S&P Global
Ratings

RatingsDirect®

Islandsbanki hf

Primary Credit Analyst:
John Wright, London (44) 20-7176-0520; john.wright@spglobal.com

Secondary Contact:
Richard Barnes, London + 44 20 7176 7227; richard.barnes@spglobal.com

Table Of Contents

Table Of Contents (cont.)

Islandsbanki hf

SACP	bbb
Anchor	bbb-	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Adequate	

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating

BBB/Stable/A-2

Credit Highlights

Overview

Key strengths	Key risks
High leverage ratios and very strong capital.	Material exposure to tourism and commercial real estate (CRE).
Stable franchise and market position across all domestic business lines.	Concentration in Iceland and exposure to the volatile domestic economy.
Limited wholesale financing needs.	Unpredictable operating environment and strong competition, which could weigh on profitability prospects.

We expect Islandsbanki's risk-adjusted capital (RAC) ratio to remain above 15%, despite capital optimization. The RAC ratio stood at 18.0% as of year-end 2020, and we expect it to decline to about 16.5% by 2023, on the back of inflation in risk-weighted assets (RWAs) and limited capacity for retained earnings. While a 50% dividend payout ratio has been approved for 2021, additional payouts are likely in 2022 and 2023, provided the recovery in the bank's performance remains robust. We expect the bank to maintain a payout ratio of about 50%, and note the successful placement of an inaugural Swedish krona (SEK) 750 million additional Tier 1 note in September 2021. On a positive note, earnings will be supported by increasing cost efficiencies and strong lending growth on the back of increased demand for mortgages.

Islandsbanki's asset-quality indicators remain vulnerable to setbacks in the recovery of international tourism. This is despite an Icelandic krona (ISK) 1.1 billion impairment release in the second quarter of 2021, driven by encouraging trends of economic reopening. The bank lacks geographical diversification and has meaningful exposure to volatile sectors such as real estate (11%) and tourism (9%) as of June 2021. The bank reclassified most of its loans to tourism companies to stage 2 in 2020, when the proportion of stage 2 loans peaked at 15.6% as a percentage of total loans, before declining to 13.7% as of end-June 2021 from 2.6% as of end-2019. The nonperforming asset (NPA) ratio has gradually improved to 2.1% as of June 2021 from 2.9% at end-2020, but we expect it to increase above 3.0% in the next 18-24 months, with coverage of about 45%, which is broadly in line our expectation for Islandsbanki's domestic peers.

Islandsbanki maintains a solid business position in Iceland, but remains closely comparable with the other two domestic commercial banks. Islandsbanki's business position reflects the bank's solid domestic franchise across most business lines in Iceland and its advanced digital offering. In terms of total lending, Islandsbanki has a strong market share of about 23%. It maintains leading market positions in most business lines, such as a 37% share in small-to-midsize enterprises (SMEs), 35% in large companies, and 32% in retail customers.

No government support is likely in the medium term. We do not consider Islandsbanki to be a strategic government-related entity for Iceland and see the government's ownership as temporary. In June 2021, the bank successfully completed an IPO on the Icelandic stock exchange, which saw Icelandic State Financial Investments (ISFI) sell a 35% stake on behalf of the Icelandic government. The government remains the largest shareholder, with 65% ownership. At present, we do not regard the bank resolution framework as effective. In June 2020, parliament approved the "Act on the Resolution of Credit Institutions and Financial Undertakings" (No. 70/2020), which entered into force on Sept. 1, 2020. Implementation is therefore at a very early stage.

Outlook: Stable

The stable outlook indicates that while we expect a gradual economic recovery in Iceland over the next two years, there are residual risks associated with COVID-19-related setbacks and/or the withdrawal of accommodative fiscal and monetary policy. Such eventualities could impair the bank's profitability, causing its return on equity (ROE) to remain in the mid-single digits, and its asset quality to deteriorate such that the NPA ratio would be likely to rise above 3.0% from 2.2% as of June 2021. In the next two years, we anticipate that Islandsbanki's RAC ratio will remain above 15% on the back of moderate loan growth and contained dividend payments.

Downside scenario

We could lower the ratings on Islandsbanki if the economic environment in Iceland becomes even more difficult, causing banks' profitability prospects to weaken for a prolonged period and Islandsbanki's RAC ratio to decline below 15%.

Upside scenario

We could raise our ratings on Islandsbanki if it proves able to strengthen its returns, efficiency, and risk profile such they are significantly better than those of its domestic peers, with no further widening of the gap between the bank and its foreign peers.

Anchor: bbb-' For Banks Operating Primarily In Iceland

We use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Iceland is 'bbb-', based on an economic risk score of '4' and an industry risk score of '6'.

Our view of the economic risk trend that Icelandic banks face is negative. Banks faced a sharp economic recession in 2020, with GDP declining by 6.6% in real terms. While we expect the economy to continue to recover from the pandemic through 2021, enabling GDP to recover by around 3% in 2021 and almost 5% in 2022, we do not expect tourism to reach pre-pandemic levels before 2023. The pace of economic recovery will determine the extent to which Icelandic banks face deteriorating asset quality, increased credit losses, reduced business and revenue, and potential capital erosion. Banks' structural exposure to local SMEs--including in the tourism sector, which we view as highly vulnerable in the current context--and CRE and construction companies (about 20% of the loan book) increase the risks.

We view the trend for industry risk in the Icelandic banking sector as stable. Although we expect that banks' lending will remain based on sound commercial practices, overall profitability will stabilize at moderate levels, which we project at a mid-single-digit ROE. This is in the absence of the substantial one-off items that banks have reported over the past few years and in light of the economic recession.

Banks' wholesale funding needs in the next two years are sizable but manageable, with no pressure on liquidity owing to strong customer-deposit inflows, prudent liquidity management, and effective capital-market funding operations.

