Translated from Icelandic

Summary of Íslandsbanki's response to the settlement with the Financial Supervisory Authority of the Central Bank of Iceland

22.7.2023

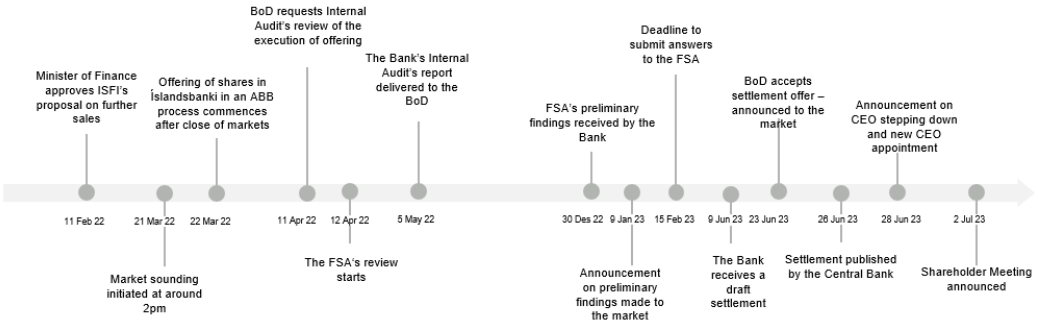
Íslandsbanki regrets the shortcomings that have been revealed in the investigation by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) and takes the results seriously.

The Bank has received enquiries from shareholders, customers, the press and other stakeholders, requesting explanations and the Bank's views on various issues that are discussed in the settlement. The Bank has written this document in response to this, with the aim of giving information on the findings of the FSA's investigation of the Bank's performance of its duties in the Offering as presented in the settlement, and the Bank's comments and response to each point. The Bank hopes that this document may give stakeholders answers to their questions so that they may draw their own conclusions on the matter.

To the extent that the Bank will or has answered individual enquiries directly, those answers will also be published in this forum.

It should be noted that under the terms of the settlement between the Bank and the FSA, the Bank undertook to carry out certain remedial measures within a specified period. The Bank's internal auditor is required to prepare a report on the Bank's compliance with the remedial measures for confirmation to the Board of Directors of the Bank and submission to the FSA before 1 November 2023. The information provided below on the Bank's action to the shortcomings discovered after the Offering, is not intended to imply that the remedial measures currently under way is not called for.

I. Timeline



II. On the procedure

On 22 March 2022 Íslandsbanki acted as one of the joint global coordinators and the settlement agent in the accelerated book building offering (the Offering) by the Icelandic State Financial Investments (ISFI). In the Offering a 22.5% stake in Íslandsbanki owned by the Icelandic State was sold to qualified investors, both domestic and international. Following the Offering, it was heavily criticised in public debate.

As a result of this the Board of Directors of Íslandsbanki, on 11 April 2022, commissioned the Bank's internal auditor to present the Board with a report on the Bank's performance in the Offering. The internal auditor submitted his initial findings in a report on 5 May 2022, which were immediately submitted to the FSA. The Report revealed substantial shortcomings in the Bank's performance of the Offering. It was stated that a number of phone calls had not been recorded as is required by law, no risk assessment of the project had been carried out in advance of the Offering, a conflict of interest analysis had not been

carried out, employee participation in the Offering was criticised, internal rules on customer categorisation had been violated and the participation of retail investors was criticised.

Following the Report, the Bank began work on remedial measures. In the months of May and June 2022, the Bank changed its rules on employee trading in financial instruments. The Bank's policy and rules on conflicts of interest were revised. Rules and procedures on recording of phone calls were strengthened stipulating that all phone calls in relevant units had to be unconditionally recorded.

The FSA began an investigation into Íslandsbanki's performance in the Offering with an information request received on 12 April 2022. Íslandsbanki received the FSA's preliminary assessment on 30 December 2022 and was given the opportunity to present its comments and views by 15 February 2023. On 6 January 2023 the Bank requested to conclude the matter by settlement, based on the fact that the FSA had drawn the Bank's attention to that possibility and the Bank's Board of Directors believed that the Bank's interests were best served by concluding the matter with a settlement.

