avoid any overlap of prudential framework, the scope of CSRBB could be restrained to the non-customer asset side of the banking book.

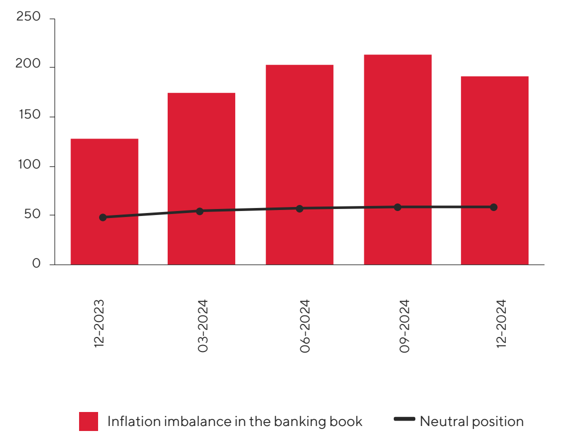
The Bank uses a Principal Component Analysis (PCA) approach to calibrate the size of plausible but unlikely credit spread shocks. In accordance with the guidelines, the use of PCA effectively separates the idiosyncratic component from the systemic component, that are the parts of credit spreads that are influenced by broad market conditions, hence, affecting all issuers.

At year-end 2024, the Bank's CSRBB assessment in terms of potential EVE impact was ca. ISK 200m. The Bank will take this amount into account in the ICAAP process to cover its structural credit spread risk.

5.3.3 Inflation Risk

The Bank is exposed to inflation risk since assets linked to the CPI exceed liabilities linked to the CPI. The net carrying amount of all CPI-linked assets and liabilities changes according to changes in the CPI at any given time, and all changes in the CPI impact the profit and loss via interest income. The inflation risk inherent in the trading book positions is captured through the interest rate risk of the positions. The inflation imbalance in the banking book experienced a significant rise in the first half of 2024 due to an increase in inflation-linked assets. It peaked in 3Q24 and has since been on a downward trend. Exhibit 5.6 shows the development of the banking book inflation imbalance against a neutral position that minimises fluctuations to the Bank's CET1 capital ratio arising from unanticipated changes in CPI levels. The rise in inflation imbalance in 2024 is mainly due to customers having increasingly opted to refinance their loans from non-indexed to CPI-linked.

Exhibit 5.6. Quarter-end development of the banking book inflation imbalance compared to a neutral position in 2024 (ISK bn). Consolidated.



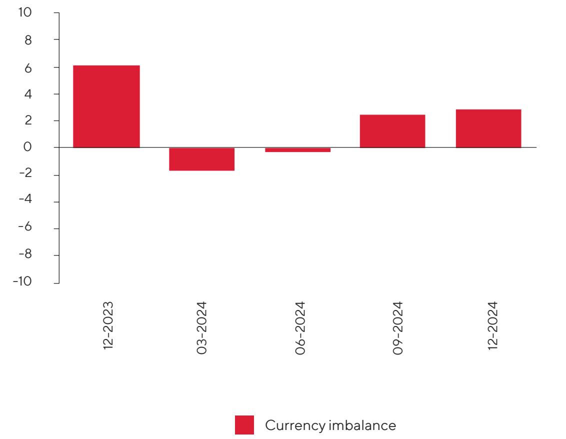
5.3.4 Currency Risk

Currency risk arises when financial instruments are not denominated in the Bank's reporting currency, especially if there is a mismatch in the currency denomination of assets and liabilities.

Currency risk is managed within regulatory and internal limits, with separate limits for the banking book and the trading book. Exhibit 5.7 shows the development of the currency imbalance in 2024. The currency imbalance was small throughout the year, deriving primarily from regular business activities and fluctuations in the fair value of assets and liabilities. The overall consolidated currency imbalance was positive by ISK 2.9bn at year-end 2024 compared to ISK 6.1bn at year-end 2023.

In the first quarter of 2024, the Bank changed its method for calculating the net open position in each currency from amortised cost to net present value.

Exhibit 5.7. Quarter-end development of the currency imbalance in 2024 (ISK bn). Consolidated.



The change was in line with Article 352 in CRR and mostly affected valuation of derivatives in the banking book. This aligns the measurement and steering of the foreign exchange imbalance with its treatment in the Bank's financial accounts.

In the third quarter of 2024, the Bank integrated the provisions on closely correlated currencies from Article 354 in CRR, leading to a more accurate measure of currency risk.

5.3.5 Equity Risk

Equity risk arises from flow trading, market making, shares acquired through restructuring of companies, and strategic investments.

The equity risk is managed through limits on aggregate market value and maximum exposure or market share in single securities. Equity risk includes bonds with equity-like features but excludes hedges against customers' equity forward positions.

The quarter-end figures for equity risk in 2024 are presented in Exhibit 5.8. Equity exposure in the trading book increased in 2024 with an average position of ISK 3.3bn compared to ISK 1.0bn in 2023. The Bank has no equity underwriting positions.

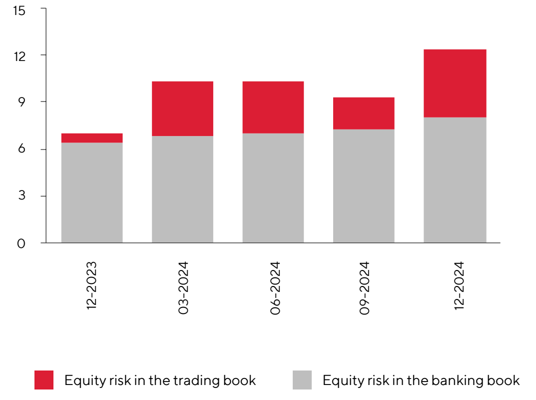
5.3.6 Derivatives

The Bank offers various types of derivative products to its customers and uses derivatives to hedge risks on its own balance sheet. The main products offered to customers are interest rate swaps (IRS), cross-currency interest rate swaps (CIRS), foreign exchange swaps (FX swaps), outright forwards (FX forwards) as well as equity and bond forwards. The Bank uses derivatives to hedge imbalances with respect to currency exposure, interest rate risk and inflation risk in the banking book. For accounting purposes, these instruments are classified and measured at fair value. Other derivatives are insignificant.

All derivative positions that carry direct market risk are subject to risk limits. The overall position in interest rate swaps and cross currency interest rate swaps is subject to both BPV and duration limits, while options are subject to several limits, including a limit on the open delta position in each underlying instrument.

At year-end 2024, Íslandsbanki's aggregate gross forward position in foreign currency against the ISK amounted to 26% of the Bank's total capital base, well within the regulatory limit of 50%.

Exhibit 5.8. Quarter-end development of equity risk in 2024 (ISK bn). Consolidated.



Derivative positions that are fully hedged do not carry direct market risk but are exposed to indirect market risk due to counterparty credit risk. These positions include customers' forward contracts on equities, bonds and foreign exchange. Such positions are subject to notional limits that cap the Bank's indirect exposure to the underlying risk factors. The Bank's counterparty credit risk management is discussed in Section 4.5. For further information on derivative contracts see Note 24 in the Consolidated Financial Statements.

5.4 Capital Requirements

The Bank reports its Pillar 1 capital requirements for market risk according to the standardised approach of the CRD. An overview of the Pillar 1 capital requirements for market risk is displayed in the MR1 table in the Additional Pillar 3 Disclosures. Capital add-on for market risk under Pillar 2-R is estimated in the annual ICAAP process and reviewed by the regulator through the SREP. In 2024, the main add-on for market risk under Pillar 2-R was due to risk factors not addressed under Pillar 1, namely interest rate risk in the banking book and inflation risk.

6 Liquidity Risk

The Bank maintained a strong liquidity position throughout 2024, and all regulatory metrics were well above limits. At year-end 2024 the Bank's Liquidity Coverage Ratio (LCR) was 168% and the Net Stable Funding Ratio (NSFR) was 125%.

Deposits rose by approximately ISK 73bn or 8.4% from year end 2023. The change was mainly due to an increase in retail deposits (ISK 98bn) and deposits from pension funds (ISK 7bn), with reduction in deposits from corporations (ISK 35bn).

The Bank continued to diversify its funding in 2024, issuing senior preferred bonds in the form of EUR 300m, a combined SEK / NOK 1.5bn, thereof 1bn in green funding. In 2024, due to a strong liquidity and MREL position, the Bank bought back a EUR 300m senior preferred issue maturing in 2026 and EUR 147m of an issue maturing in 2025.

6.1 Strategy, Organisation and Responsibility

The Bank defines liquidity risk as the risk of not being able to meet its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

Sound and efficient management of liquidity risk is a key factor to ensure the viability of the Bank's operations and to achieve and maintain a target credit rating. The Bank takes a conservative and prudent approach to managing liquidity risk and its liquidity strategy assumes that the Bank always fulfils regulatory requirements, internal thresholds and can sustain a prolonged period of stress. Following are the key principles on which the Bank's liquidity risk management framework is based:

- Clear responsibilities and ownership of liquidity risk and liquidity risk control.
- The definition, categorisation and management of liquid assets shall be clear.
- The Bank maintains a portfolio of liquid assets to be able to service its liabilities even if access to funding markets is impaired.
- The Bank has in place a Liquidity and Capital Contingency Plan which shall be tested regularly.

The Bank's liquidity risk appetite is reflected in the liquidity risk framework and guided through the liquidity limit structure.

The Board defines the liquidity risk governance framework and the acceptable level of liquidity risk through the *Risk Management and Internal Control Policy*, the *Risk Appetite Statement* and the *Liquidity Risk Policy*.

The All Risk Committee (ARC) is responsible for the review and implementation of the *Liquidity Risk Policy, Liquidity and Capital Contingency Plan* and the liquidity risk appetite. The Asset and Liability Committee (ALCO) decides on individual proposals for internal and external pricing, subject to the policies and models approved by the Board and ARC. ALCO also reviews and approves investment policies for managing the Bank's liquid assets, reviews and approves the contingency stage assessment as part of the Bank's *Liquidity and Capital Contingency Plan* and reviews information about the liquidity position of the Bank with respect to targets and limits.

The Chief Financial Officer (CFO), as the managing director for Treasury, is responsible for ensuring the necessary resources and training of employees for understanding, identifying, measuring or assessing, monitoring, mitigating, and reporting on funding and liquidity risk. Treasury is responsible for the liquidity management of the Bank, in line with the internal and regulatory limits and policies, and the associated risks. Treasury is also responsible for the Bank's funding operations and the internal pricing framework.