On Oct. 27, 2020, The Financial Action Task Force removed Iceland from its "gray list" of monitored jurisdictions. This is in line with our expectations and reflects the improvements Iceland has made in multiple areas to strengthen its anti-money laundering and financial crime framework.

Business Position: Diverse Business Model Within The Limits Of The Icelandic Economy

Our assessment of Islandsbanki's business position balances the bank's solid domestic franchise across most business lines in Iceland with its advanced digital offering.

With total assets of ISK1.44 trillion (about €9.6 billion) as of end-June 2021, Islandsbanki is similar in size to its domestic peers Arion Bank and Landsbankinn. In terms of total lending, Islandsbanki has a strong market share of about 23% and maintains a comparable market position in most business lines, such as 19% in residential mortgages (up from 16% in 2019). It also has a rising market share in the corporate and SME segment. The bank has diverse revenues from retail banking, including asset financing and credit cards; wealth management; trading activities; and corporate finance. However, the small domestic economy limits Islandsbanki's diversification prospects, in our view.

In 2020, Islandsbanki sold its remaining 63.5% stake in payment services company Borgun hf. The sale resulted in a profit of ISK427 million, which the bank has classified under discontinued operations. In our view, the sale reduces earnings volatility, but also limits business diversification and increases reliance on net interest income.

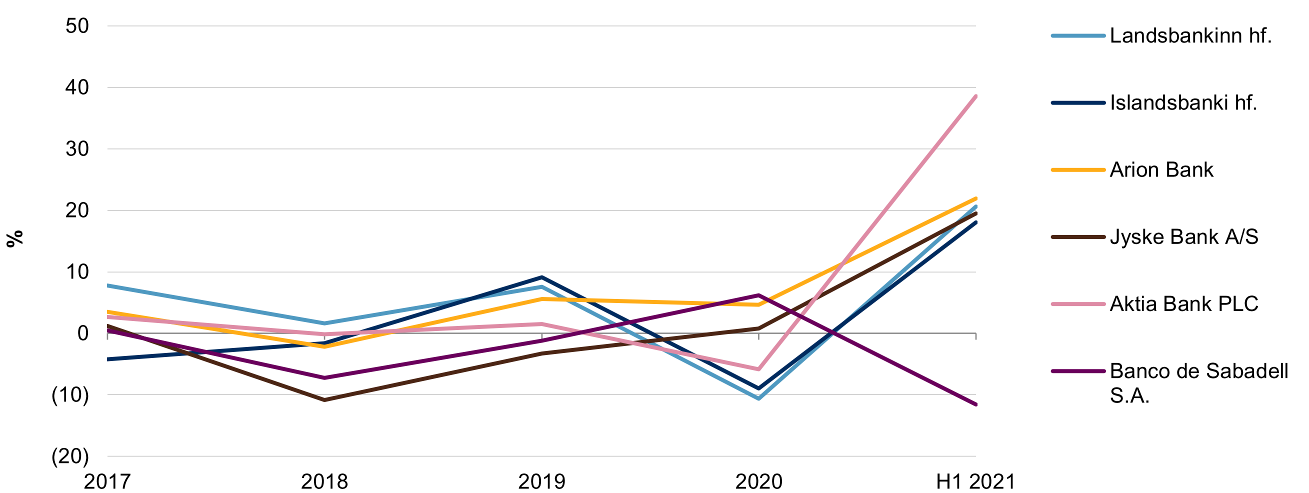
Islandsbanki is a government-owned entity, resulting from the banking sector restructuring after the 2008 collapse. We do not see the bank as a strategic investment for the government and view its ownership as temporary. In June 2021, the bank successfully completed an IPO on the Icelandic stock exchange, which saw ISFI sell a 35% stake on behalf of the Icelandic government. The government remains the largest shareholder with 65% ownership. While bank privatization has been a key government objective since 2015, the IPO is unlikely to prompt any meaningful change in the bank's strategy or stable risk appetite.

In 2019, Islandsbanki produced an updated strategy focused on increasing efficiency through further process automation, workforce reduction, and asset repricing in the corporate segment, while further encouraging the use of its digital customer platforms.

In our view, Islandsbanki is well ahead of many other European banks in preparing for technological disruption. While the bank operates with a smaller branch footprint than its domestic peers, with 12 branches, consumers' use of its digital channels has risen sharply. In 2020, 56% of sales and 99% of customer interactions took place through digital channels. Islandsbanki has established a relatively advanced digitalized banking environment, and conducts almost all credit scoring digitally. The bank is also progressing toward fully automated lending processes for both consumer loans and mortgages.

Chart 1

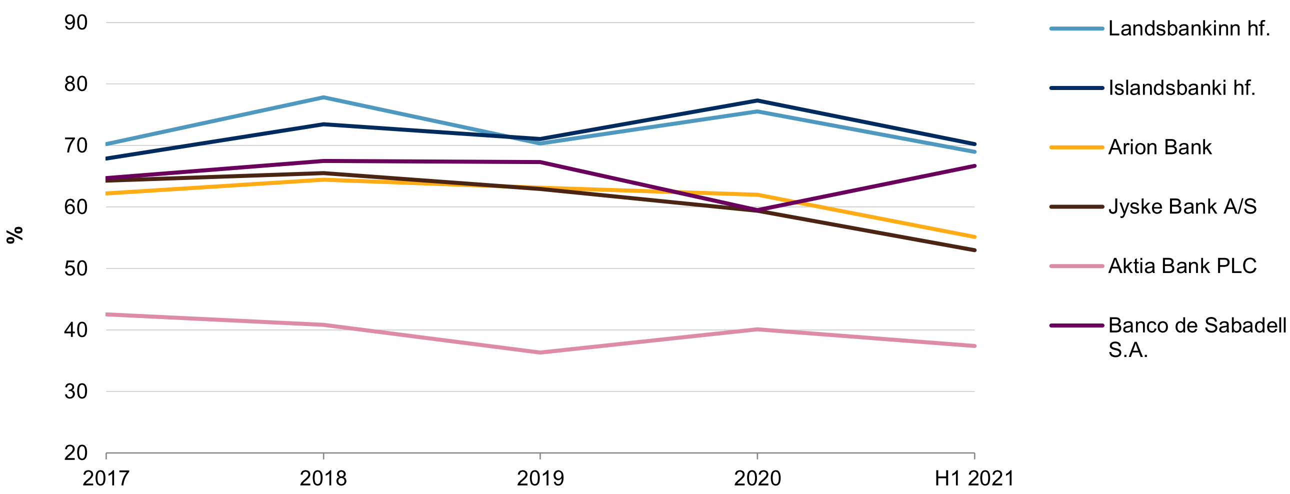
Icelandic Banks Reversed A Slowdown In Operating Revenues In 2021
Year-on-year growth in operating revenues