On 9 June 2023 the Bank received the FSA's proposal for settlement. The Bank's Board of Directors approved the settlement on 22 June 2023. It was the Board's view that the Bank's interests would be best served by accepting the settlement as presented by the FSA. In the settlement the Bank admits, that in the preparation and execution of the Offering, it did not comply with certain applicable legal requirements and internal rules of the Bank on the provision of investment services, particularly in relation with recording of telephone communications, disclosures made to purchasers of shares in the Offering, investor categorisation requirements, and measures to prevent conflicts of interest e.g., segregation of duties and employees' transactions. The Settlement Agreement states that the Bank's implementation of governance and internal controls as well as a risk-based approach to supervision of recordings of telephone communications were insufficient. Furthermore, the Settlement Agreement states that the Bank should have carried out a separate risk assessment regarding its role in the Offering. The Settlement Agreement also states that in executing the Offering the Bank did not, in all respects, satisfy its obligation to act honestly, fairly and professionally and to promote market integrity.

Having evaluated the matter, the Board assessed that the FSA would impose a higher fine if a settlement was not reached. Once the Bank's Board of Directors had made a comprehensive assessment of the case, it believed that the Bank's interests were best served by accepting the settlement and focusing its efforts on necessary improvements pursuant to the settlement.

In the following sections, the findings of the FSA are presented with the Bank's actions and response under each section.

1. Measures against conflicts of interest

It is the conclusion of the FSA that the Bank violated Article 32:1 of Act 115/2021 on Markets in Financial Instruments (mffi.), Article 38:2 and Article 41:2 of regulation (EU) 2017/565, cf. Article 32:2 mffi., by not performing a conflict of interest assessment in connection with the Bank taking part in the Offering. As a result of this lack of conflict of interest assessment, the Bank did not consider necessary measures to eliminate or reduce conflicts of interest, whether further measures were needed for the project, or whether the Bank should have refrained from taking on the role as a joint global coordinator or a settlement agent in the offering.

More specifically, the FSA concluded that the Bank did not carry out and document an analysis of the following potential conflicts of interest:

- In advance of or following the Bank's presentation to STJ Advisors on 7 February 2022, where it was stated that the Bank's Corporate Finance, Securities Sales and Asset Management units would take part in the Offering.
- When a managing director in the Bank requested a meeting with the Bank's compliance department in an email on 8 February 2022 or following that meeting on 23 February 2022.
- Before a contractual relationship was established between the Bank and ISFI on 4 March 2022, when the Bank accepted ISFI's terms as a joint global coordinator and settlement agent, subject to reservations.
- Before signing the contract with ISFI on 22 March 2022.

Íslandsbanki should have done a thorough conflict of interest analysis before taking on the project and in the time leading up to that. As no such analysis was carried it is not possible to assess whether the Bank's measures for conflicts of interest were adequate, whether further measures were needed for the project or whether the Bank should have refrained from taking on the role of joint global coordinator and settlement agent in the Offering.

The Bank has now revised its work procedures to ensure that a conflict of interest analysis is always carried out when appropriate. Internal policies have been revised to reflect changes in law and to ensure that the Bank takes all appropriate measures to identify, prevent or reduce the impact of conflicts of interest.

2. Participation of employees and managers of the parties in the Offering

It is the conclusion of the FSA that the Bank, violated Article 32:1 of mffi. by not performing an analysis of conflicts of interest. As a result of this the Bank did not assess whether employees of the Bank should be allowed to participate in the Offering on 22 March 2022. As the project created a risk of conflicts of interest, the Bank's duty to perform such an analysis was particularly strong in the opinion of the FSA. As a result of missing assessment of conflicts of interest in connection with the Offering, the Bank had insufficient grounds to decide on employee participation in the Offering.

If an adequate conflict of interest analysis had been carried out, such an analysis should have resulted in the employees being denied participation in the Offering.

The limits on employee transactions for their own account have now been significantly strengthened. Employees in Securities Sales and Proprietary Trading are no longer allowed to trade for their own account in individual securities. Employee training on the changes in internal rules and procedures has been significantly enhanced.

3. Separation of functions

It is the conclusion of the FSA that the Bank, with its conduct, violated Article 32:1 of mffi., cf. point a of paragraph 3 in Article 34 of the delegated regulation (EU) 2017/565, cf. Article 3 in mffi. by not ensuring adequate separation of Corporate Finance and Securities Sales. It is also the conclusion of the FSA that the Bank violated Article 21:2 in mffi. by not ensuring the efficiency of the Bank's corporate structure, which should have enabled the Bank to take all available measures to prevent conflicts of interest from having a negative effect on the interests of customers.

