Arion Bank

# Investor Presentation

February 2020

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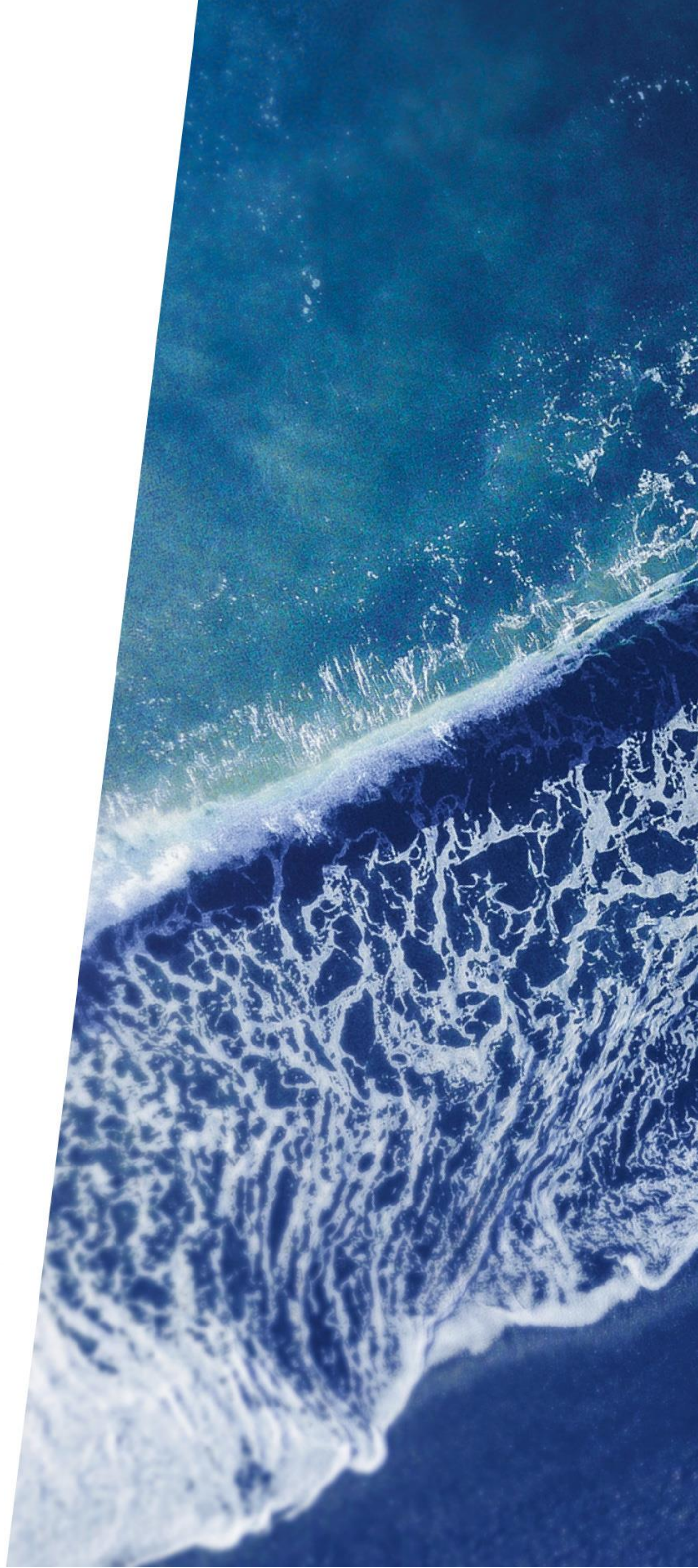


# Highlights of the year 2019

Arion Bank is on a new trajectory after having undergone significant management and organizational changes and improvement measures in Q3

Earnings from continuing operations are ISK 14 billion and improve significantly. ROE from continuing operations improves YoY from 4.3% to 7.2%

Negative developments in businesses held for sale, reduce net earnings to ISK 1 billion but are not reflective of future performance