Source: S&P Global Ratings.

Chart 2

Icelandic Banks Rely Heavily On Net Interest Income
Net interest income/operating revenue



Source: S&P Global Ratings.

Capital And Earnings: Capitalization Will Likely Remain Robust Even Though COVID-19 Will Weigh On Profitability

Islandsbanki's level of capital remains a rating strength, and it has the capacity to absorb material losses, despite the balance between equity and subordinated capital instruments. The RAC ratio stood at 18.0% as of year-end 2020, and we expect it to decline to about 16.5% by 2023, on the back of RWA inflation and limited retained earnings due to renewed capital-optimization efforts. Islandsbanki has proposed a dividend payout of about 50% (ISK3.4 billion) for year-end 2021, with the possibility of an additional payout based on its performance in 2021. Our capital forecast incorporates a dividend payout ratio of 50% in the next 18-24 months, along with the potential for special dividends and/or share buybacks as the bank implements its ISK30 billion capital-optimization plan.

Compared with its domestic peers, Islandsbanki's RAC benefits from the smaller equity positions on its balance sheet. As of June 30, 2021, the bank's common equity Tier 1 ratio was 20.1% and the total capital ratio 22.9%. We compare these ratios with the current regulatory total capital requirement of 17.8% and the bank's target of an additional 50-200 basis point (bp) management buffer. Islandsbanki's Pillar 2 capital requirements are lower than at its two domestic competitors, which, in our view, reflects both Islandsbanki's contained equity portfolios, and a narrowing of the competitors' consumer price index (CPI) imbalances in recent years.

Following the successful IPO in June, we expect Islandsbanki to maintain its capital optimization, which includes the successful placement of an inaugural SEK750 million additional Tier 1 note in September 2021. Islandsbanki has already met its Tier 2 requirement with 2.6% of regulatory RWAs.

Islandsbanki's leverage ratio, measured as adjusted common equity as a share of adjusted assets, was 12.4% on June 30, 2021, and is considerably higher than that of its Nordic peers and most global commercial banks. Although the leverage ratio has fallen from 14.2% in December 2019, we anticipate that the ratio will remain above 12% because of the bank's capital targets.

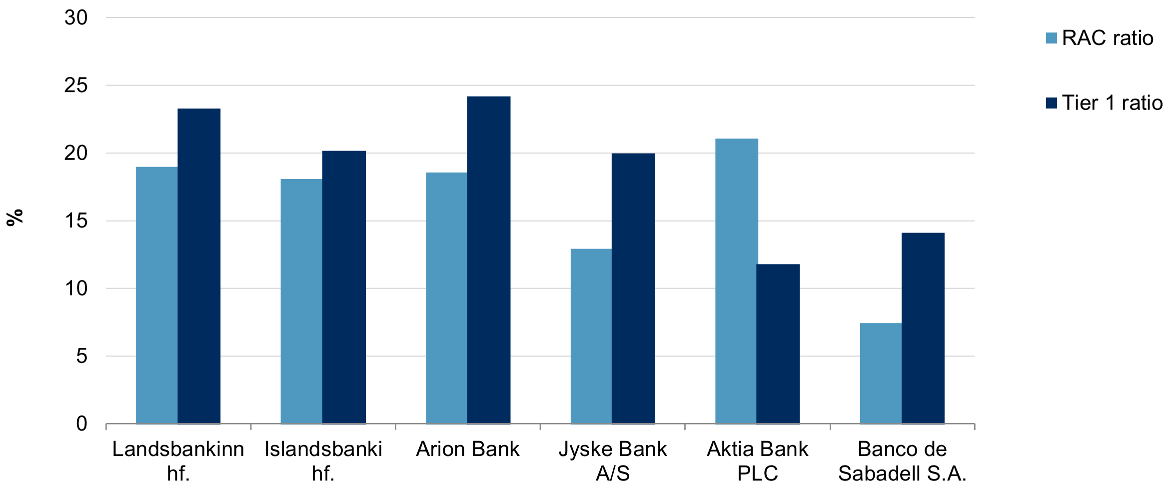
Islandsbanki's profitability metrics in 2020 were dented by the COVID-19 pandemic, as well as structural factors, such as the lowering of interest rates, and competition in the corporate and household segments, both among banks and nonbank players. That said, the first half of 2021 saw a strong rebound, and while we believe the ROE of 11.6% in the second quarter of 2021 will prove unsustainable due to the one-off sizable impairment release, increasingly we see the bank's medium-term target of high-single-digit ROE as achievable.