The Bank's internal rules provide for the physical separation of different business units. Thus, different units of the Bank are physically separate and access to information systems is controlled accordingly, as required by law. When employees from two or more units must work jointly on a project, it may be necessary to temporarily move an employee from their space and review and restrict access to information systems. In preparing for the Offering the Bank was too late in moving an employee of Bank's Securities Sales unit out of his workspace. It should have been done at an earlier stage. Improvements have been implemented by updating and strengthening work procedures and employee training, to ensure that an adequate assessment of conflicts of interest is carried out and due consideration on whether there is a need to move employees temporarily while a project is being carried out and stipulate at what point in the project such a transfer should take place.

4. Updating of the parties' policy and rules on measures against conflicts of interest

It is the conclusion of the FSA that the Bank violated Article 21:1 of mffi. by not taking adequate measures to update its internal rules and policies on conflicts of interest, in accordance with mffi. The Bank's rules and policy documents on conflicts of interest that were in force before and during the Offering did not comply with the provisions of the Act on mffi.

The Bank should have reviewed and revised its policy documents when the Act on mffi. entered into force. Prior to the act on mffi. entering into force, the Bank had updated its rules in line with the bill on the new legislation that had then been introduced. The wording and references in the Bank's internal rules were not revised when the new act came into force.

The Bank's policy on conflicts of interest and its rules on measures against conflicts of interest were updated in January 2023 to address these shortcomings that were presented in the preliminary findings by the FSA and later in the settlement. The policy and the rules on the conflicts of interest are meant to ensure that the Bank takes all appropriate measures to identify and prevent or deal with conflicts of interest.

The Bank has increased the frequency at which the rules on measures against conflicts of interest and the policy on conflicts of interest are reviewed. The rules and policies are now revised annually instead of every other year previously. In addition, a council within the Bank monitors all changes in the regulatory framework and informs stakeholders of changes in the regulatory framework, to trigger revisions in internal rules and procedures.

Risk Assessment

It is the conclusion of the FSA that the Bank violated the provisions of Article 17:1 of Act 161/2002 on Financial Undertakings stating that the Bank should at all times have systems in place to control and monitor its risk. The Bank's violation is manifested in the fact that the Bank did not carry out a risk assessment in relation to the Bank's involvement in the Offering.

Since the Offering had to do with shares in the Bank itself, and the fact that the shares in the Offering were State owned, a thorough risk assessment should have been carried out and the risks associated with taking part in such an offering should have been carefully assessed. Ideally the Bank should have assessed the reputational risk, political risk, and risk of conflicts of interest associated with the Bank's participation in the Offering. Procedures have been and will be updated to ensure that an appropriate risk assessment is carried out at the start of new business projects. All securities services (products) will be

reviewed, and an appropriate risk assessment will be made for each product. Criteria for risk assessment will be defined and a decision tree aimed at ensuring the input from relevant units will be defined and implemented.

Work procedures have now been updated so that at the start of a business project, employees must assess risks related to the project or customers before commencing work on the project. Furthermore, as described above, the assessment of risks associated with individual business projects will benefit from strengthened rules on the conflict of interest analysis.

5. Recording and the retention of telephone communications and electronic communications

It is the conclusion of the FSA that the Bank violated Article 23:2 of mffi. by not recording and retaining the recordings of 162 calls that employees had made in connection with the Offering. It is the conclusion of the FSA that the Bank had not taken all available measures to record and retain the recordings of communications with customers, that result or may result in transactions for the Bank's own account or lead to the receipt or execution of customer orders. The Bank's conduct is in violation of Article 23:2 of mffi. Furthermore, it is the conclusion of the FSA that the Bank violated Article 76:6 of the delegated regulation (EU) 2017/565, cf. Articles 23:3 in mffi., which states that regular monitoring of recordings/records of transactions and instructions must be risk-based and reasonable in scope. The FSA finds that the Bank's compliance with the rules on the recordings of phone calls had been an ongoing problem for a long time without the Bank taking adequate measures to comply with the provisions of Article 23 of mffi. cf. Article 76 of the delegated regulation.