The balance sheet was decreased in a tactical manner

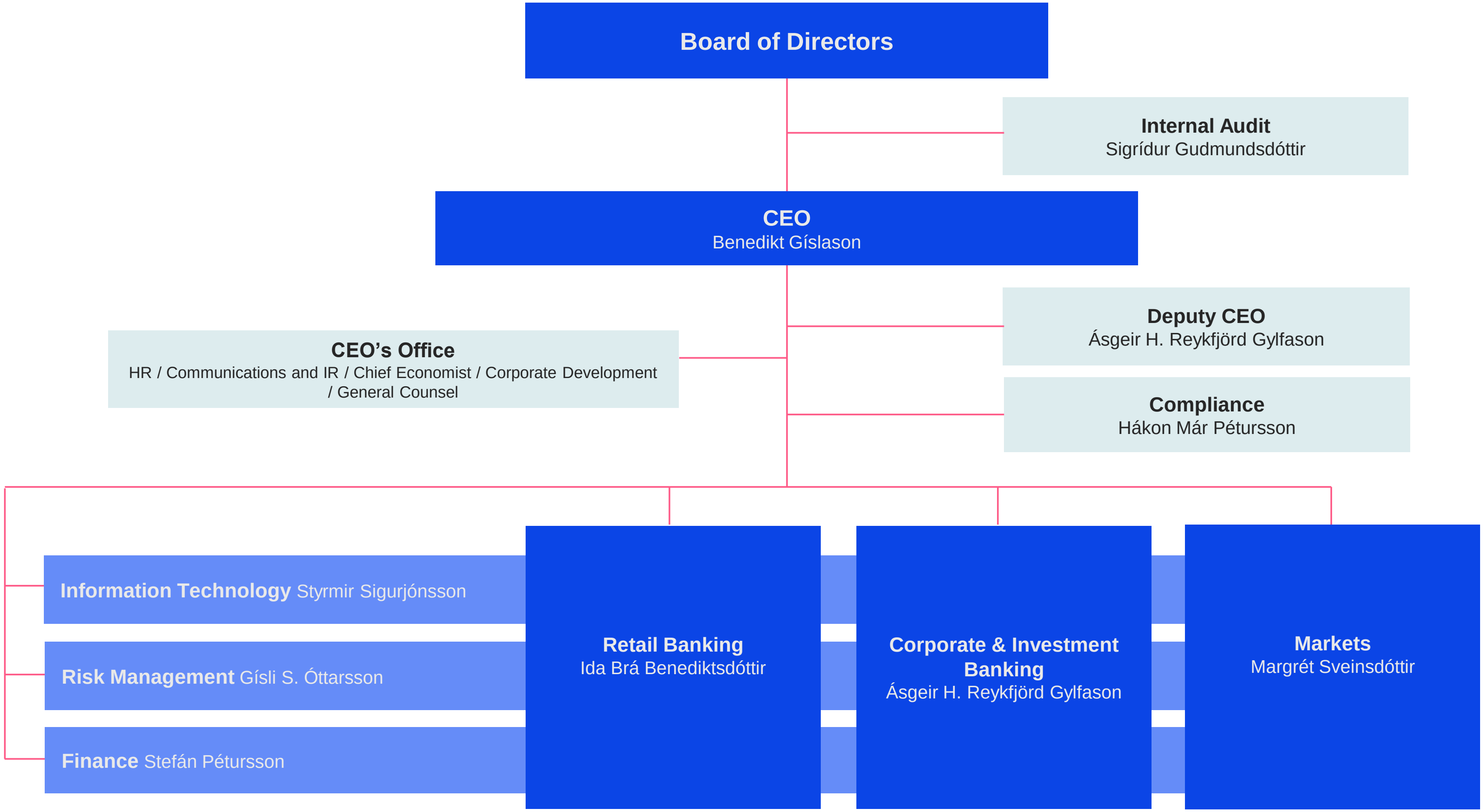
Return on assets under management was very good and the Bank has retained its number one position in equities trading for the 4th year in a row

The Bank has substantial surplus capital which allows it to pay a dividend of ISK 10.0 billion. This corresponds to a dividend yield of 6.4% on market cap year end

The Bank adopted a new environmental strategy and will put increased emphasis on such matters both in operations and lending

# New organizational structure

Introduced in Q3 2019



# Arion Bank Group

## Diversified business model and strong market position

### Retail Banking

- Digital leader in the retail market
- Large private provider of residential mortgages in Iceland
- ~ 29% market share[1]
- Wide range of financial services for individuals and SMEs[2]

### CIB

- Corporate banking and strategic advisory
- Use of own capital and increased capital market intermediation
- Managed c. 2/3 of all IPOs in Iceland since 2011

### Markets

- Largest asset manager in the Icelandic market
- A leading capital markets house
- Largest custody service provider in Iceland

STEFNIR

Arion Bank's subsidiary **Stefnir** is a leading fund management company in Iceland

ROE for 2019: 38.6%

### Insurance

- The Bank's subsidiary Vördur is the largest life insurance and the 4th largest universal insurance company in Iceland
- Has been a growing contributor to Arion Bank's operating income mix in the last three years
- ROE for 2019: 24.9%

vördur

| Business profile: | Retail Banking | CIB | Markets |
|---|---|---|---|
| **Client lending** | ISK 470 billion | ISK 303 billion | - |
| **RWA allocation** | ISK 266 billion | ISK 324 billion | ISK 14.4 billion |
| **Assets under Management** | - | - | ISK 1,013 billion |