6.2 Measurement and Monitoring

Key measures for the assessment of liquidity risk are the LCR and NSFR ratios introduced by the Basel Committee on Banking Supervision and incorporated into European law through the CRD.

The Central Bank of Iceland has set specific requirements on LCR through the *Rules on Credit Institutions' Liquidity Ratios* (no. 1520/2022). The rules on NSFR follow the provisions of the CRR. Credit institutions in Iceland are required to satisfy at least 50% of their liquidity requirement in Icelandic krona and maintain an 80% minimum liquidity ratio in euros when euro-denominated liabilities equal 10% or more of total liabilities. The minimum requirement for NSFR follows the 100% overall requirement set out in the CRR.

In addition, the Central Bank (CB) receives additional liquidity monitoring metrics (AMM) to obtain a comprehensive view of the Bank's liquidity risk profile. The AMM cover a wide array of monitoring metrics, including a maturity ladder, funding concentration, concentration of counterbalancing capacity and rollover of funding.

According to the CB's rules on liquidity ratios, the Bank submits monthly reports on the LCR and NSFR ratios along with AMM reports. In addition to these regulatory measures, the Bank monitors several quantitative and qualitative liquidity measures, both static and forward-looking, to assess and quantify its liquidity position and thereby its liquidity risk. These include predefined triggers for the assessment of liquidity stage and forecasts of the development of the LCR. The assumptions for the internal liquidity measures are reviewed regularly.

Treasury, as a first line of defence, is responsible for continuous monitoring of the liquidity risk inherent in the Bank's operations and for notifying senior management of any foreseeable breaches from either internal thresholds, regulatory limits, or strategic direction. Risk Management, as the second line of defence, is responsible for providing an independent view on liquidity risk on a consolidated basis to internal and external stakeholders and for managing the annual Internal Liquidity Adequacy Assessment Process (ILAAP). The Bank's ILAAP report is approved by the Board of Directors and submitted to the Central Bank which then reviews the report in its Supervisory and Review Process (SREP).

6.3 Liquidity Position

The Bank maintained a strong liquidity position throughout 2024, and all regulatory and internal metrics were above limits. The Bank continues to steer its liquidity ratios with the aim of reducing liquidity cost further while keeping the ratios comfortably above minimum requirements.

6.3.1 Liquidity Coverage Ratio

The LCR is defined as the proportion of High-Quality Liquid Assets (HQLA) to net cash outflow over the next 30 calendar day period.

HQLA are defined as assets that can be easily and immediately converted into cash at little or no loss of value. These include cash, central bank deposits, government bonds and corporate debt securities. The main outflow factors include on-demand deposits, committed credit and liquidity facilities, contractual lending obligations within a 30-day period, derivative cash outflow and other contractual cash outflows. This is offset by contractual cash inflows from outstanding exposures that are fully performing and derivative cash inflows.

To prevent banks from relying too much on anticipated inflows to meet their liquidity requirements, the amount of inflows that can offset outflows is capped at 75% of total expected cash outflows. Banks are therefore required to maintain a minimum stock of HQLA equal to 25% of the total cash outflows.

Even though the LCR is mostly stable over time, significant changes can arise from new bond issuances, large deposit changes and large issuances maturing within the 30-day window. The LCR remained above all regulatory limits during 2024 due to high level of HQLA, which has remained stable between years. Outflows have grown slightly with inflows remaining relatively stable. Level 1 HQLA assets hold the most significant portion of the Bank's total HQLA. Level 1 assets primarily include government bonds, both domestic and foreign, and cash and balances with the Central Bank. Level 2A assets solely comprise covered bonds and amount to around 17% of the HQLA at year-end. The Bank calculates and monitors LCR for all significant currencies (exposure over 5%) and foreign currencies combined. The currency mismatch risk is not considered a material driver for the LCR. An overview of the Banks' liquidity reserve can be found in Note 53 in the Consolidated Financial Statements.

The EU LIQ1 in the Additional Pillar 3 Disclosure shows the breakdown of the Group's positions underlying the LCR in 2024. According to the LCR disclosure standards, the figures show the average of end-of-month positions throughout 2024.

6.4 Funding

The Bank monitors the concentration of funding to avoid undue reliance on individual funding sources and continues to be predominantly funded by deposits, although borrowings through bond issuance amount to 29.8% of the total funding. The Bank has gradually increased its borrowing in recent years with the issuance of covered bonds and unsecured bonds in foreign and local currencies, as well as subordinated debt. Note 35 in the Consolidated Financial Statements gives an overview of the terms of outstanding bonds issued by the Bank at year-end.

6.4.1 Net Stable Funding Ratio

A key metric for assessing the long-term viability of the Bank's funding structure is the NSFR. The ratio measures the proportion of stable funding to long-term assets for a time horizon of over one year. In particular, the NSFR is structured to ensure that long-term assets are funded with at least a minimum amount of stable liabilities and thus to limit overreliance on short-term wholesale funding.

The amount of *Available Stable Funding* (ASF) is measured based on the assumed relative stability of an institution's funding sources reflected in the corresponding ASF factor. The available amount of stable funding is composed mostly of retail deposits, wholesale deposits with remaining maturity of greater than one year, borrowings with a residual maturity over one year and equity.

The amount of *Required Stable Funding* (RSF) is measured based on the liquidity risk profile of an institution's assets and off-balance sheet exposures. The required amount of stable funding is mainly in the form of encumbered and unencumbered assets with maturity of more than one year and other on- and off-balance sheet exposures. All categories are weighted by the appropriate RSF factor.

The EU LIQ2 in the Additional Pillar 3 Disclosure shows the breakdown of the Group's positions underlying the NSFR at year-end 2024.

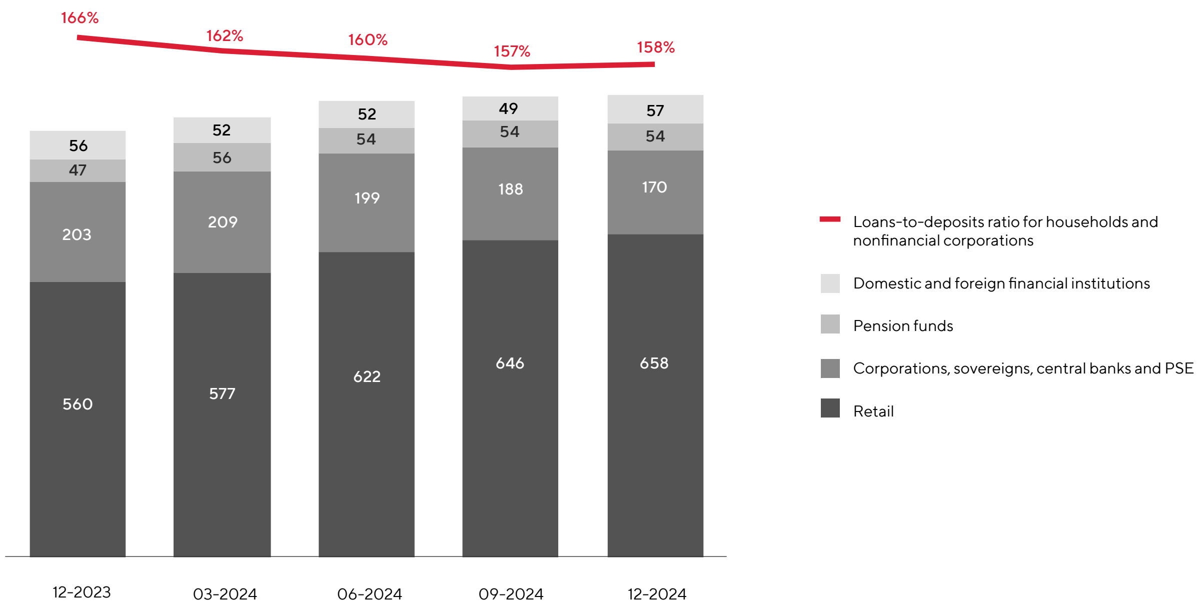
6.4.2 Deposits

The Loan-to-deposit ratio for households and non-financial corporations was 158% at year-end 2024 compared to 166% at year-end 2023. The reduction is mainly due to growth in deposits from customers exceeding growth in loans to customers. The ratio is expected to remain in this range and deposits to continue to be the largest source of funding for the Bank in the years ahead.

The deposit balance rose by approximately ISK 73bn over the course of 2024 as shown in Exhibit 6.1. The change was mainly due to a significant increase in retail deposits (ISK 98bn) and to lesser extent deposits from pension funds (ISK 7bn) which was offset by a reduction in deposits from corporations (ISK 35bn).

The proportion of term deposits decreased slightly in 2024 to 18% of total deposits at year-end 2024

Exhibit 6.1. Deposits by liquidity coverage ratio category in 2024 (ISK bn) and the Loan-to-deposit ratio for households and nonfinancial corporations. Consolidated.



compared to 19% at year-end 2023. The largest increase in term deposits came from retail deposits (ISK 6bn). For an overview of deposits see EU LIQ2 in the Additional Pillar 3 Disclosure.

Deposit concentration is monitored since a substantial amount of the Bank's deposits are from relatively few counterparties. The Bank's highest deposit concentrations are in wholesale deposits from corporations, foreign and domestic financial institutions and pension funds. The deposit concentration in 2024 reduced from 10% to 8% of the Bank's deposits belonging to the 10 largest depositors and decreased from 26% to 22% belonging to the 100 largest depositors.

6.4.3 Capital Markets Activity

Íslandsbanki is one of the largest issuers of covered bonds in the domestic market. Domestically, the Bank is also an issuer of senior preferred and Tier 2 bonds. The Bank's USD 2.5bn Euro Medium-Term Note (EMTN) Programme is the Bank's platform for senior and Tier 2 funding in domestic and international markets, alongside the Bank's Covered Bond Programme.

Íslandsbanki has a EUR 4bn covered bond programme in place, issued under Act 11/2008 on Covered Bonds. Issuance is regulated by the Central Bank which additionally appoints an independent inspector to monitor the programme. Íslandsbanki sold ISK 22bn of ISK denominated covered bonds during 2024 in five transactions, compared to ISK 31bn in 2023.

Credit spreads in the international bond markets were recovering after the generally wide levels seen since 2022, the effect of hawkish actions by central banks in response to the conflict in Ukraine and the resulting inflation across most developed economies. As central banks began to pivot towards monetary easing, improving sentiment allowed the Bank to issue several times in foreign currencies in the first half of 2024 at progressively tighter levels.