In advance of the mffi. Act (MIFID-II) entering into force in Iceland, the Bank implemented a solution for the recording of mobile telephone calls made by its employees. The solution required actions by employees to initiate recordings. Unfortunately, this solution was not sufficient. The Bank did not implement the solution with adequate training, education or supervision. Management should have ensured that employees rejected calls that were not recorded, and in retrospect it was a mistake for the Bank to rely on a technical solution that required actions from employees to trigger recordings. All calls through landlines were recorded.

Changes to the rules and procedures regarding the recording of calls and the traceability of business orders have been implemented. They include i.a. automatic and unconditional recordings of all calls on mobile phones made or received by employees of relevant units. The Bank's internal rules on the traceability of client orders have been updated and the monitoring and supervision of the recordings has also been strengthened.

6. Categorisation of clients

a. Eight clients wrongly categorised

It is the conclusion of the FSA that the Bank wrongly categorised eight customers as qualified investors in breach of Article 54:1 of mffi. without them fulfilling at least two of the three conditions listed in the 3rd paragraph of Article 54:1 of mffi., cf. section 2.2.2. in the Bank's internal rules on customer classification. In view of this, it was the conclusion of the FSA that the conduct of the Bank was in violation of Article 54:1 of the mffi.

The FSA considered the submitted data on securities holdings of five individual customers insufficient. In one case, the FSA found that certain futures transactions should not

have been considered to involve a significant risk as they contained a "stop loss" clause and thus could not be counted in the number of transactions. Íslandsbanki did not follow its own internal procedures when categorising two customers, as the Bank did not consider internal rules that dictated that when evaluating the number of transactions, only transactions over a certain threshold amount should be considered.

New statements for customers' asset positions have been implemented, so that it is clear that the summary details only unencumbered asset position. In addition, work is underway to update procedures and work instructions. The new rules are intended to implement reliable data, so that there can be no doubt that a correct categorisation is carried out in each case and that it can be demonstrated that this has been done in a simple and reliable manner.

b. The Bank initiated categorisation

It is the assessment of the FSA that the Bank violated Article 54:1 of mffi. by having either initiated and/or encouraged 21 of its clients to request the status of professional investor thereby waiving their legal protection guaranteed to retail investors. When interpreting Article 54:1 of mffi. the FSA considered [the wording of the provisions of Article 54:1 of mffi. and ESMA's Q&A on the provisions of MIFID2, which discusses the implementation of changes to customer categorisation]. It is clearly stated that such categorisation should always be at the customer's initiative and that securities firms should refrain as much as possible from encouraging, pressuring or taking the initiative for a client to waive their legal protection.

Íslandsbanki should have directed the Offering only to those customers that had already been categorised as qualified investors in the Bank's systems prior to the Offering. The categorisation of investors who requested being categorised as qualified investors, should only have been changed at the customer's own initiative and before the Offering. This has been highlighted in the procedures of the units within the Bank that provide investment services. More emphasis will be placed on how to approach investors, with education and work instructions.

c. The timing of the client classification

It is the conclusion of the FSA that the Bank's categorisation of customers after the Offering had commenced and prior to settlement was in violation of Article 54:1 of the mffi. The Bank should have completed the categorisation before the Offering was directed at customers to look after their interests. The Bank invited 11 retail investors and three uncategorised clients to participate in the Offering that was intended only for institutional investors and authorised counterparties. As a result, the Bank could not be sufficiently certain that the customers met the categorisation criteria when the Offering was directed at them. With this conduct, the Bank did not look after its customers' best interests.

The Bank should only have accepted offers from those investors that were registered as qualified investors in Bank's own systems before the Offering started. This has been enhanced in the procedures of the units within the Bank that provide services for investors. More emphasis will be placed on how to approach investors, with education and work instructions.

7. Provision of information to customers

It is the conclusion of the FSA that the Bank violated Article 34:1 of mffi., by providing the ISFI with misleading information by not disclosing that offers from retail investors were

included in the orderbook that was submitted to the ISFI on the evening of 22 March 2022. The Bank did not demonstrate that the ISFI had been informed that retail investors were included in the offer from the Bank's Asset Management unit and that the offers had been submitted in the same manner as the offers from the clients of Securities Sales and Corporate Finance. It had thereby been implied that the offer had been made based on an active asset management agreement on behalf of the respective customers. As a result of this, the ISFI received misleading information about the offer from the Bank's Asset Management in the order book. Hence, the ISFI did not receive information about the names of individual investors and the amount of offers from each of them, even though such information was available to the Bank. Nine of the Bank's clients who were behind the bids in the offer book, which was the basis of the ISFI's recommendation at the end of the Offering, had not been categorised as qualified investors at that point in time. This led to the ISFI receiving misleading information from the Bank about the categorisation of participants in the tender. The Bank furthermore stated to customers, in nine instances, that the Offering was subject to a minimum amount of ISK 20 million, which was false and misleading information in violation of the Bank's obligations to provide information to customers.