### VALITOR

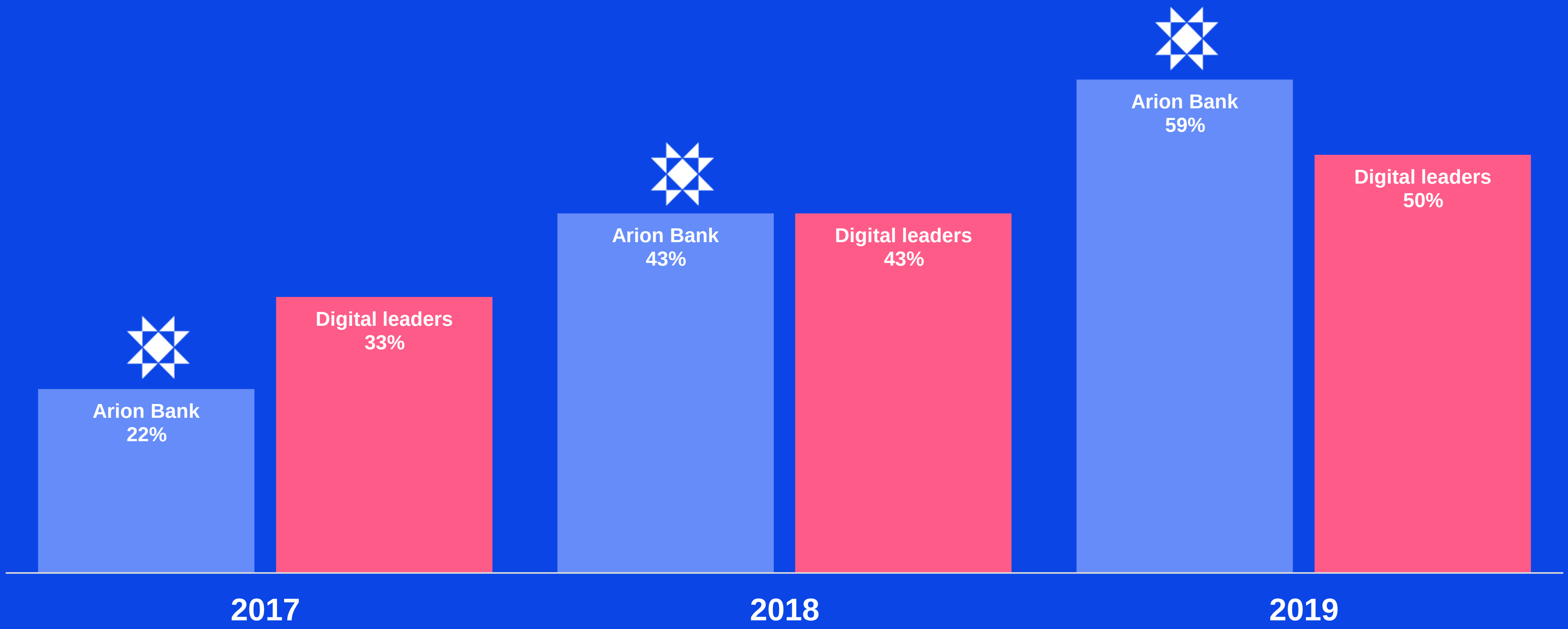
- Largest card payments company in Iceland based on operating revenues[3]
- **Valitor is currently in a sales process** and defined as held for sale in the accounts

1. Capacent. Based on monthly customer survey (individuals), year end 2019. Q: What is your main retail bank?
2. 31.12.2019 including subsidiary Stefnir
3. Based on 2018 annual accounts (Valitor, Borgun and Kortaþjónustustan)

The subsidiaries (Vördur, Stefnir and Valitor) are independent entities regulated by the FME. Arion Bank exercises ownership through strategy and board memberships.

# World leader in digital sales

Digital sales as % of total sales - Arion Bank compared to international digital leaders




Finalta reports 2017, 2018 and 2019

# Building long-term shareholder value

Customer focus with efficient use of capital

## Reduce cost of capital

- Share buy-back program
- Group capital and funding optimization
- Reduce operating leverage
- Reduce earnings volatility through long term client relationships and disciplined capital allocation
  - Increased co-investment strategy through syndication and intermediation
- Transparency around business plan and asset quality

## Increase cash flows

- Enhance product / client ownership and responsibility and improve cost transparency
- Cutting costs / improve margins
- Cut assets / products that have ongoing and foreseeable sub-par returns
- Disciplined capital allocation towards higher ROE / growth products & clients
- Leveraging partnerships for infrastructure costs

## Enhance equity story

- Strengthen and build on existing competitive advantages
- Reinforce long-term client relationships through best-in class products and services
- Digital solutions at the core of all activities
- Leveraging partnerships in Fintech
- Increase capital turnover
- Building a winning team
- Sustainable long-term values

# Arion Bank is committed to its medium-term targets

## New revenue target introduced and loan growth target amended

**Return on Equity**

Exceed **10%**

**Revenues / RWA's**

Exceed **6.5%**

**Cost to Income Ratio**

Reduce to **circa 50%**

**Loan growth**

The loan book will grow in line with economic growth. However, the corporate loan book will continue to decrease at the current rate over the next few quarters as non-core portfolio is reduced

**CET1 Ratio (Subject to regulatory requirements)**

Reduce to **circa 17%**

**Dividend Policy / Share buy-back**

Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buy-back of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above the minimum requirements set by the regulators in addition to the Bank's management buffer

# The road to sustainable +10% ROE [1]

## Release of CET1 plays a fundamental role

**Reported 0.6% ROE 2019**

**Underlying ~5.5% ROE**

- Discontinued operation excluded and impairments normalized to 30 bps of loans to customers [2]

- **Exit from non-core assets, primarily on the corporate side, that are not yielding acceptable returns**

- **Capital release to the 17% CET1 target [3]**
  - Surplus capital
  - Issuance of Tier 2 and AT1
  - Share buy-back and dividend payments

- **Increased revenues from RWAs**
  - New target of 6.5% for the Bank, an increase from 5-6% in recent years
  - Result of more capital velocity, higher margins and fee generation

- **Cost to income to reach target of < 50%**
  - Structural changes to support more efficient operation and continued focus on digitalization, both in front line and support functions
  - Decrease in number of FTE's in Q3 2019 the first step on the road