In January 2024, the Bank inaugurated its updated Sustainable Funding Framework by launching its first green-labelled bonds in foreign currencies. Two tranches of senior 3-year senior preferred paper, one NOK 500m and the other SEK 500m, were placed with investors through a syndicated process at a spread of 3-month NIBOR/STIBOR + 235 basis points. The deal was more than 3 times oversubscribed, attracting close to NOK / SEK 4bn of orders. Simultaneously the Bank bought back notes in NOK / SEK maturing in 2024 and 2025.

In March, the Bank issued a EUR 300m four-year senior preferred bond at a spread of mid-swaps +185 basis points. There was strong interest from investors in the issue with peak orders amounting at EUR 1.7bn which enabled a print 45 basis points tighter than the initial price talk. A tender to buy back the Bank's EUR 300m March 2025 bond was launched concurrently – the first tender for that bond launched in 2024. The Bank received valid tenders of €73,622,000 which were all accepted.

In June, the Bank issued a combined NOK/SEK 500m three-year dual tranche senior preferred issue paying NIBOR/STIBOR +120 basis points - close to half the spread of January's four-year issues in those currencies. This performance would seem to underline the faith that investors have in the Bank and the

Icelandic economy – an economy that continues to outperform the majority of European jurisdictions.

The Bank issued a total of ISK 16bn of senior preferred bonds in the domestic senior market in 2024 in three transactions, doubling the total outstanding volume to ISK 32bn. At the end of the year, ISK-denominated senior preferred bonds accounted for 22% of the total senior preferred bonds outstanding. The continued development of the domestic ISK bond market is of substantial benefit to the Bank in that reduces reliance on foreign capital markets, increases diversification and reduces the overall cost of funding. Additionally, the Bank now has three ISK-denominated Tier 2 bonds outstanding, issued in 2022 and 2023, amounting to ISK 22bn, which means that after calling the SEK 500m in June 2024, at its first call date, the domestic market has now completely supplanted foreign markets for access to Tier 2 capital.

There was considerable liability management activity during the year. The Bank's very robust liquidity and MREL position allowed for three tenders to take place to buy back outstanding FX denominated senior preferred issues in 2024. Most notably, in June the Bank launched a tender to buy back the EUR 300m May 2026 senior issued launched in 2023. That bond, issued at a spread of mid-swaps +421 basis points in May 2023 was one of the first issued by the Bank that contained a provision for a "clean-up call." In practice, this allows the Bank to call a bond if it has bought back more than 75% of the issue. The tender price was set at 106% and resulted in 92% of the issue being tendered, the balance was then "cleaned-up" in full. Otherwise, there were two tender offers launched for the EUR 300m March 2025 senior preferred issue – one in March (concurrent with the new EUR 300m issue) and a second tender in November. The net result of these tenders was that the Bank bought back just under EUR 147m of the bond ahead of its maturity in March 2025.

The ratings environment has been supportive of the strong secondary performance of the Bank's issues. Moody's Ratings held the Bank's A3 rating with stable outlook steady over the course of the year. However, in April S&P Global Ratings raised the rating on the Bank to BBB+ with a stable outlook, citing improvements in the economic risk facing the banks in Iceland, house price stability and good performance prospects for the economy. In November, the outlook on the Bank's BBB+ long term rating was changed from a stable to a positive outlook, whilst maintaining its A-2 short-term rating.

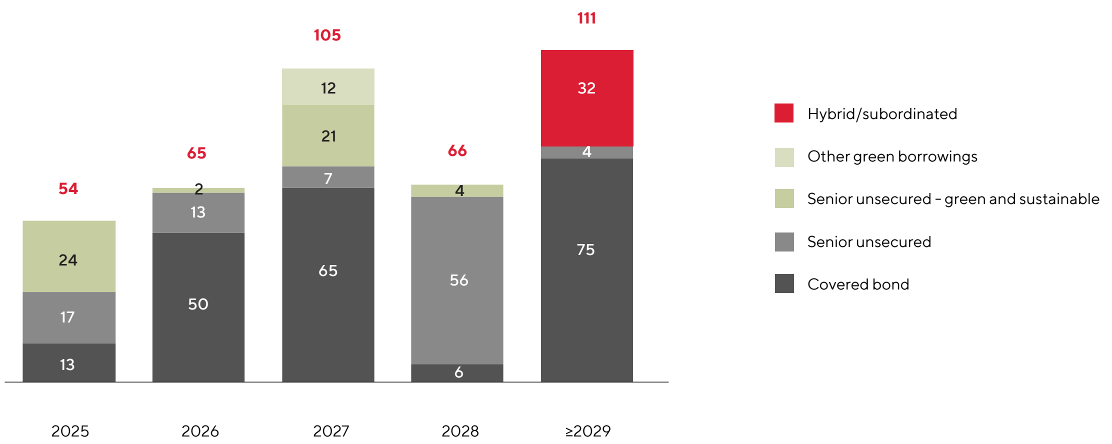
Exhibit 6.2 provides a summary of how the maturity of outstanding bond issues is distributed over the coming years including instalments. Note 35 in the Consolidated Financial Statements gives an overview of the terms of outstanding bonds issued by the Bank at year-end.

6.4.4 Asset Encumbrance

The asset encumbrance ratio is critical when monitoring the consequences of changes in funding sources and the ability to withstand funding stress. The Bank's asset encumbrance predominately consists of:

- Loans and securities serving as collateral for covered bond issuance which is one of the Bank's strategic long-term funding sources.
- Cash and securities as collateral for currency swap agreements.
- Central Bank (CB) term deposits for the payment system.

Exhibit 6.2. Maturity profile of long-term funding (ISK bn) as of year-end 2024. Consolidated.



Íslandsbanki asset encumbrance ratio was 19% at year-end 2024 and Exhibit 6.3 shows the development of the reported encumbrance in 2024.

6.4.5 Funding Outlook

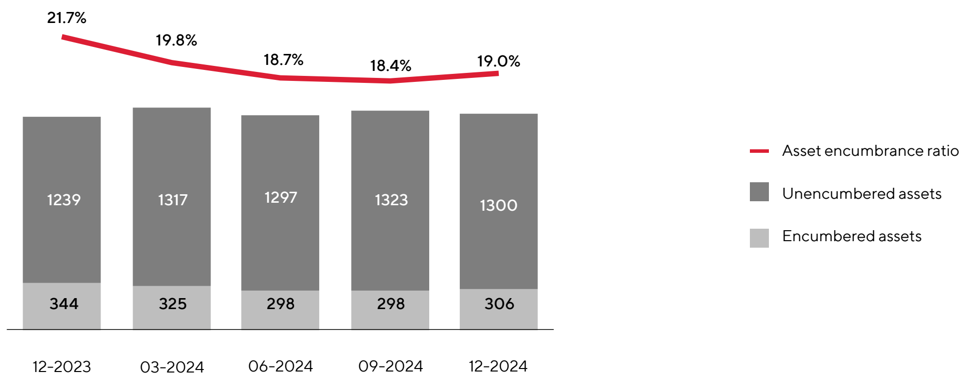
The Bank has approximately ISK 13bn of ISK denominated covered bonds maturing in 2025 and plans to refinance them in the local market during the year. Issuance need will depend on development in the Bank´s deposit base, upcoming maturities, Bank´s mortgage book development and general market conditions.

The Bank plans to continue issuing senior preferred bonds in ISK in a continued effort to promote and develop the domestic bond market. The timing and size of such issues will depend on the Bank's funding needs and market conditions. The Bank may also issue a new Tier 2 transaction in ISK subject to market conditions. Issuance in foreign currencies under the EMTN Programme will depend largely on loan growth in foreign currencies, the Bank's MREL requirements as well as on upcoming maturities. There is a EUR 300m senior preferred bond maturing in March 2025, of which the Bank already has bought back approximately EUR 147m, that will drive some refinancing, whether in EUR or in other currencies. The Bank aims to continue optimising its capital structure by issuing further Additional Tier 1 capital instruments, subject to market conditions.

The Bank will most likely make use of buybacks in 2025, in both local and foreign markets, in order to maintain a strong balance sheet position whilst efficiently applying surplus liquidity.

The Bank will look at further opportunities to diversify funding channels where appropriate. At the same time, sustainable financing in 2025 will be in line with the Bank's strategy, both by issuing new sustainability bonds and by tapping existing issues.

Exhibit 6.3. Development of asset encumbrance in 2024 (ISK bn). Consolidated.



7 Operational and Compliance Risk

The Bank continued to strengthen its risk management framework in 2024 with a focus on non-financial risks. Strengthening the banks AML framework has been the priority over the past year as part of a settlement with the Central Bank of Iceland.

A contingency group was established to assess forward-looking operational risk status each month. The Bank is continuously reviewing and strengthening its controls in ICT and security risk, and it is offering training to employees and customers on how to respond to fraudulent incidents to minimise possible losses and disruptions.

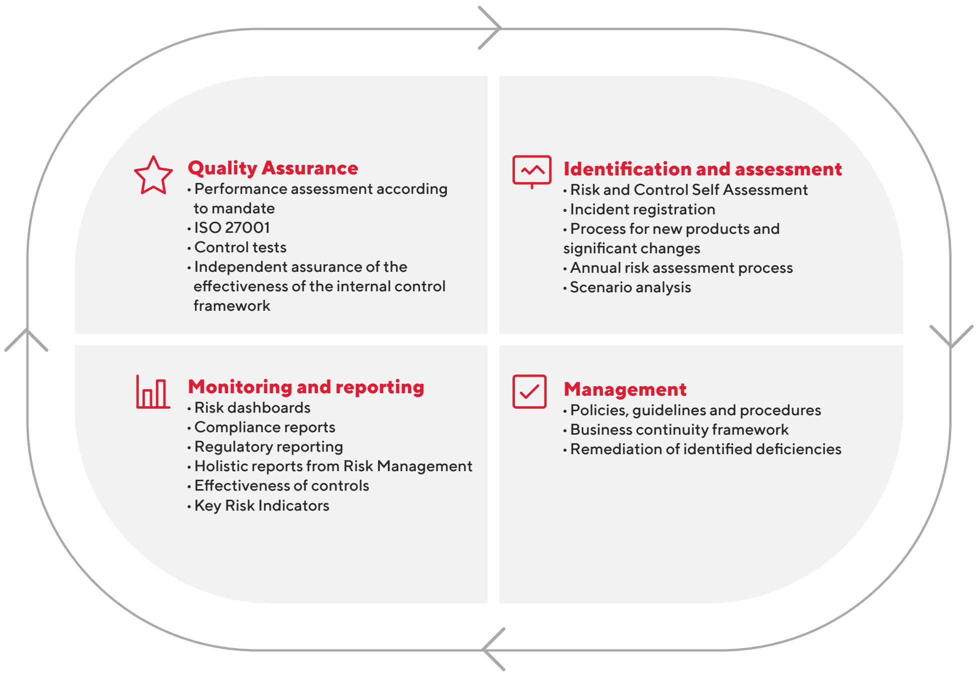
7.1 Strategy, Organisation and Responsibility

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. The Bank's definition of operational risk includes reputational risk, legal risk, ICT and security risk, model risk, outsourcing risk, business and strategic risk, process risk, conduct risk and compliance risk.