The central bank's reduction in the key reference rate to a historical low of 0.75% by November 2020 from 4.5% in May 2019 led to strong growth in mortgages. The number of mortgages increased by 34% in 2020 and offset the pressure on net interest income due to declining margins. While the reference rates increased to 1.25% as of August 2021, we have also seen the loan book grow by a further 8.2% in the first six months of 2021, and expect this trend to continue. Although there is great uncertainty relating to credit loss levels in the coming two years, we expect the cost of risk to moderate to around 35-40 bps in 2021 and around 25–30 bps by 2023, from 91 bps at year-end 2020. On a positive note, management initiatives to improve cost efficiency--for example, a reduction in the number of full-time employees and process automation--and the Borgun disposal improved the efficiency ratio to 54% in 2020 from 61% in 2019. This remains a strong area of focus for the bank and will continue to have a positive bearing on its results in the next two years.

We project Islandsbanki's earnings buffer to be around 160-180 bps in 2021 and 2022. This buffer measures the bank's ability to generate capital given normalized losses (127 bps as of Dec. 31, 2020).

Chart 3

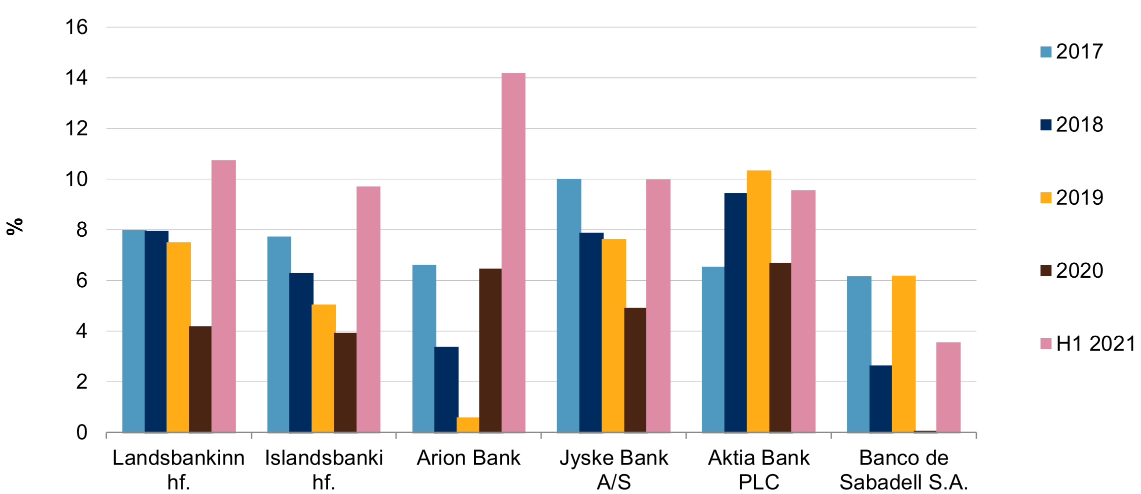
Icelandic Banks Have Strong RAC Ratios Compared To Peers
S&P Global Ratings RAC versus Tier 1 ratios



Source: S&P Global Ratings. 2020 annual figures. RAC--Risk-adjusted capital.

Chart 4

Icelandic Banks Have Performed In Line With Peers
Return on average common equity



Source: S&P Global Ratings.

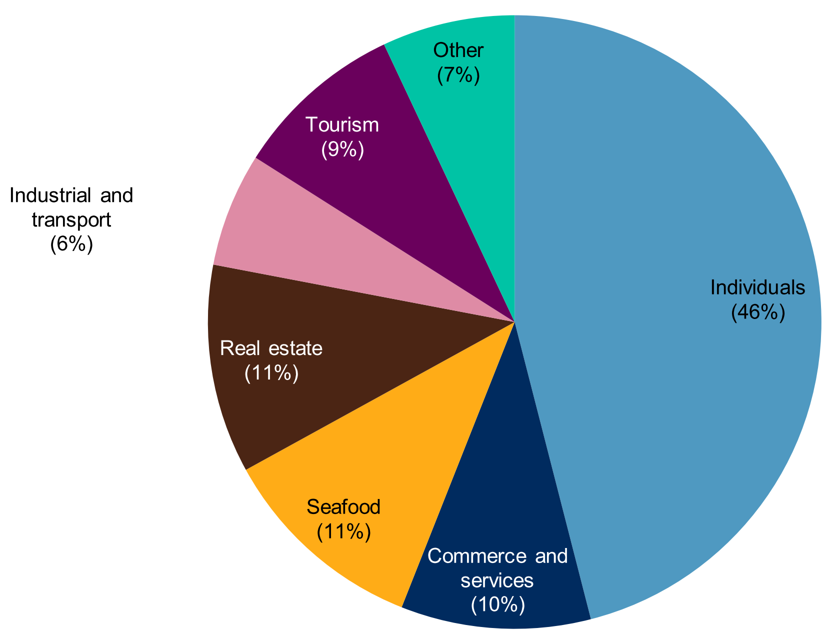
Risk Position: Highly Correlated With Systemic Risks In Iceland

Our assessment of Islandsbanki's risk position reflects the bank's lack of geographical diversification, its presence in a concentrated market, and its inherent exposure to the volatile domestic economy. Our standardized capital calculation does not fully capture these risks.

In our view, Islandsbanki has broad exposure within Iceland to the retail and commercial banking market. Islandsbanki's loan book is primarily focused on retail loans (46% of total loans), real estate (13%), and fishing/seafood (12%). Islandsbanki's exposure to the tourism sector is around 9% of total loans, including hotels, transportation, and other services. This sector is prone to volatility and is now vulnerable to ongoing global travel restrictions. The sector has seen strong wage inflation and investments in recent years, while there are still several small players. On a positive note, we recognize that Islandsbanki has continued to increase its mortgage exposure to 40% in 2021 from 31% in 2019.