It is not the Bank's conclusion that its employees intentionally misled or deceived its customers.

The offer book contained orders from customers who had not been categorised as qualified investors in the Bank's systems at the time their offers were made. Most of the clients of the Bank's Asset Management were retail investors, and transactions on their behalf were not based on discretionary asset management contracts, but according to their own decisions. The ISFI was not informed about this specifically. The Bank considered the transactions permissible based on a consulting agreement, where the asset manager is a qualified investor. The FSA has concluded that this is not permitted, given that it was the customer and not the Bank on his behalf, that had made the investment decision.

In some cases, Íslandsbanki provided asset management clients with incorrect information that the minimum bid amount in the auction was ISK 20 million when the terms of the tender clearly stated that it should only be directed to qualified investors without a minimum amount.

The Bank has and will continue to review and revise its internal policies and work procedures. More emphasis will be placed on these aspects in employee training and written work instructions. The Bank believes that an adequate risk assessment and conflict of interest analysis would have prevented the above-mentioned mistakes. By revising its policies and work procedures and by improving the analyses of conflicts of interest and a general risk assessment the Bank aims to ensure that the mistakes in the performance of the Bank's duties under the Offering are not repeated.

8. Obligation to act honestly, fairly and professionally in accordance with normal and sound business practices and customs when providing investment and ancillary services, with the credibility of the financial market and the interests of its clients in mind:

The FSA found that the Bank violated the provisions of the Act on Markets for Financial Instruments when it did not follow its own internal rules and procedures when providing investment services to clients. The Bank did not comply with the set terms of the Offering and, in addition, provided misleading and incorrect information to its clients. With the

aforementioned conduct, the FSA found the Bank violated its obligations according to the provisions of Article 33:1 of mffi. to act honestly, fairly and professionally, in accordance with normal and sound business practice and customs when providing investment and ancillary services, with the credibility of the financial market and the interests of its clients in mind, when the Bank prepared for and performed its duties under the Offering.

The FSA found that the Bank failed in its duty to act honestly, fairly and professionally in accordance with normal and sound business practice and customs when providing investment and ancillary services in the preparation for and the provision of its services in the Offering. The Bank has commenced work on the review and analyses of the Bank's framework for risk management and internal control. The project includes:

- *Redefining the Bank's appetite for non-financial risks*
- *Analysis of the structure of the Bank's executive committees and their mandates*
- *Scrutinising the division of work between the three lines of defence*
- *More specific and improved criteria will be established for key risk management processes*

9. Corporate governance

In light of the conclusions of the FSA in other sections of the settlement, the FSA is of the opinion that the Board of Directors, during the period covered by the investigation, and the Bank's CEO did not adequately ensure that the Bank operated in accordance with the laws that apply to its activities and that the internal rules of the Bank were followed. The Board of Directors and the Bank's CEO did not adequately implement governance and internal controls to ensure efficient and prudent management of the Bank and the prevention of conflicts of interest, so the Bank contributes to the integrity of the market and the interests of clients. They did not ensure that the Bank met applicable legal requirements for the provision of investment services. Taking this into account, it was the opinion of the FSA that the Bank had, with its conduct, violated Article 54 of mffi., cf. Article 10 of mffi. In light of the fact that the Offering was on the sale of State property which is subject to the Act on mffi. regarding the sale treatment of the State's holdings in financial companies, and furthermore taking into account that in the Offering shares of the Bank itself were offered for sale, the Bank, in the opinion of the FSA, should have taken special care to show professionalism and thoroughness in its conduct in the Offering, as well as taking special care of governance and internal control therefore connect. In particular high standards must be set for the preparation and execution in all respects in offerings of shares in a bank that is majority-owned by the State, especially when a sales method is used that does not assume that the public can participate.

Íslandsbanki reiterates that the Bank deeply regrets the shortcomings that have been revealed in the investigation by the FSA and takes them very seriously. The Bank will strive to strengthen its risk culture and intends to act quickly and effectively on the remedial requirements that the FSA has put forward.