A healthy risk culture, supported by a clear risk appetite limit, is a key factor in a sound operational risk framework. The framework is maintained and further developed through staff training on policies, processes, risk strategy, and employee awareness of risk-taking.

Business continuity management is an integral component of operational risk management and refers to the measures taken to ensure the Bank's ability to operate on an ongoing basis and to limit losses in the event of severe business disruption.

Operational risk management framework.



The Board of Directors is the Bank's supreme governing body and has the final word on operational risk management within the Bank by approving the *Operational Risk Policy* and the *Risk Appetite for operational risk*. The operational risk management framework is based on the following principles:

- Clear responsibilities and ownership of operational risk and operational risk controls.
- The Bank accepts no undue operational risk. After careful consideration, accepts operational risk when benefits outweigh the costs.
- The Bank has no appetite for compliance risk that can lead to financial loss or loss of reputation.
- The Bank promotes a strong risk culture, emphasising employees' understanding of and compliance to internal and external laws and regulations.

A key feature of a strong risk culture is to foster a "no blame" environment where operational risk events are recognised and registered to enable continuous improvement to the Bank's operations.

The Bank takes appropriate measures, in all its operations, to ensure the safety and health of its customers and employees.

The All Risk Committee (ARC) is responsible for the review and implementation of the operational risk framework. The Operations and Security Committee (OSC) decides on individual proposals for assuming and mitigating operational risk on behalf of the Bank within the appetite and limits approved by the Board and ARC. The OSC also reviews and approves proposals for new products, services, outsourcing and other material changes within the Bank.

The managing directors for individual business and support units are responsible for the operational risk inherent in their business and reporting on their operational risk profile to the Operations and Security Committee. This entails identifying the sources of operational risk in their operations, assessing whether the cost of avoiding the risk outweighs the benefits and ensuring that unacceptable operational risks are mitigated, and losses prevented.

Risk Management is responsible for implementing the Bank's operational risk framework, for developing and maintaining the Operational Risk Policy and for communicating the policy to the Bank's employees. Key risk factors related to operational risk are addressed in other policies such as the Security Policy, Outsourcing Policy, Compliance Policy and New Products, Significant Changes and Product Governance Policy. These policies outline the risk management and internal controls specific to these risk categories.

Risk Management monitors the overall operational risk profile of the Bank, ensures proper escalation and reporting of operational risk issues and provides an independent view on the overall operational risk inherent in the Bank's operations. Furthermore, Risk Management is responsible for reporting on operational risk events and limit breaches to senior management, the Board of Directors and to the competent authorities in accordance with internal procedures and regulatory requirements.

The Bank maintains an operational risk insurance covering loss events where insurance is deemed to be a cost-effective mitigation of operational risk. The insurance coverage limits financial loss caused by serious unexpected events or legal liabilities that occur despite other operational risk management procedures. The Bank's insurance also offers coverage for wrongful act claims brought solely against directors and officers of the Bank.

7.2 Measurement and Monitoring

The main processes for measuring and managing operational risk are the Business Continuity Framework including the *Crisis Management Plan*, the Risk and Control Self-Assessment, development and monitoring of Key Risk Indicators, compliance monitoring of risk policies and underlying processes, and the follow up and reporting of all significant operational risk events in the Bank's Loss Event Database (LED).

Aggregated registered operational risk losses in any given quarter shall not exceed a given percentage of the Bank's capital, as defined in the Risk Appetite Statement. The Operational Risk Policy describes the reporting limits on operational risk losses in any given quarter to the Board of Directors.

In the year 2024, there was a 40% decrease in the number of risk events in the Bank's LED compared to the previous year. The LED is categorised according to the Basel event type classification. The loss events in the categories "External fraud," "Business disruption and system failures" and "Execution, delivery and Process Management" accounted for 92% of the total number of events in 2024 while loss events in the category "Execution, delivery and Process

Management" accounted for 99% of the total loss amount attributed to operational risk in 2024, which was mainly due to the AML settlement with the Central Bank discussed in Section 7.3.

Managing directors are required to ensure that Risk and Control Self Assessments (RCSAs) are conducted at least annually within their divisions. The RCSA process includes the identification of risks related to all critical processes, evaluation of inherent risk, mapping of risk controls, evaluation of residual risk, assessment of the acceptability of residual risk in relation to the Bank's risk appetite, and the design and planning of additional controls if the residual risk is deemed outside the Bank's risk appetite.

A framework of key risk indicators (KRIs) covering all material sub-categories of operational risk has been implemented, with a clear connection to the risk appetite. The aim of well-defined risk indicators is to measure whether non-financial risk is within risk appetite, to detect negative trends, and identify and reduce operational risks before negative consequences materialise. In mid-2024, a contingency group for operational risk was established. The role of the group is to propose a forward-looking contingency stage status for non-financial risk each month based on the KRIs. The Contingency Group proposes the contingency stage to the Operations and Security Committee, which confirms the risk level and determines the necessary actions to achieve an acceptable level, if applicable.

Regular assessments and compliance monitoring of risk policies and underlying processes are integral parts of the monitoring framework. Additionally, model validation plays a crucial role in identifying and mitigating model risk within this framework.

Cybersecurity incidents have surged globally in recent years. The landscape is becoming increasingly challenging with technological advances and emerging risks like artificial intelligence (AI). Criminal organizations continue to use tactics such as phishing, smishing, investment fraud, ransomware, and romance fraud to target individuals and companies. The Bank has also seen an increase in fake bank phishing sites and credential phishing. AI has enabled fraudsters to enhance their tactics, making schemes like trusted relation fraud, fake advertisements, and business email compromise more convincing. The Bank continuously reviews and strengthens its ICT and security controls and provides training to employees and customers to effectively respond to fraudulent incidents, minimising potential losses and disruptions.

7.3 Compliance risk

The Bank's compliance approach focuses on managing compliance risk through a comprehensive process of identification, advisement, monitoring, and reporting. This approach aims to ensure the proper conduct of its businesses and services, prevent market abuse, insider dealing, and conduct breaches, and combat financial crime and personal data breaches.

Following the Central Bank's on-site inspection of the structure and implementation of anti-money laundering and terrorist financing (AML) measures, carried out in the autumn of 2022, Íslandsbanki settled the case and paid an ISK 570m fine to state treasury.

In response, the Bank has undertaken extensive remedial actions with support from an international advisory firm, leading to a thorough review and strengthening of the Bank's governance and internal procedures. Significant investments have been made in the Bank's AML infrastructure and related technical solutions, complemented by increased focus from the Bank's management. Íslandsbanki is committed to continuously strengthening and developing its AML control framework to ensure robust compliance with regulatory requirements.

7.4 Capital Requirement

The Bank uses the Standardised Approach of CRD to calculate capital requirements for Pillar 1. Details on the operational risk own funds requirements and risk-weighted exposure amounts can be seen in OR1 in the Additional Pillar 3 Disclosure.

With the implementation of CRR 3, the existing Standardised Approach will be replaced with the new Standardised Approach, intended to provide comparability between banks. The new approach is based on business indicator components that depend on the size of the operation and for Íslandsbanki it is expected to lower the Pillar 1 capital requirements due to operational risk by 20%.

8 Sustainability Risk

In 2024, the Bank continued to emphasise sustainability risk, further developing its methodologies to identify, measure, and manage these risks. Sustainability risk refers to the potential of being directly or indirectly negatively affected by externalities within the areas of environmental, social, and governance considerations. These include, but are not limited to, climate change, anti-corruption, human rights, labour conditions, data privacy, and business ethics.

The regulatory environment concerning sustainability and sustainability risk continues to evolve, with new legislations implemented during the year and additional regulations anticipated in the coming years. Enhanced disclosure requirements from non-financial corporations are expected to improve the quality and availability of data regarding sustainability risk.

This chapter is based on the Implementing Technical Standards (ITS) for prudential disclosures on ESG risks in accordance with Article 449a of the Capital Requirements Regulation (CRR). It encompasses sections on Governance, Business Strategy and Processes, Risk Management, and Metrics and Targets.

In 2023, the Bank performed an initial phase of a double materiality assessment, mapping its business model and previous impact analyses against the European Sustainability Reporting Standard (ESRS). In 2024, the Bank commenced on a second phase of the double materiality assessment, focusing on financial materiality and conducting a detailed evaluation of risks and opportunities. This process not only enhances the Bank's sustainability initiatives but also fortifies its financial resilience by proactively addressing potential risks and capitalising on opportunities for sustainable growth.

In accordance with national regulations, the Bank publishes information on the classification system for sustainable investments (EU taxonomy) in an unaudited appendix to the annual accounts. The regulation, which came into effect in 2023 for financial institutions and other entities subject to its requirements, mandates reporting on the Bank's assets that meet the criteria for environmental sustainability as defined by the European classification system.

The Taxonomy key performance indicators (KPIs) and green asset ratios (GAR) are reported for the first time, based on input from Icelandic non-financial counterparties. Financial counterparties had not yet reported their Taxonomy KPIs at the reporting date, thus they are not included in the metrics. Taxonomy-eligible and non-eligible activities related to the EU environmental objectives are classified based on data for the financial year 2023.

The total GAR based on turnover, at the consolidated level for Íslandsbanki Group, including Iceland Funds, amounted to 0.20%, and the total GAR based on Capital Expenditures (CAPEX) amounted to 0.26% of total covered assets as at year-end 2024.