Chart 5

Islandsbanki's Loan Breakdown By Sector: Concentrations In Real Estate And Tourism



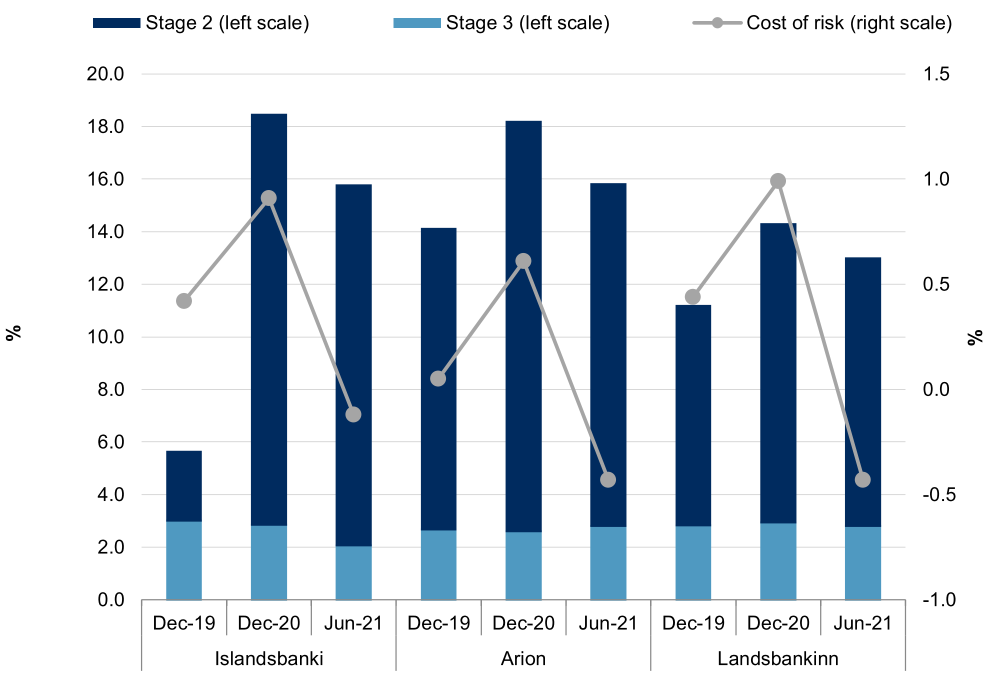
Source: Islandsbanki hf. Q1 report.

Islandsbanki entered the economic recession with a relatively clean balance sheet. Gross NPAs have remained below

3.6% throughout the pandemic and improved by a further 78 bps since year-end 2020 to 2.1% as at June 2021. (Under new International Financial Reporting Standard disclosures, we include all stage 3 loans.) This proportion is notably lower than 23.2% in fourth-quarter 2012 following the global financial crisis. However, we expect that NPAs could increase to above 3% in the next 18-24 months, as fiscal support is withdrawn, with coverage of about 45%-50%, broadly in line our expectations for Islandsbanki's domestic peers.

Chart 6

Islandsbanki's Loan Breakdown Shows An Increase In Stage 2 Loans And Then A Recovery In 2021
Stage 2 and Stage 3 loans



Source: S&P Global Ratings.

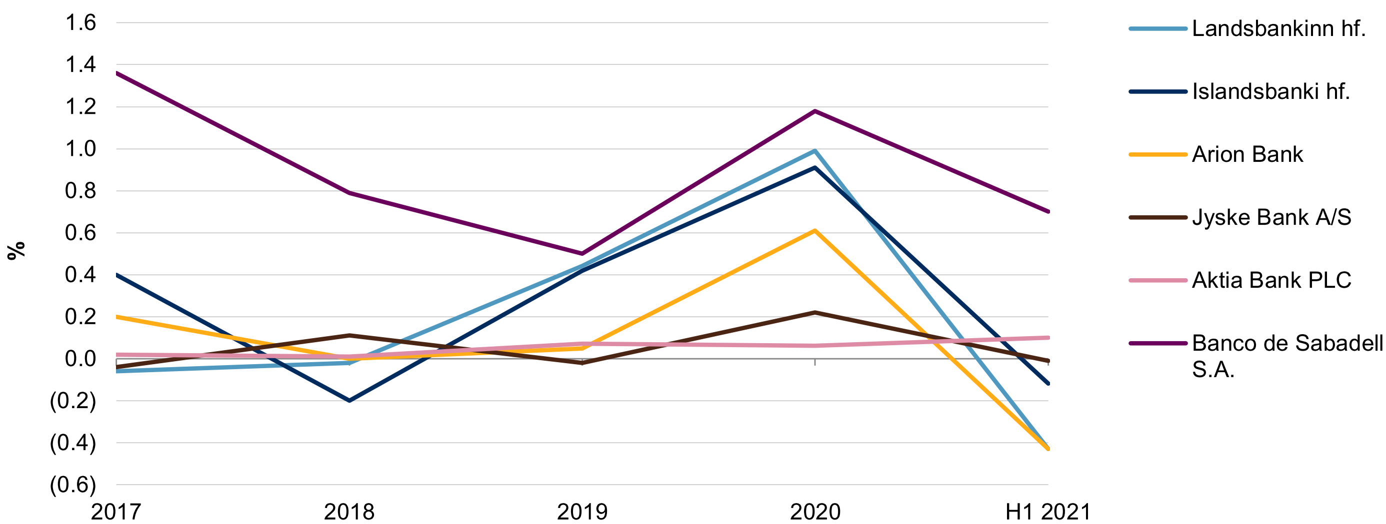
Stage 2 loans, that is, loans that carry increased credit risk but are not impaired, improved from a peak of 15.6% of total loans in the fourth quarter of 2020 to 13.7% in the second quarter of 2021. This proportion is elevated compared to the pre-pandemic level of 2.6% at year end-2019, as the bank reclassified most of its tourism loans as stage 2. Loan loss provisions to customer loans increased to 91 bps from about 42 bps in 2019, and we expect this to moderate to 30-40 bps in the next two years.