**>10.0% ROE**

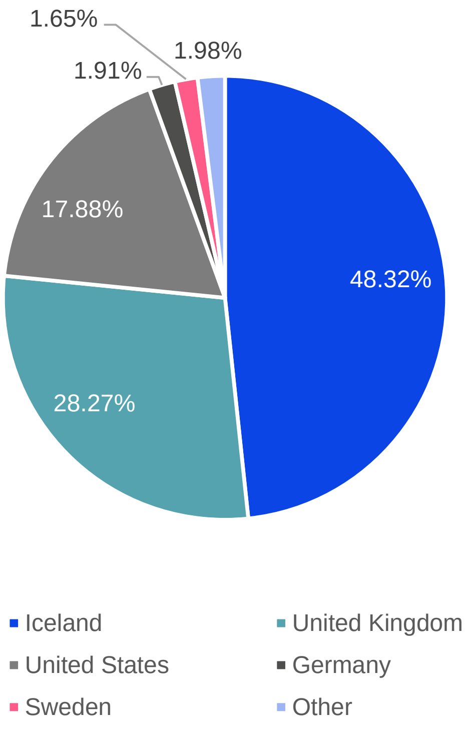


1. Bars in chart are illustrative and not to scale
2. 30 bps. impairments on loan book are based on average cost of risk from Risk models
3. Subject to regulatory approval, market conditions and other factors

# A well diversified ownership

More than 6,500 shareholders

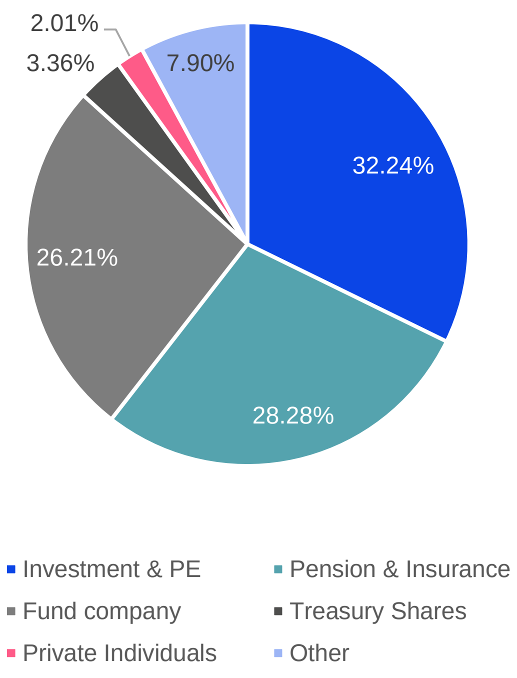
### Ownership distribution by country




### Top 10 largest shareholders

| | |
|---|---|
| Taconic Capital Advisors UK LLP | 23.5% |
| Sculptor Capital Management | 9.5% |
| Gildi Pension Fund | 8.8% |
| Stoðir Hf. | 5.0% |
| Lansdowne Partners | 4.2% |
| Live Pension Fund | 3.9% |
| Goldman Sachs International | 3.7% |
| Arion Banki Hf. | 3.6% |
| LSR Pension Fund | 3.5% |
| Eaton Vance | 3.2% |

### Ownership distribution by type






Sources: Nasdaq CSD, Euroclear and Morningstar (12 February 2020)

# Macroeconomic environment

# Iceland is focused on sustainability
## - Committed to being carbon neutral by 2040

- Iceland ranks at the forefront when it comes to share of renewables in energy consumption, mostly through hydro and geothermal energy
- The second largest export industry in Iceland is fisheries. Most of the fisheries have MSC certification which supports eco-friendly fishing, stock strength and responsible and sustainable fisheries management
- The Icelandic population has grown by 9.5% in the last five years which equals an annual growth rate of 1.8%.
- Iceland is committed to being carbon neutral by 2040 according to government announcement

| | |
|---|---|
| Gender equality world rank 2019 | 1 |
| Global peace index rank 2018 | 1 |
| Democracy index world rank 2018 | 2 |
| Life expectancy world rank 2020 | 10 |

**1946**
**Member of United Nations**

**1948**
**OECD founding member**

**1949**
**NATO founding member**

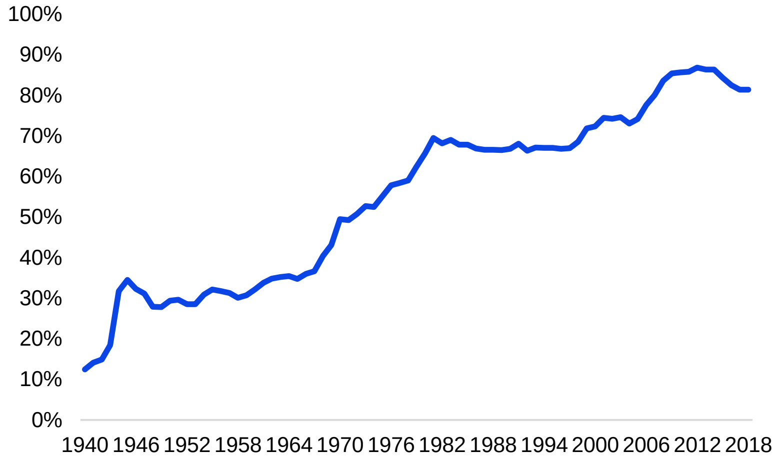
**1994**
**Access to European Economic Area (EEA)**