The Bank has identified a significant portion of household mortgages and mother vehicle loans that meet the substantial contribution criteria for climate change mitigation. However, due to the lack of official data, the criteria for "do no significant harm" cannot be formally fulfilled. Note that the Taxonomy KPIs do not include lending activities with small and medium-sized enterprises (SMEs).

The requirements for Environmental, Social, and Governance (ESG) disclosures are rapidly evolving, particularly within the banking industry. There is an increasing demand for greater transparency and detailed reporting on ESG-related activities. This evolution presents several challenges, including uncertainties in interpretation and limitations in data availability and granularity. Consequently, the Bank is continually refining its methodologies and enhancing data collection processes to align with emerging guidelines and standards. As additional guidance and information becomes available, the Bank will further improve its ESG reporting practices, resulting in more robust and comprehensive disclosures.

8.1 Governance

The Board of Directors approves the *Sustainability Policy* and sets the Bank's strategy and the *Risk Appetite Statement*, which includes a qualitative statement on sustainability risk in line with the Bank's Sustainability Principles, as stated in the *Sustainability Policy*. When taking on new business or evaluating proposals, in relation to existing business relationships, the Bank shall aim for full alignment with the Sustainability Principles. The Board is regularly updated on corporate sustainability matters and the utilisation of the *Bank's Sustainable Funding Framework*.
The Corporate Governance and Human Resource Committee, a subcommittee of the Board, supports the Board in overseeing the implementation of the *Sustainability Policy*. The monthly Risk Dashboard includes a section on current sustainability risk, and the Bank's ICAAP methodology mandates a separate chapter on potential future sustainability risk, both of which are discussed at Board level.

The CEO is responsible for executing the *Sustainability Policy* and has appointed a Sustainability Committee as a key component of the governance structure. The Committee serves as the formal forum for discussions on all issues related to sustainability risk, sustainable procurement, and business opportunities in sustainability. The Committee operates independently from credit committees and must approve proposals for sustainable loans and investments before their inclusion in the Sustainable Funding Framework. The Committee includes the CEO, Head of Sustainability, and senior representatives from business units and Risk Management. Additionally, a separate Sustainability Working Group, comprising employees from various business areas and departments within the Bank, focuses primarily on educating members on significant sustainability issues and discussing matters at hand.

Sustainability risk is one of six main risk types according to the Bank's *Risk Taxonomy*. To ensure thorough oversight, relevant sustainability risk issues are reviewed by the All Risk Committee and incorporated into the *Risk Assessment Framework*. The framework is essential for identifying risks inherent in the Bank's operations and assessing both capital and liquidity adequacy.

The framework encompasses all significant risks faced by the Bank and its subsidiaries, forming the foundation of the Bank's risk and capital management strategy. By integrating sustainability risk into this framework, the Bank ensures that potential ESG factors are evaluated as well as traditional financial risks.

The Bank's risk governance is structured around a three lines of defence model, which promotes informed decision-making and a strong culture of risk awareness throughout the organisation. This approach ensures that sustainability risks are not only identified and assessed but also managed effectively in alignment with the Bank's overall strategic objectives.

8.2 Business Strategy and Processes

The Bank focuses on integrating sustainability considerations into its activities, as well as its financial objectives and profitability goals. The Bank continues to foster broad collaboration and increase awareness of responsible business practices that contribute to sustainable development in the Icelandic economy, support the Icelandic Government's Climate Action Plan, and uphold the United Nations Sustainable Development Goals (UN SDGs). The Bank has specifically chosen UN SDGs in the areas of education, gender equality, innovation, and climate action to guide its sustainability efforts.

The Bank aims to set a positive precedent by taking immediate action, thereby gaining and maintaining the trust of its customers. As part of this initiative, the Bank defined seven primary sustainability goals to be achieved in the year 2025 and discloses annual targets for each of these main goals.

The Bank is committed to reaching net-zero emissions by 2040, and an important step on that journey is the report published in 2022: Road to Net-Zero. The report includes sector-specific emission reduction targets covering 64% of total lending and 78% of total emissions, including the seafood sector. The net-zero commitment is mainly focused on the Bank's financed emissions, as the operations have been carbon neutral since 2019. To honour this commitment, the Bank joined Partnership for Carbon Accounting Financials (PCAF) in 2020 and the Net-Zero Banking Alliance in 2021. The PCAF partnership aims to harmonise greenhouse gas accounting methods and stipulate a consistent method to measure the financed emissions. The initiative focuses on how companies can achieve their carbon reduction targets so they align with the Paris Climate Agreement. For financial institutions, the framework addresses the lending and investment activities.

Iceland Funds, a subsidiary of the Bank, is a member of Principles for Responsible Investments (PRI). PRI is an independent organisation for responsible investments, supported by the United Nations Environment Programme Finance Initiative (UNEP FI) and the United Nations Global Compact (UNGC). PRI analyses the impact of investments on environmental, social, and governance issues, assisting signatories in incorporating these factors into their investment and ownership decisions. Iceland Funds is also a founding member of the Iceland Sustainable Investment Forum (IcelandSIF), which promotes knowledge and discussion about sustainable and responsible investments.

The seven main goals in 2025

1. Achieve full carbon neutrality no later than 2040.
2. Offer its customers a wide range of sustainability products.
3. Encourage equality and inclusion through products and services.
4. Further increase diversity and inclusion in the workplace.
5. Work with suppliers and partners that champion sustainability.
6. Assess and disclose sustainability risks and build a robust sustainability governance framework.
7. Support four of the UN SDGs in the areas of education, gender equality, innovation, and climate action.

The Bank has a Code of Conduct for its Suppliers based on ESG criteria. The aim of the Code is for the Bank and its suppliers to collaborate on implementing ESG considerations into their operations, in alignment with the Bank's Sustainability policy and UN SDGs. By utilising the Code, the Bank ensures that the procurement of goods and services are efficient, non-discriminating, and transparent. The Bank assesses its suppliers according to ESG risk, using the Code of Conduct as well as other tools to identify risks and to encourage suppliers to enhance their focus on sustainability.

Equality and the participation of all are of paramount importance to the Bank, which strives to ensure equality and diversity within its ranks. A limit has been established to ensure that the proportion of any gender within the Bank's management team does not exceed 60%. Specific equality goals have been set in the Bank's investment banking, information technology and front-line departments, where the gender proportion is currently unequal. The Bank has a Policy on equal pay, which supports wage decisions based on informed judgements and prevents gender-based discrimination. The Bank has received equal pay certification according to the ÍST 85:2012 standard every year since 2018. According to the most recent equal pay appraisal, the unexplained pay gap for jobs of equal value is 0.2%.

8.2.1 Sustainable Funding Framework

Íslandsbanki was the first Icelandic bank to publish a sustainable financing framework in late 2020, which was updated in January 2024 and rebranded as the new *Sustainable Funding Framework*. The framework is in alignment with the International Capital Market Association (ICMA) Green Bond Principles from 2021 (GBP), the Social Bond Principles from 2023 (SBP), and the Sustainability Bond Guidelines from 2021 (SBG). The framework also takes into account the global practitioner's guide for bonds to finance the sustainable blue economy (blue-themes bonds).

Íslandsbanki is part of the following networks

Signatory of:

The framework follows the core components and key recommendations of the ICMA's principles: use of proceeds, process for project evaluation and selection, management of proceeds, reporting, and external review. It is based on best practices in Europe and benchmarked with similar frameworks from financial institutions that have been leading the way in sustainability and sustainable funding activities.

Sustainalytics, a leading international Second Party Opinion provider, has reviewed the framework and provided the Bank with a conformation that the framework is according to market practice. Sustainability experts from Swedbank provided advice on the development of the framework.

Under this framework, the Bank utilises funding options from public and private placements, as well as listed and non-listed instruments, collectively referred to as "Sustainability Instruments". These Sustainability Instruments are issued under the terms Green, Social, and/or Sustainability Instruments.

Amounts equal to the net proceeds of the Sustainability Instruments are used for Eligible Assets that support the transition towards sustainability. These Eligible Assets comply with at least one of the Project Categories, classified as either Green for the environment or Social for supporting social initiatives.

The Bank has issued several bonds in international and domestic markets under its frameworks, as well as sustainable deposit accounts and a wholesale loan from the Nordic Investment Bank. The impact is further described in the Bank's Annual and Sustainability Report.

Annual Report

8.2.2 Sustainability Policy

The objective of the *Sustainability Policy* is to define the Bank's main focus areas on sustainability, encompassing both its operations and the impact it can have on its immediate environment. The integration of sustainability perspectives into the Bank's operations is intended to enhance risk management, reduce costs, attract and retain skilled employees, customers, and investors, as well as being an opportunity for the Bank to be a true force for good in the Icelandic society. The policy is applicable to all activities of the Bank and its subsidiaries. All employees of the Bank are required to operate in accordance with the policy.

The principles in the policy aim to align the Bank and its business model with society's goals as expressed in the UN SDGs and the Paris Climate Agreement. As part of the policy, credit granting at the Bank is always conducted in compliance with relevant regulatory instruments, including consumer protection provisions, anti-money laundering, and anti-corruption rules. The policy reiterates that this compliance applies to the overall credit process and the credit risk culture at the Bank. The policy further states that loans shall always be processed without reference to ethnic origin, gender, race, religious beliefs, or other comparable factors. Additionally, the policy specifies that the Bank shall consider ESG criteria, as well as other risk factors, when making credit decisions and pricing risk.

Through its lending activities, the Bank is committed to supporting companies and households in their efforts to adopt more sustainable practices. The Bank's exclusion list, which includes a set of activities that the Bank will not finance either directly or indirectly, was added as an appendix to the *Sustainability Policy* in 2022.

8.2.3 Sector Guidelines

The Bank has published sector-specific guidelines that introduce sustainability concepts to companies and provide them with an overview of the associated risks and opportunities within various industries. The guidelines comprise a set of standards and recommendations that the Bank suggests customers incorporate into their operations. The guidelines are continually evolving and are expected to adapt in line with general standards and requirements. To date, the Bank has published guidelines for four sectors: construction industry, tourism, seafood industry, and production, commerce and services.

Sector Guidelines

8.3 Risk Management

The Bank incorporates sustainability criteria in its analysis of risks and opportunities, as well as in evaluating its impact on sustainability. The Bank is continuously enhancing and developing its approach to identifying, assessing, and managing sustainability risk. Sustainability risk is integrated into the Bank's Risk Taxonomy and encompassing climate-, social-, and governance risks.