Foreign-currency lending represents 16% of the total loan book. However, the bank mitigates this risk by granting credit to customers with income in, or correlated with, foreign currency. This mainly includes customers in the fishing and transportation industries, with modest exposure to Norwegian offshore companies.

Like other domestic peers, a substantial part (about 25% in the second quarter of 2021) of Islandsbanki's loan book is linked to the CPI, a proportion that has been reducing from 27% at end-2020 or 33% at end-2019. CPI imbalances represent 15% of core equity as of end-June 2021.

Chart 7

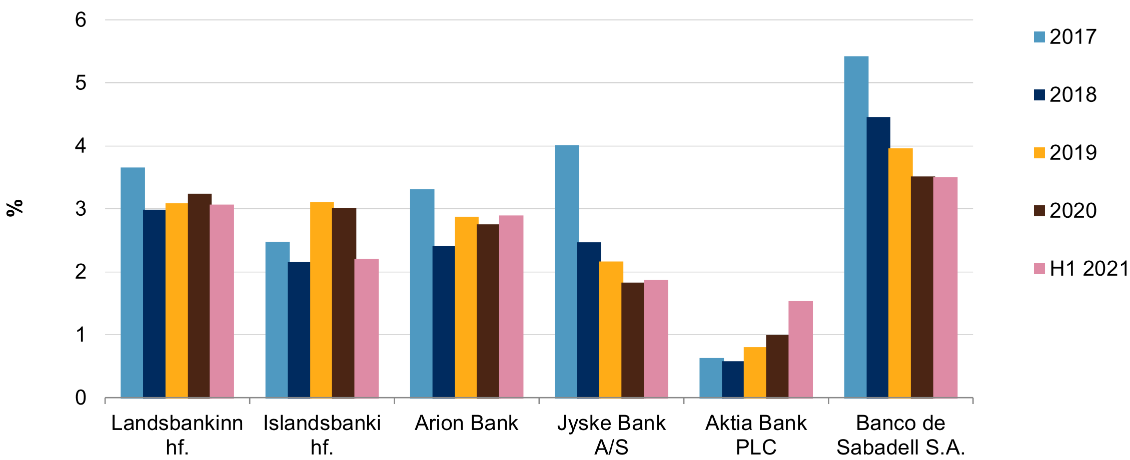
Credit Losses At Icelandic Banks Spiked During The Pandemic
New loan loss provisions/average customer loans



Source: S&P Global Ratings.

Chart 8

Icelandic Banks Have Performed In Line With Peers
Nonperforming assets



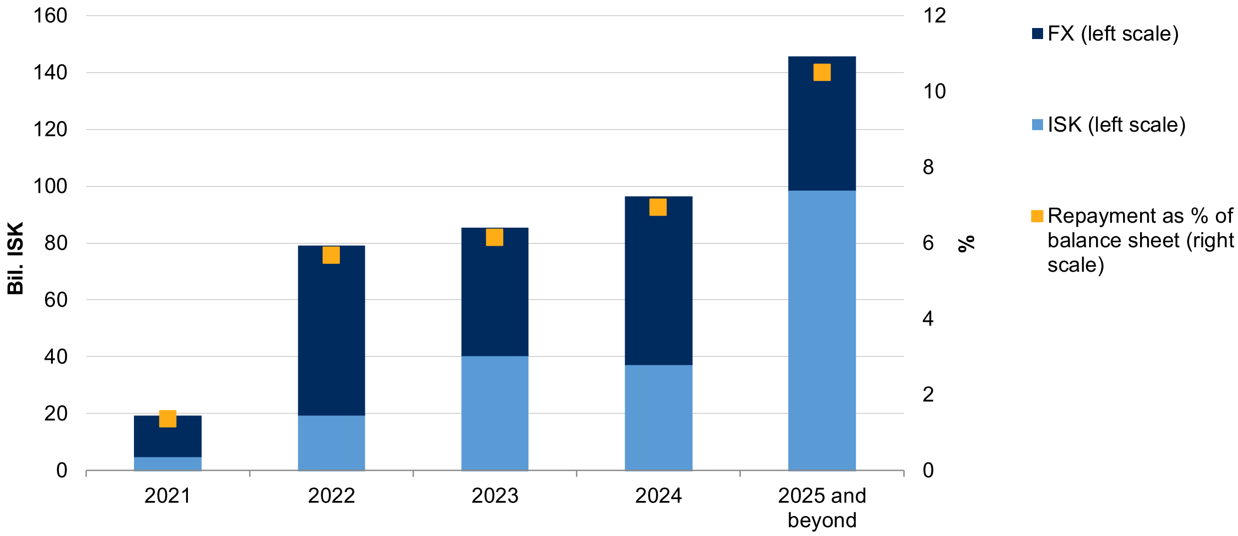
Source: S&P Global Ratings.

Funding And Liquidity: Limited Wholesale Debt Maturities And A Stable Liquidity Position

Islandsbanki is predominantly funded by customer deposits, as they constitute the majority of total funding (62% as of June 2021). The granularity of Islandsbanki's deposit base has reduced--the 10 largest depositors made up 16% of total deposits in 2020 compared with 24% in 2015--and 62% of total deposits come from retail customers. The remaining part of the bank's funding consists primarily of senior unsecured bonds and covered bonds in the domestic market. Islandsbanki is one of the largest covered bond issuers in Iceland. In the next 24 months, we expect Islandsbanki to maintain its stable funding ratio around the same level as 111% as of June 2021. Islandsbanki has high upcoming debt maturities in foreign currency, but we see limited pressure on funding as the bank has had access to the wholesale markets in recent years. In 2020, the bank also issued its first sustainable bond (€300 million, with a three-year maturity) and green bond (ISK2.7 billion, with a five-year maturity), further diversifying its investor base.