**2015**
**Iceland becomes a signatory to the Paris Agreement**

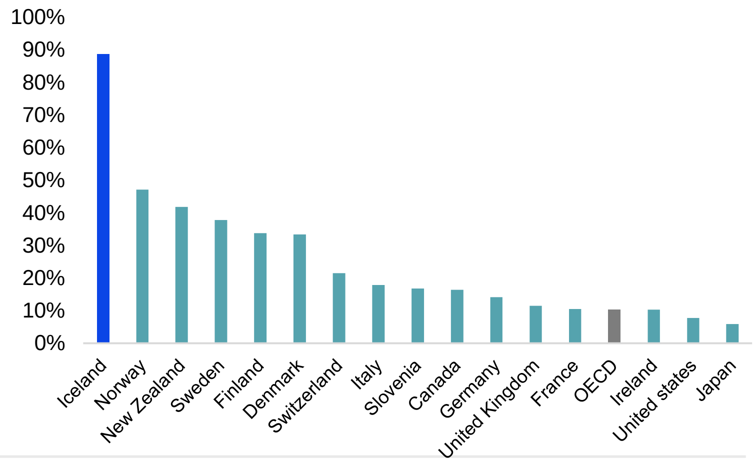
**2018**
**Iceland prioritizes 65 UN sustainable development goals**

**2018**
**Government climate action plan launched for 2018-2030**

**Iceland: Share of Renewables in Primary Energy Use 1940-2018**




**Contribution of renewables to energy supply in selected OECD countries 2018**





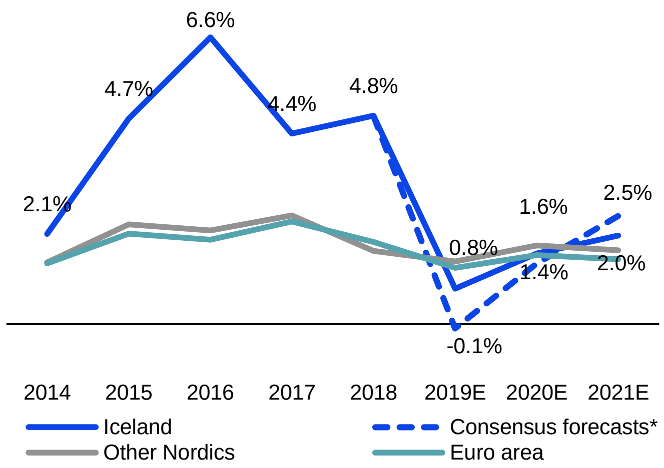

Source: Statistics Iceland, United Nations, IMF, The World Factbook, The World Economic Forum, The Institute of Economics and Peace
1 Based on real GDP national currency. Ireland 2015 GDP growth is in excess of 26% when including overseas companies in value of corporate sector.
2. Isavia 3. Defined as export if the industry is a source of foreign currency income

# Soft landing, slow takeoff

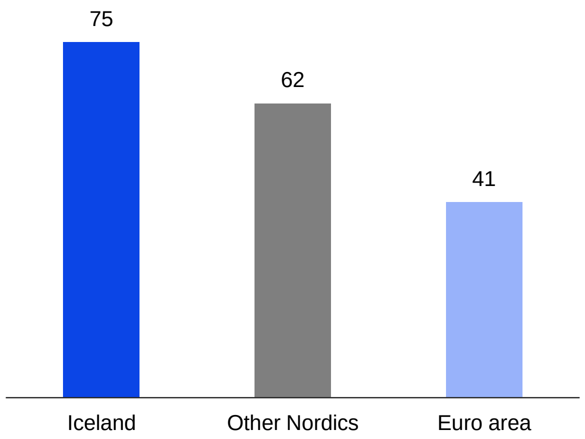
GDP growth measured 0.2% in the first nine months of 2019, indicating milder slowdown than expected

- Despite falling exports the contribution of foreign trade to GDP growth is positive due to an even larger drop in imports. This development has played a key role in sustaining GDP growth
- Even though most expect a softer landing than before, the outlook for 2020 has deteriorated due to slower growth in the country's main export sectors. However, GDP per capita will remain high
- The economy is well equipped to handle a slow down, with the monetary policy having already lowered interest rates by 150 bps.
- The proposed fiscal easing sides with the monetary policy, further softening the blow to the economy
- Consumption, both private and public, is expected to drive GDP growth in 2020