Climate-related risks consist of two primary categories: transition risks and physical risks. Transition risks include policy, legal, technological, reputational, and market changes arising from the adoption of new climate-related requirements and the transition to a low-carbon economy. Physical risks pertain to the direct impacts of climate change, such as extreme weather events and long-term shift in sea temperature and acidity.

Transition risks can disrupt the business models of the Bank's customers due to changes in demand for products and services. Anticipated shifts in demand will necessitate strategic business decisions. In sectors where such adjustments do not occur organically, tax incentives and disincentives are likely to play a role. For instance, during the transition to cleaner energy in the transport sector, tax incentives may be provided for vehicles using cleaner energy, while carbon taxes could be significantly increased.

The Bank's customers are exposed to physical risks related to climate change, such as those in the seafood industry, where the availability of fish and shellfish may decline due to changes in ocean temperature and acidity around Iceland. Physical risks can have a direct financial impact through damaged assets and supply chain disruptions. As awareness of the potential impact grows, the value of exposed assets may decrease.

Furthermore, the Bank acknowledges that loans may have adverse effects on biodiversity and other sustainability aspects. An initial assessment, based on a preliminary double materiality analysis, concluded that biodiversity did not constitute a significant impact area for the Bank.

Physical and transition risk are interrelated. As physical risk increases, the likelihood of implementing transitional mitigating measures, such as policies and regulation, also rises. Consequently, physical risk is expected to decrease once additional transitional measures are put into place.

Although the Bank's operations are not carbon-intensive and climate change does not affect day-to-day activities, the Bank is exposed to climate risk through its customers. Both transition and physical risks can lead to reduced profitability in certain sectors and decrease real estate value due to specific acute events

Exhibit 8.1: The transmission channels of climate risk.

Climate risk

TRANSITION RISK
- Policy and legal
- Technology
- Market behaviour
- Reputational

PHYSICAL RISK
- Acute
- Chronic

Transmission channels

- Lower profitability
- Lower real estate value
- Lower household wealth
- Lower asset performance
- Increased cost of compliance
- Increased legal cost

Financial risk

CREDIT RISK
- Probability of default and loss given default increases
- Lower collateral valuations

MARKET RISK
- Shift in market prices
- Asset stranding

OPERATIONAL RISK
- Physical damage
- Business continuity

LIQUIDITY AND FUNDING RISK
- Clients withdrawing money
- Refinancing risk

Source: Adapted from EBA report on Management and supervision of ESG risks for credit institutions and investment firms.

such as flooding and mudslides. This, in turn, results in a higher probability of default and loss given default. Social risks refer to the potential adverse impacts on the Bank's social capital due to its actions or those of others within its operating environment. These risks can include events that damage the Bank's reputation, public perception, or relationships with stakeholders. Examples of social risk factors include human rights, health and well-being, the work environment, professional rights, and equality.

Governance risks pertain to the structures and processes for decision-making, accountability, control, and behaviour at the highest levels of an organisation. Poor governance can lead to issues such as fraud, corruption, and mismanagement, which can harm a company's financial health and reputation. Effective governance ensures transparency, ethical behaviour, and alignment with stakeholders' interests.

The Bank conducts regular training sessions for employees on climate risk to enhance their abilities to engage with customers and identify opportunities and threats related to climate-related matters. Additionally, the Bank mitigates risk by offering a wide variety of educational courses on social and governance-related matters. The aim of these courses is to educate staff, foster open discussions, and create an inclusive workplace for all members of society.

8.3.1 Climate Risk Assessment

To assess climate-related risks within the loan portfolio, the Bank conducts an analysis of the potential financial impacts of both transition risks and physical risks across business sectors using a heatmap. This heatmap is a qualitative assessment that identifies potential climate-related risk factors within the portfolio. It is divided into two time periods: 1-5 years and 5 years and more.

The Bank considers transition risk to potentially have the greatest impact on its customers. Within transitional risk, regulatory changes, technological advancements, and evolving market behaviour driven by climate awareness are the primary risk factors. In the short-term, transition risk within the transportation sector is expected to have the most significant impact. Physical risk has been identified for residential real estate mortgages. However, the greatest long-term impact could arise from chronic physical risks in the seafood sector. The heatmap for transition risk

Exhibit 8.2. Climate-related risks and potential financial impacts, transition risk.

Sector			Transition risk							
	Carrying amount as % of portfolio	Financed GHG emissions as% of tCO_2eq	Legal and policy		Technology		Market behaviour		Reputational	
			1-5 years	5 years +	1-5 years	5 years +	1-5 years	5 years +	1-5 years	5 years+
Construction	7%	4%								
Real Estate	12%	1%								
Industry	3%	9%								
Agriculture	0%	4%								
Transportation	2%	46%								
Seafood	5%	19%								
Energy	1%	1%								
Commerce and services	14%	14%								
Road vehicles to indviduals	1%	2%								
Total	**44%**	**97%**								

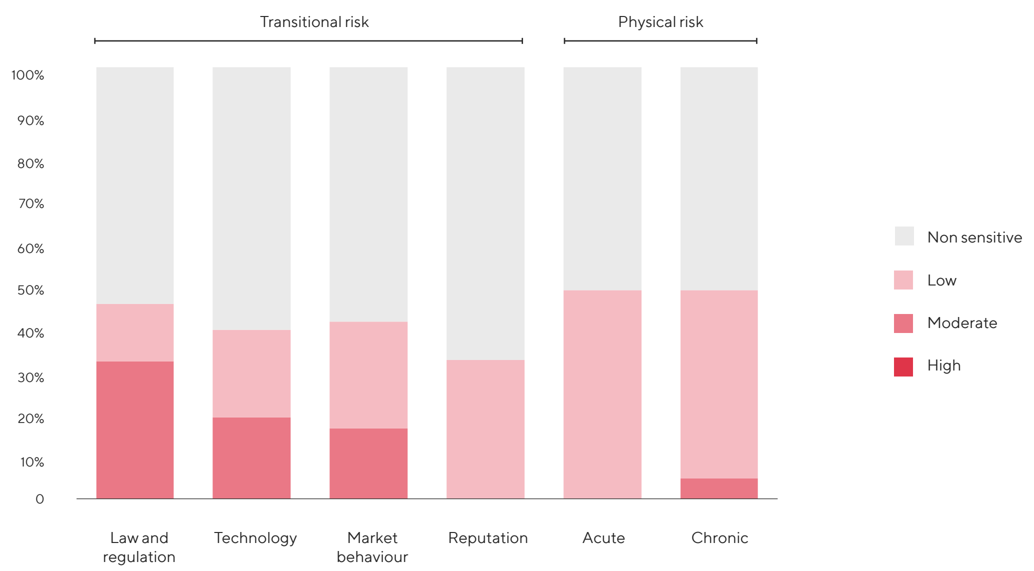
Non sensitive Low Moderate High

Exhibit 8.3. Climate-related risks and potential financial impacts, physical risk.

Sector			Physical risk			
	Carrying amount as % of portfolio	Financed GHG emissions as% of tCO_2eq	Acute		Chronic	
			1-5 years	5 years +	1-5 years	5 years +
Seafood	5%	19%				
Mortgages to individuals	44%	1%				
Total	**48%**	**19%**				

Non sensitive Low Moderate High

Exhibit 8.4. Overview of different types of climate risks that have been identified, by carrying amount.



encompasses approximately half of the Bank's loan amount but accounts for over 90% of the financed greenhouse gas emissions, under scope 1 and 2.

While the heatmap provides insights into transition risk at the sector level, a deeper understanding can be obtained by assessing transition risk at the customer level. Customers are evaluated by experts on their short-term vulnerability to transition risk, with a focus on their ability to adapt to changes, particularly those associated with the shift towards a low-carbon economy. This evaluation considers upcoming changes in laws, regulations, taxation, possible consumption behaviour, and business models aimed at achieving carbon neutrality and sustainability.

The Bank considers physical risk for residential- and commercial housing to be low since properties and structures in Iceland are insured by the Natural Catastrophe Insurance (Icelandic: Náttúruhamfaratrygging Íslands, NTÍ). This public institution is responsible for insuring properties and structures against damage caused by natural disasters, such as earthquakes, volcanic eruptions, landslides, avalanches, and floods.

Insurance plays a crucial role in managing and mitigating risks associated with acute climate-related impacts, which are a significant aspect of sustainability risk. Insurance can significantly reduce the financial and social impacts of such events, thereby contributing to overall sustainability and resilience.

The NTÍ covers all fire insured properties against natural disasters. Fire insurance for properties is mandatory in Iceland, with the insured amount determined by the fire insurance valuation from the Housing and Construction Authority (Icelandic: Húsnæðis- og mannvirkjastofnun, HMS). This also applies to other assets that have fire insurance, such as properties under construction, household contents, and other movable property, where the insured amount is based on the registered value in home insurance, movable property insurance, and fire-insured vehicles, respectively.

The Bank conducts exploratory climate stress test scenarios on its portfolio. The objective of this analysis is to identify sectors within the Bank's portfolio that may have significant adverse impacts on the environment. These sectors are then further analysed in comparison to the Climate Action Plan of the Government of Iceland. The Bank will continue to enhance the climate stress testing methodologies in the coming years.

8.3.2 ESG Risk Assessment

To systematically identify and manage ESG risks, the Bank has established a framework that analyses exposures based on environmental, social, and governance factors. The Bank employs a six-category scale ranging from A (best) to F (worst) to rank customers in terms of sustainability-related matters. This framework undergoes an annual review, and continuous improvements are made as the Bank refines its methodologies and strengthens its approach to ESG risk assessment.

The objective is to assess customers and counterparties behind majority of the Bank's asset portfolio, including loans to customers, loans to credit institutions, bonds and debt instruments, equities, and investments. The aim of the ESG assessment is to reflect risks that may lead to borrowers being unable to repay loans or to a decline in the value of assets, thereby serving as an assessment of financial risk for the Bank.