Chart 9

Islandsbanki's Long-Term Debt Maturity Profile



ISK--Icelandic krona. FX--Foreign currency. Source: Islandsbanki as of June 30, 2021.

Islandsbanki's liquidity position is set to remain comfortable, supported by high liquid assets on the balance sheet and moderate loan growth. The ratio of broad liquid assets to short-term wholesale funding declined to 2.2x as of June 2021 from 3.5x in December 2020, due to high upcoming debt maturities. However, we expect this ratio to normalize in the medium term as the debt maturity profile normalizes. In September 2021, the Central Bank of Iceland announced an increase in the countercyclical buffer to 2% from 0%, reversing the 2020 precautionary measure, and effective 12 months from the announcement.

Support: Government Support For Icelandic Banks Is Uncertain

We do not consider Islandsbanki to be a strategic government-related entity for Iceland and see the government's ownership as temporary. Nevertheless, we view Islandsbanki as having high systemic importance in Iceland. We do not apply any notches of uplift to the stand-alone credit profile (SACP) to arrive at the issuer credit rating, as we view future extraordinary government support as uncertain. This reflects our view of the Icelandic government's track record of not supporting senior creditors and its still-limited--but improved--capacity to support the country's new, smaller banking system in the event of severe financial stress.

At present, we do not regard the bank resolution framework as effective. As such, we do not incorporate additional loss-absorbing capacity into our ratings on Icelandic banks. We regard the current framework as open-ended but, in our view, the authorities' method of dealing with failing banks so far indicates a tendency to safeguard depositors rather than senior unsecured creditors.

In June 2018, the Icelandic parliament passed a bill that incorporates into the local legislation part of the EU's Banking Recovery And Resolution Directive (BRRD) provisions, including recovery plans, early interventions, and intra-group support. In June 2020, the parliament approved the "Act on the Resolution of Credit Institutions and Financial Undertakings" (No. 70/2020), which entered into force on Sept. 1, 2020. Implementation is therefore at a very early stage. A recently established resolution authority will oversee resolution and related matters. For now, the Financial Stability Committee is due to wield powers of resolution and will be in control of the earliest intervention measures. Full implementation of the Icelandic resolution framework, including bail-in powers, could open the door for additional rating support if the three largest banks--Landsbankinn, Islandsbanki, and Arion Bank--are required to build additional subordinated loss-absorbing buffers, and we consider that this could offer a bank's senior creditors extra protection if the bank fails.

Environmental, Social, And Governance (ESG)

We assess Islandsbanki's ESG credit factors as being broadly representative of its domestic and European peers, and the bank's corporate governance as consistent with industry norms.

Islandsbanki has increased its focus on environmental sustainability in recent years, helping customers to transition to more sustainable products and reducing its own carbon footprint. It continues to work on ensuring its sustainability framework applies to all product lines. As with its peers, gender equality is a priority, evident from superior representation ratios to those of a broad European peer set.

Islandsbanki implemented a sustainable financing framework in 2020, the first bank to do so in Iceland, to serve as a platform for green and sustainable bond issuance and specific lending activities. The bank subsequently issued two sustainable and green bonds in euros and Icelandic krona, respectively, while continuing to actively support four key sustainable development goals—education for all, gender equality, innovation, and climate action. The bank has also made public commitments to reduce the carbon footprint from its operations by 50% from 2019 to 2024. In April 2021, the bank committed to achieving carbon neutrality no later than 2040, including emissions relating to its loan and asset portfolio.

Group Structure, Rated Subsidiaries, And Hybrids

Hybrid ratings

We rate Islandsbanki's subordinated debt 'BB+', two notches below the bank's 'bbb' SACP. We deduct one notch due to the instruments' subordination to senior creditors' claims, and another notch because the instruments are available to absorb losses at the point of the bank's non-viability via statutory loss absorption. Given the lack of going-concern loss absorption, we do not include the instruments in our calculation of total adjusted capital.

Key Statistics

Table 1

Islandsbanki hf--Key Figures

	--Fiscal year end Dec. 31--				
	June 2021	**2020**	**2019**	**2018**	**2017**
Adjusted assets	1,443,553.0	1,340,713.0	1,195,160.0	1,125,401.0	1,031,591.0
Customer loans (gross)	1,089,723.0	1,006,717.0	899,632.0	846,599.0	755,175.0
Adjusted common equity	182,535.0	178,733.0	169,232.0	165,421.0	163,810.0
Operating revenues	23,657.0	43,153.0	47,408.0	43,460.0	44,189.0
Noninterest expenses	12,684.0	23,425.0	29,043.0	28,823.0	27,638.0
Core earnings	8,955.6	6,815.6	7,934.8	9,253.6	8,908.9

Table 2

Islandsbanki hf--Business Position

	--Fiscal year end Dec. 31--				
(%)	**June 2021**	**2020**	**2019**	**2018**	**2017**
Total revenues from business line (ISK mil.)	23,774.0	43,617.0	48,585.0	45,899.0	51,218.0
Commercial & retail banking/total revenues from business line	87.7	92.0	82.7	81.0	68.9
Trading and sales income/total revenues from business line	5.9	(0.3)	(0.0)	(4.4)	1.5
Brokerage/total revenues from business line	4.7	4.9	4.3	4.4	4.2
Other revenues/total revenues from business line	1.7	3.4	13.0	19.0	25.4
Investment banking/total revenues from business line	5.9	(0.3)	(0.0)	(4.4)	1.5
Return on average common equity	9.7	3.9	5.0	6.3	7.7

ISK--Icelandic krona.