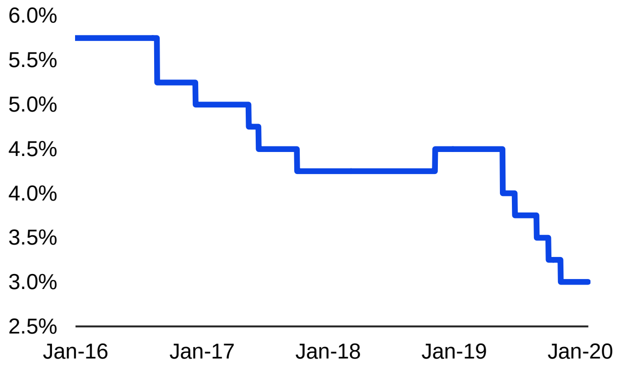
**GDP growth**



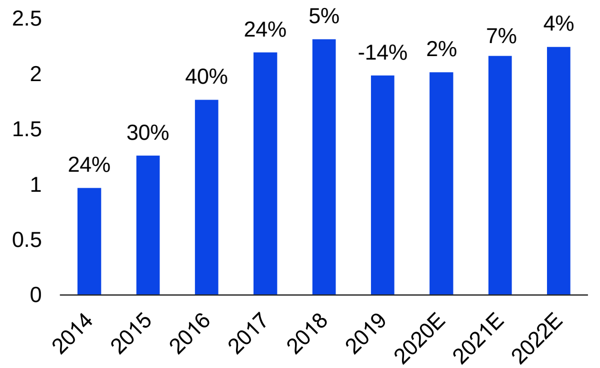

**GDP per capita in 2018** (USD thousands)




**Key interest rate – seven-day term deposit rate**




**Tourist arrivals via KEF airport** (millions and YoY growth)





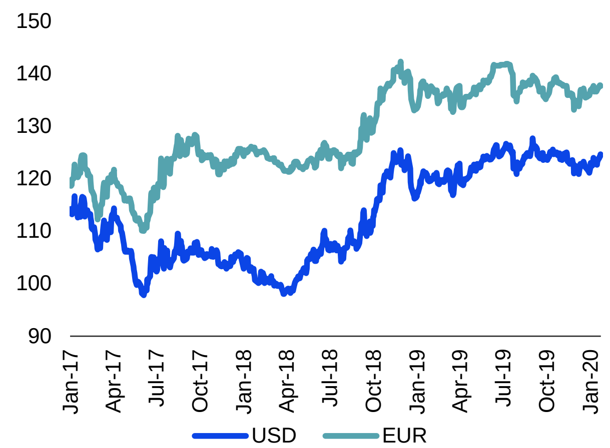

Sources: Icelandic Tourist Board, CBI, Statistics Iceland, Arion Research, IMF. * Domestic analysts

# Unemployment expected to peak in 2020

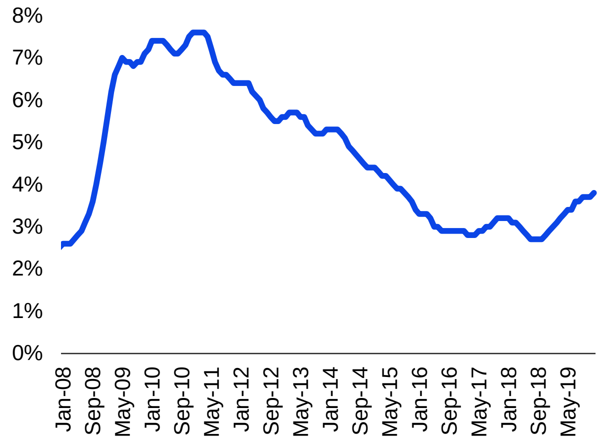
## Economic adjustment through the labor market, not the price level

- Much larger drop in imports than anticipated and slower outflow into foreign assets supported the ISK in Q4, contributing to the modest appreciation.
- In former economic cycles the ISK has worked like a reset button for the economy, depreciating sharply when the export sectors have struggled causing inflation to spike.
- This time, however, inflation has remained low and is expected to stay below the CBI's inflation target in the coming months, largely due to the stable ISK.
- Collective wage agreements in April coincided with a softer economic outlook and reduced uncertainty in the economy.
- Reduced uncertainty is reflected in the payment card turnover, which has been showing positive signs in recent months.
- Although unemployment has continued to increase the climb hasn't been as steep as many feared. Unemployment is expected to peak in 2020.

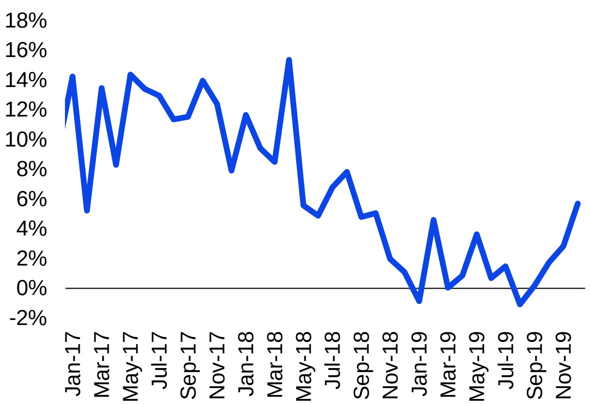
**The ISK against major trade currencies**