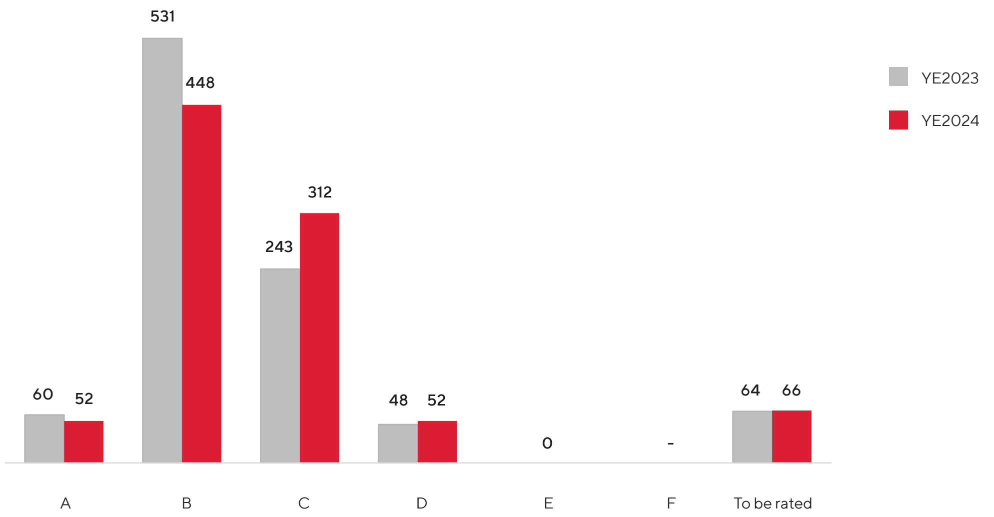
Ratings A and B are assigned to customers who have demonstrated a clear intention to manage their own ESG risks. Rating C is considered neutral, while ratings D and E require the Bank to engage with the customers to motivate or educate them on sustainability matters. Rating F and is used only in the unlikely event that customers willingly contravene the Bank's *Sustainability Policy*. Loans to customers with a rating of D or worse are not eligible for the Sustainable Funding Framework.

The Bank has so far assessed customers comprising around ISK 900bn in exposures, or 93% of the portfolio that will be rated. Only around ISK 66bn are yet to be rated but it is estimated to be finished early in 2025. The most common rating is B, followed by C, but very few customers receiving an E and none an F. The Bank uses the ESG rating to conduct further analysis of industry sectors and to assess the performance of its customers in sectors considered to have high climate impact.

8.3.3 Double Materiality Assessment

The Bank has conducted an initial double materiality assessment to ensure a holistic understanding of its sustainability impact and financial implications. This

Exhibit 8.5. The distribution of the asset portfolio in ESG risk classes. Over 90% has already been covered (ISK bn).



assessment aligns with the European Sustainability Reporting Standards (ESRS) and helps identify key areas where the Bank's operations intersect with environmental, social, and governance factors.

In the initial phase of the double materiality assessment, the Bank mapped its business model and previous impact analyses against the ESRS. This process identified four primary material topics: *climate change, own workforce, consumers and end-users,* and *business conduct*. These topics are crucial as they reflect the areas where the Bank's activities have significant environmental and social impacts.

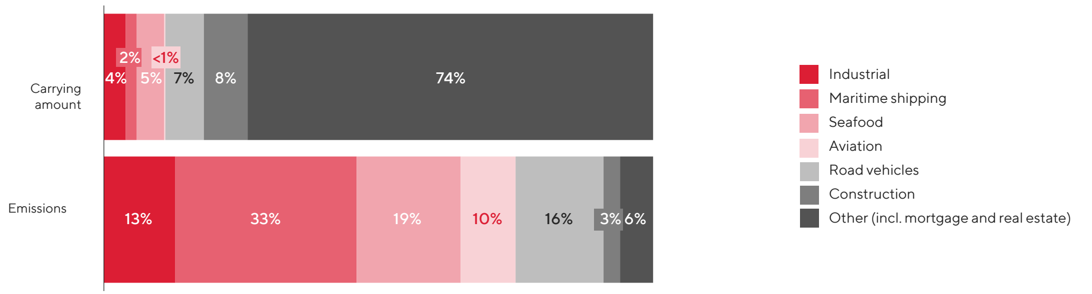
The Bank's primary areas of impact, risk and opportunities are evaluated through its value chain activities. The analysis covers various segments, including Retail and Corporate lending, Finance, Asset Management, Corporate Finance, and Treasury. Each segment is scrutinised to understand better how the Bank's activities affect and are affected by ESG factors. The second phase of the double materiality assessment focuses on financial materiality, involving a detailed evaluation of risks and opportunities. This phase emphasises qualitative risk analysis, which estimates the potential negative financial impacts on employees, operations, and reputation, and assesses the likelihood of these risks materialising. Additionally, it includes specialist stakeholder assessment, where a group of specialists is engaged to identify and evaluate risks based on each ESRS topic. The identified risk factors with the most significant impact on the Bank are then subjected to further examination in the Internal Capital Adequacy Assessment Process (ICAAP).

By conducting a double materiality assessment, the Bank ensures a robust approach to identifying and managing ESG risks and opportunities. This process not only enhances the Bank's sustainability efforts but also strengthens its financial resilience by proactively addressing potential risks and leveraging opportunities for sustainable growth.

8.4 Metrics and Targets

The Bank has measured the greenhouse gas emissions from operations, both direct and indirect, since 2017. Detailed information about the environmental, social, and governance impact of its operations is reported according to the European Sustainability Reporting Standards (ESRS), which have been built upon among other things, the Nasdaq ESG Guidelines and relevant GRI standards, which the Bank has disclosed on since 2019. The Bank has measured and published its Scope 3 financed emissions for 2019-2024, using the PCAF methodology.

Exhibit 8.6. Carrying amount and financed emissions for industry sectors at year-end.



The industrial and transportation sector, including road vehicles, aviation and maritime shipping, are the most carbon intensive. In 2024, they accounted for 72% of financed emissions while representing only 11% of the carrying amount.

In 2022, the Bank published its Road to Net-Zero report in accordance with the Net-Zero Banking Alliance Guidelines. Initially, sector targets were set for transportation, power generation, and commercial and residential real estate. In 2023, the seafood sector was added to the list.

Road to Net-Zero

Exhibit 8.7. Connection to balance sheet at year-end 2023 and 2024

	31.12.2024					31.12.2023				
Assets	**Total assets**	**In scope for financed emissions**	**Out of scope**	**Emissions**	**Intensity**	**Total assets**	**In scope for financed emissions**	**Out of scope**	**Emissions**	**Intensity**
	(ISK m)	(ISK m)	(ISK m)	(kt CO_2eq)	(tCO_2eq/ISKm)	(ISK m)	(ISK m)	(ISK m)	(kt CO_2eq)	(tCO_2eq/ISKm)
Cash and balances with Central Bank	65,716		65,716			87,504		87,504		
Loans to credit institutions	50,486		50,486			73,475		73,475		
Bonds and debt instruments	142,618	116,492	26,126	129.58	1.11	161,342	160,435	907	180.12	1.12
Derivatives	5,324		5,324			5,776		5,776		
Loans to customers	1,295,388	1,185,430	109,958	161.83	0.14	1,223,426	1,115,018	108,408	152.39	0.14
Shares and equity intruments	24,330	17,763	6,568	3.05	0.17	13,241	10,818	2,423	6.13	0.57
Investment in associates	4,701		4,701			4,051		4,051		
Investment property	2,600		2,600							
Property and equipment	5,039		5,039			6,562		6,562		
Intangible assets	2,684		2,684			2,930		2,930		
Other assets	7,302		7,302			3,638		3,638		
Non-current assets held for sale	1,617		1,617			749		749		
Total	1,607,807	1,319,685	288,122	294.45	0.22	1,584,394	1,286,271	296,423	338.64	0.26

Loans to customers										
	(ISK m)	(ISK m)	(ISK m)	(kt Co_2eq)	(kt Co_2eq)	(ISK m)	(ISK m)	(ISK m)	(kt Co_2eq)	(kt Co_2eq)
Individuals	625,262	578,331	46,931	4.39	0.01	594,631	553,445	41,186	5.77	0.01
Commerce and services	184,667	176,572	8,095	22.36	0.13	182,808	173,605	9,023	22.21	0.13
Construction	95,558	92,205	3,353	6.60	0.07	80,099	73,520	6,579	11.11	0.15
Energy	11,800	11,652	148	1.48	0.13	7,938	7,900	38	0.53	0.07
Financial services	715	711	4	0.00	0.00	214	74	140	0.00	0.04
Industrial and transportation	82,423	73,167	9,256	95.20	1.30	75,802	63,932	11,870	85.73	1.34
Investment companies	42,960	36,600	6,360	0.09	0.00	45,931	36,963	8,968	2.16	0.06
Public sector and non-profit organisations	20,448	11	20,437	0.00	0.27	18,476	4	18,472	0.00	0.84
Real estate	154,913	153,706	1,207	1.56	0.01	144,173	138,769	5,404	1.03	0.01
Seafood	76,642	62,475	14,167	30.14	0.48	73,354	66,804	6,550	23.85	0.36
Total	1,295,388	1,185,430	109,958	161.82	0.14	1,223,426	1,115,016	108,230	152.39	0.14

For seafood emission reduction targets, the Bank used an assessment conducted by the Icelandic seafood sector in collaboration with the Icelandic Government, incorporating economic dimensions according to IEA NZ 2050 framework to ensure coherence with other sectors.

The reduction targets depend on the renewal of the Icelandic fishing fleet, as the average vessel is currently outdated. This renewal aims to increase efficiency and transition from fossil fuels. Given that the Icelandic government has not implemented specific constraints for the period from 2030 to 2040, it is estimated that the reduction will follow similar constraints to those international maritime transport, as the sector faces analogous technology challenges.

Exhibit 8.8. Estimated pathway of emissions from balance sheet and actual financed emissions ($ktCO_2e$).

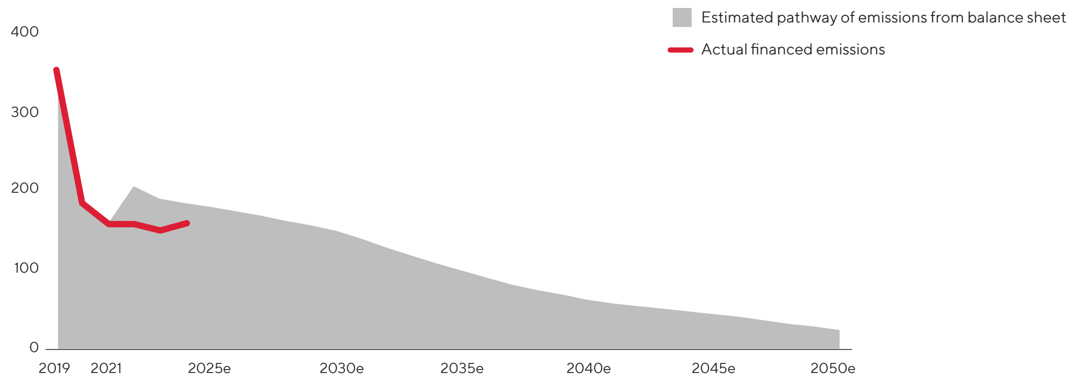


Exhibit 8.9. Sector-specific emission reduction targets.