Table 3

Islandsbanki hf--Capital And Earnings

	--Fiscal year end Dec. 31--				
(%)	**June 2021**	**2020**	**2019**	**2018**	**2017**
Tier 1 capital ratio	20.1	20.1	19.9	20.3	22.6
S&P Global Ratings' RAC ratio before diversification	0.0	18.0	17.0	18.6	20.5
S&P Global Ratings' RAC ratio after diversification	0.0	12.8	12.1	13.0	14.2
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	70.2	77.3	71.0	73.5	67.9
Fee income/operating revenues	24.4	24.4	28.2	28.1	31.1
Market-sensitive income/operating revenues	4.8	(2.2)	(1.4)	(2.3)	(1.7)
Cost to income ratio	53.6	54.3	61.3	66.3	62.5
Preprovision operating income/average assets	1.6	1.6	1.6	1.4	1.6
Core earnings/average managed assets	1.3	0.5	0.7	0.9	0.9

Table 4

Islandsbanki hf Risk-Adjusted Capital Framework Data

(ISK 000s)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global RWA	Average S&P Global RW (%)
Credit risk					
Government & central banks	89,673,472	2,136,841	2	1,186,691	1
Of which regional governments and local authorities	10,548,361	2,136,841	20	1,186,691	11
Institutions and CCPs	97,899,917	23,201,134	24	20,814,348	21
Corporate	516,140,781	509,178,737	99	464,688,781	90
Retail	500,447,774	242,584,107	48	255,487,878	51
Of which mortgage	370,844,770	157,676,988	43	135,469,595	37
Securitization§	0	0	0	0	0
Other assets†	35,155,067	43,558,462	124	44,856,280	128
Total credit risk	1,239,317,011	820,659,282	66	787,033,978	64
Credit valuation adjustment					
Total credit valuation adjustment	--	1,728,458	--	0	--
Market risk					
Equity in the banking book	6,652,753	9,770,506	147	53,561,316	805
Trading book market risk	--	16,626,112	--	24,939,167	--
Total market risk	--	26,396,618	--	78,500,483	--
Operational risk					
Total operational risk	--	85,025,669	--	128,948,003	--
(ISK 000s)	**Exposure**	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	933,810,026	--	994,482,464	100
Total diversification / concentration adjustments	--	--	--	401,117,867	40
RWA after diversification	--	933,810,026	--	1,395,600,332	140
(ISK 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		187,868,661	20.1	178,733,000	18.0
Capital ratio after adjustments‡		187,868,661	20.1	178,733,000	12.8

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. ISK--Icelandic krona. Sources: Company data as of 'Dec. 31 2020', S&P Global Ratings.

Table 5

Islandsbanki hf--Risk Position

	--Fiscal year end Dec. 31--				
(%)	June 2021	2020	2019	2018	2017
Growth in customer loans	16.1	12.6	6.5	11.6	9.2

Table 5

Islandsbanki hf--Risk Position (cont.)

	--Fiscal year end Dec. 31--				
(%)	**June 2021**	**2020**	**2019**	**2018**	**2017**
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	39.9	42.8	43.9
Total managed assets/adjusted common equity (x)	7.9	7.5	7.1	6.8	6.3
New loan loss provisions/average customer loans	(0.1)	0.9	0.4	(0.2)	0.4
Net charge-offs/average customer loans	0.1	0.1	0.2	0.6	0.7
Gross nonperforming assets/customer loans + other real estate owned	2.2	3.0	3.1	2.1	2.5
Loan loss reserves/gross nonperforming assets	69.1	56.9	36.7	43.9	54.9

N/A--Not applicable.

Table 6

Islandsbanki hf--Funding And Liquidity

	--Fiscal year end Dec. 31--				
(%)	**June 2021**	**2020**	**2019**	**2018**	**2017**
Core deposits/funding base	62.4	59.7	62.9	63.5	70.4
Customer loans (net)/customer deposits	142.3	148.2	145.5	146.2	133.2
Long-term funding ratio	90.7	93.8	94.9	94.6	94.7
Stable funding ratio	110.6	117.1	114.5	113.8	116.1
Short-term wholesale funding/funding base	10.7	7.2	6.0	6.5	6.4
Broad liquid assets/short-term wholesale funding (x)	2.2	3.5	4.0	3.9	4.5
Net broad liquid assets/short-term customer deposits	21.2	30.6	30.2	31.4	34.4
Short-term wholesale funding/total wholesale funding	28.6	17.8	16.3	17.7	21.7
Narrow liquid assets/3-month wholesale funding (x)	6.1	7.3	9.3	7.0	15.5

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Bulletin: Icelandic Government's Proceeding With Planned Islandsbanki IPO is Unlikely to Affect The Bank's Strategy, May 31, 2021
- Research Update: Iceland 'A/A-1' Ratings Affirmed; Outlook Stable, May 14, 2021
- Leading Nordic Banks Keep Calm And Carry On Despite COVID-19 Stress, Feb 23, 2021
- Bulletin: Islandsbanki's Planned IPO Will Test Investor Appetite For Icelandic Banks, Feb. 02, 2021
- Banking Industry Country Risk Assessment: Iceland, Dec. 18, 2020
- Bulletin: Iceland's Removal From FATF's Gray List Underlines Its Fast Anti-Money Laundering Response, Oct. 27, 2020
- Nordic Banks' Strong Capital Deflects COVID-19 Impact, Sep 08, 2020
- Bulletin: Icelandic Bank Resolution Act Completes The European Map, But Implementation And Effectiveness Remain Unclear, Sep. 01, 2020

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	**4**	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	**bbb-**	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of October 18, 2021)*	
Islandsbanki hf	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Issuer Credit Ratings History	
24-Apr-2020	BBB/Stable/A-2
23-Jul-2019	BBB+/Negative/A-2
25-Oct-2017	BBB+/Stable/A-2
25-Oct-2016	BBB/Positive/A-2

Ratings Detail (As Of October 18, 2021)*(cont.)	
Sovereign Rating	
Iceland	A/Stable/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.