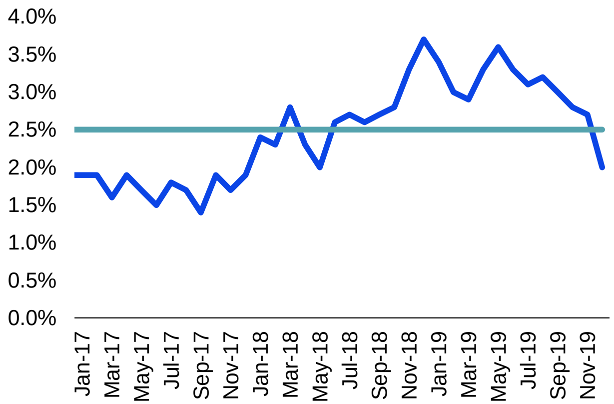

**Unemployment–** seasonally adjusted trend




**Total payment card turnover**




**Inflation and inflation target**





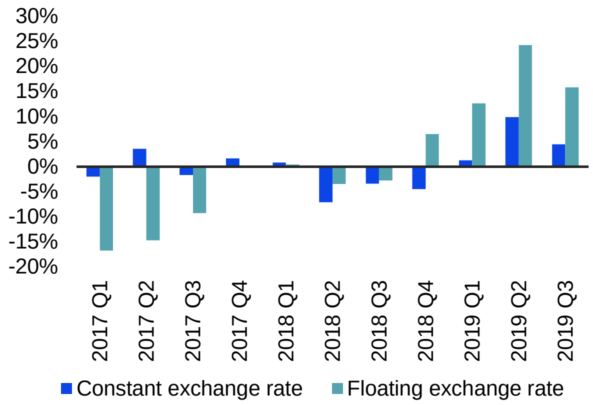

Sources: CBI, Statistics Iceland, Arion Research

# Strong foundations

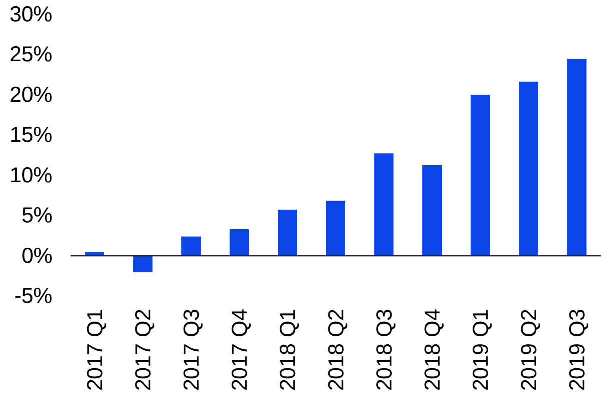
The export sectors, especially tourism, have proved to be resilient in the face of adversity

- Since WOW air's bankruptcy, spending per tourist has increased significantly, both in ISK and FX.
- A plausible explanation for this development is that each tourist is staying for longer, on average, than before.
- The drop in total overnight stays is mainly due to unlisted accommodation while hotels have mostly held their ground.
- The recent tourism figures are extremely positive for Icelandic tourism and the economy as a whole.
- The economy is well equipped to handle a short recession, with a positive net external position and historically low debt levels, both in the private and public sector.
- Recent economic development, coupled with monetary easing, has contributed to long-term ISK yields coming down and the Icelandic housing market holding its ground.

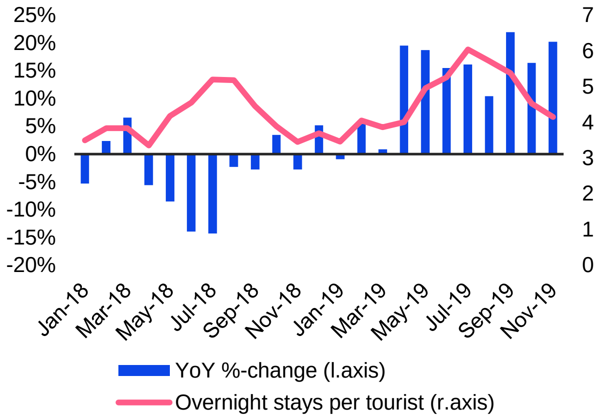
**Consumption per tourist** - YoY %-change



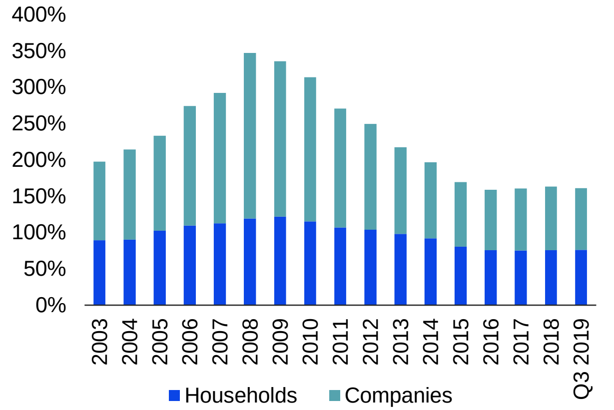

**Net international investment position** - % of GDP




**Total overnight stays per tourist**




**Household and non-financial corporate debt** - % of GDP






Sources: CBI, Centre for Retail Studies, Statistics Iceland, Arion Research

# Arion Bank focuses on sustainable and responsible banking

UNEP FINANCE INITIATIVE | PRINCIPLES FOR RESPONSIBLE BANKING

## International and domestic commitments

- A founding signatory of the **UN PRB** and will strategically align its business with the **Sustainable Development Goals** and the **Paris Agreement** on Climate Change
- UN Principles for Responsible Investment, **UN PRI**
- UN **Global Compact**
- Festa and City of Reykjavík's **Declaration on Climate Change**

## Arion Bank's Environment and Climate Policy

- Set in December 2019
- Contribute to Iceland's efforts to meet its **international agreements**
- Focus on financing projects on **sustainable development and green infrastructure**
- We will **evaluate our loan portfolio** according to green criteria, set ambitious targets and adopt a policy on loans to individual sectors **and evaluate our suppliers**