	Share of balance sheet at YE 2019			Reduction targets vs. 2019		
Sector	**Amount**	**Emissions**	**Comment**	**2030**	**2040**	**2050**
Aviation and maritime shipping	3%	63%	Estimated aviation and maritime shipping emission reductions in 2020 and 2021 were significantly more than required by IEA NZ2050 pathway (1.5-degree compatible). After COVID-19 recovery in 2022 emissions are projected to decline by 3% annually.	>65%	>75%	>95%
Road vehicles	5%	7%	In 2030 importing new fossil fuel passenger vehicles to Iceland will be prohibited and financed emissions for passenger cars will reach zero by 2037. In addition, 95% of heavy-duty vehicles should run on clean energy by 2040.	>50%	>75%	100%
Commercial and residential real estate	52%	<1%	About 85% of houses in Iceland are heated with geothermal energy and renewable energy provided almost 100% of electricity. Therefore, emissions from operating real estates are already low but expected to grow in line with GDP until 2030.	<0%	<0%	<0%
Power generation	1%	<1%	Íslandsbanki's power generation funding is 100% hydropower generation (one of the least emission intensive electricity generation methods available) hence the sector-specific target is to keep the emissions unchanged.	<0%	<0%	<0%
Seafood	8%	11%	Estimated emission reductions follow published information by the seafood industry in Iceland until 2030. After 2030, no local information is available and the seafood sector is expected to follow international shipping as the two sector face similar technological constrictions.	>43%	>75%	>95%
Total	**69%**	**82%**				

Note that Íslandsbanki has negligible (and no plans to increase) credit exposure for other carbon-intensive sectors specified by NZBA: aluminum, cement, coal, iron and steel, oil and gas.

A new government was formed in December 2024, and one of its objectives, as defined in the coalition platform, is to achieve carbon neutrality by 2040 and remain in the forefront of the struggle against global warming. The Bank's net-zero 2040 ambition is highly challenging. Emissions from balance sheet activities are projected to reduce by 60% by 2030 and 85% by 2040. However, achieving reductions in aviation, maritime shipping, and seafood will be more demanding due to technological challenges and the longer lifespan of aircraft and vessels. Currently, financed emissions for both 2023 and 2024 are below the estimated pathway of emissions.

8.5 Next Steps

Building on the work completed in 2024, the Bank will focus on further advancing its sustainability and ESG risk management efforts. Following the more detailed double materiality assessment conducted in 2024, the Bank will continue to refine and expand its understanding of key issues, including climate change, human capital, consumers and customers, and business ethics. This will involve ongoing assessment to ensure these priorities remain aligned with both regulatory requirements and the Bank's strategic objectives.

The Bank will prioritise the publication of comprehensive information on climate change and human resources, in accordance with the Corporate Sustainability Reporting Directive (CSDR). This will include enhanced disclosures that meet the evolving regulatory standards and provide stakeholders with transparent and detailed reports on the Bank's ESG initiatives.

To achieve the goal of carbon neutrality by 2040, the Bank will identify and develop pathways for additional sectors, such as construction and agriculture. This will involve sector-specific strategies to address unique challenges and opportunities, ensuring a comprehensive approach to sustainability across the Bank's operations.

With the implementation of new regulations and increased disclosure of information related to the EU taxonomy, the Bank will further enhance its ability to manage ESG risk within its portfolio. This will involve integrating new data and insights into the Bank's risk management framework, improving its capacity to identify, assess, and mitigate ESG-related risks.

By taking these steps, the Bank aims to strengthen its commitment to sustainability, enhance its financial resilience, and position itself as a leader in responsible banking practices.

9 Remuneration

The Bank's Compensation Policy states that the Board of Directors shall not make or authorise agreements for variable compensation without the shareholders' consent and on terms agreed by shareholders at a shareholders' meeting.

9.1 Regulatory Framework

The Central Bank of Iceland publishes rules regarding remuneration in financial undertakings. The rules reflect a conservative framework for remuneration schemes within the financial sector. According to the rules, a bank intending to pay variable remuneration to one or more employees is required to have in place a compensation policy approved by its board of directors. The compensation policy shall be reviewed at least annually, and the bank shall account for the policy to the Central Bank.

9.2 Compensation Committee

The Board Corporate Governance and Human Resource Committee serves as the compensation committee. The role of the committee is to guide the Board of Directors and CEO on deciding the terms of employment of senior management and other key employees, as well as ensuring that the terms of employment are in accordance with the Compensation Policy. The committee had eight meetings in 2024. Further information on composition of the committee and its mandate can be found on the Bank's website.

9.3 Compensation Policy

The *Bank's Compensation Policy* states that the Board of Directors shall not prepare or authorise any contracts for variable remuneration. An exception can be made by obtaining prior approval from the shareholders, and the terms are in accordance with the terms agreed upon at shareholders' meeting.

The Compensation Policy shall support sound operations in the long term and not encourage unreasonable risk-taking. It is the Bank's goal that the terms of employment of executives and other employees are competitive yet balanced without being leading in the market. In determining the terms of employment, responsibility and performance shall be taken into account, as well as equal rights perspectives.

The Bank has in place an Equal pay policy, intended to guarantee the rights that employees must be paid equal wages for the same or equally valuable work, regardless of gender. Equal pay means that remuneration must be determined in the same way for everyone, regardless of gender. To implement the policy, Íslandsbanki complies with the Equal Pay Standard on equal pay systems. The equal pay system covers all employees of Íslandsbanki.

9.4 Remuneration in 2024

Salary and other benefits of the Bank's management and the Board of Directors are disclosed in Note 12 in the Consolidated Financial Statements. No deferred remuneration is outstanding from previous remuneration scheme. Further information regarding remuneration can be found in the remuneration tables REM 1 – 5 in the Additional Pillar 3 Disclosures.

10 Abbreviations

ADC: Acquisition, Development, and Construction
AGM: Annual General Meeting
AI: Artificial Intelligence
ALCO: Asset and Liability Committee
AML: Anti-Money Laundering
AMM: Additional Monitory Metrics
ARC: All Risk Committee
ASF: Available Stable Funding
AT1: Additional Tier 1
BP: Basis Points
BPV: Basis Point Value
BoD: Board of Directors
BRRD: Bank Recovery and Resolution Directive
CAE: Chief Audit Executive
CAPEX: Capital Expenditures
CB: Central Bank of Iceland
CBR: Combined buffer requirement
CCF: Credit Conversion Factor
CCR: Counterparty Credit Risk
CCyB: Countercyclical capital buffer
CEO: Chief Executive Officer
CET1: Common Equity Tier 1
CFO: Chief Financial Officer
CIRS: Cross-Currency Interest Rate Swaps
CLTV: Cumulative Loan to Value
CPI: Consumer Price Index
CRD: Capital Requirements Directive
CRE: Commercial Real Estate
CRR: Capital Requirements Regulation
CRR 3: Capital Requirements Regulations 3
CRO: Chief Risk Officer
CSDR: Corporate Sustainability Reporting Directive
CSRBB: Credit Spread Risk in the Banking Book
EAD: Exposure at Default
EEA: European Economic Area
EBA: European Banking Authority
ECL: Expected credit loss
EMTN: European Medium Term Note
ESG: Environmental, social, and governance
ESRS: European Sustainability Reporting Standards
EU: European Union
EUR: Euro
EVE: Economic Value of Equity
FINREP: Financial Reporting (Regulatory financial reporting framework)
FSN: The Financial Stability Committee of the Central Bank of Iceland
FX: Foreign Currency
GAR: Green Asset Ratio
GBP: Green Bond Principles
HMS: Housing and Construction Authority
HQLA: High Quality Liquid Assets
IC: Investment Committee
ICAAP: Internal Capital Adequacy Assessment Process
IcelandSIF: Iceland Sustainable Investment Forum
ICMA: International Capital Market Association
ICT: Information and Communication Technology
IFRS: International Financial Reporting Standards
ILAAP: Internal Liquidity Adequacy Assessment Process
IPRE: Income-Producing Real Estate
IRRBB: Interest Rate Risk in the Banking Book
IRS: Interest Rate Swaps
ISDA: International Swaps and Derivatives Association
ISK: Icelandic Króna
ITS: Implementing Technical Standards
KRI: Key Risk Indicators
LAA: Loss absorption amount
LCR: Liquidity Coverage Ratio
LCCP: Liquidity and Capital Contingency Plan
LED: Loss Event Database
LGD: Loss Given Default
LTV: Loan-to-Value
MREL: Minimum Requirement for Own Funds and Eligible Liabilities
MRMF: Market Risk Measurement Framework
NIBOR: Norwegian Interbank Offered Rate
NII: Net Interest Income
NMD: Non-Maturity Deposits
NOK: Norwegian Kronar
NPL: Non-Performing Loans
NSFR: Net Stable Funding Ratio
NTÍ: Natural Catastrophe Insurance
ODF: Observed Default Frequency
OSC: Operations and Security Committee
O-SII: Other Systemically-Important Institutions
PCA: Principal Component Analysis
PCAF: Partnership for Carbon Accounting Financials
PD: Probability of Default
PRI: Principles for Responsible Investments
RCA: Recapitalisation amount
RCSA: Risk and Control Self-Assessment
RSF: Required Stable Funding
REA: Risk Exposure Amount
RRE: Residential Real Estate
RTS: Regulatory Technical Standards
SBG: Sustainability Bond Guidelines
SBP: Social Bond Principles
SCC: Senior Credit Committee
SEK: Swedish Kronar
SMEs: Small and Medium-sized Enterprises
SOT: Supervisory Outlier Test
SREP: Supervisory Review and Evaluation Process
STIBOR: Stockholm Interbank Offer Rate
S&P: Standard and Poors
TSCR: Total SREP Capital Requirement
UNEP FI: United Nations Environment Programme Finance Initiative
UNGC: United Nations Global Compact
UN SDGs: United Nations Sustainable Development Goals
USD: US Dollar
YE: Year-End