## Gender Equality

- First bank in Iceland to gain the **equal pay symbol** from the Ministry of Welfare
- **UN Women and UN Global Compact** Women's Empowerment Principles
- **Albright:** In **25th place** out of 333 listed companies in Sweden which are setting a good example in terms of **gender diversity in management teams and at board level**

## Corporate Governance

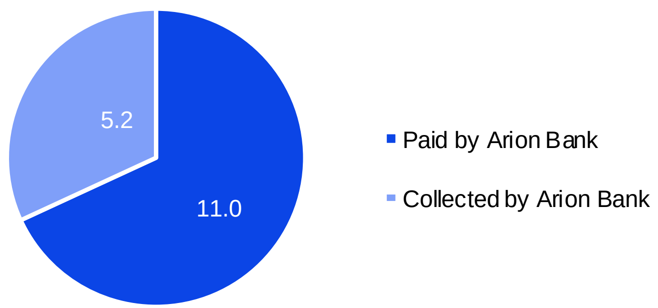
- Center for Corporate Governance's recognition of **Excellence in corporate governance**
- Since 2015 Arion Bank has been recognized as a company which has achieved excellence in corporate governance following a formal assessment based on **guidelines on corporate governance issued by the Icelandic Chamber of Commerce**

## Reporting and rating

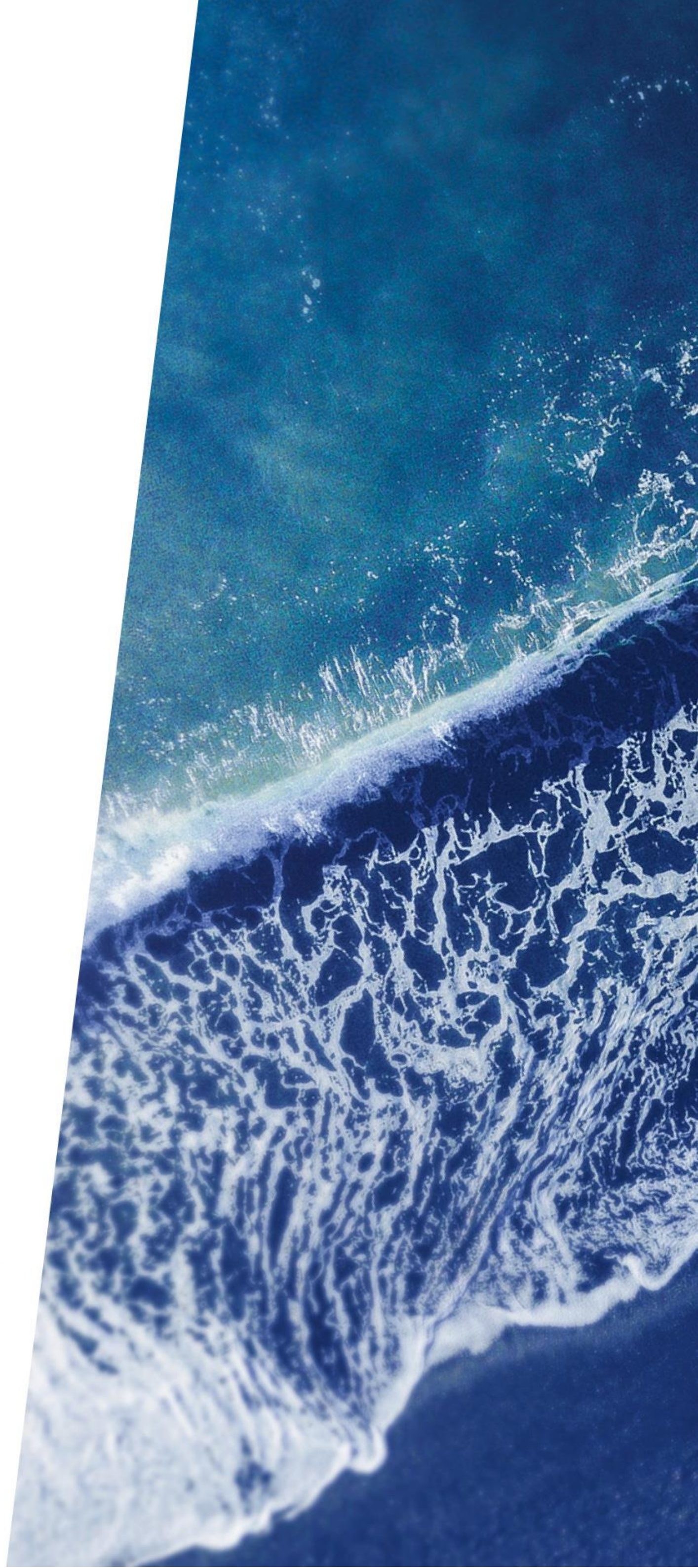
- Global Reporting Initiative standard, **GRI Core**
- **ESG reporting guide** for the Nasdaq Nordic and Baltic exchanges
- UN Global Compact **progress report**
- UN **sustainable development goals**
- Sustainalytics **ESG rating**

## Tax footprint 2019 (ISK bn)

Arion Bank's (parent company) total tax contribution in 2019 amounted to ISK 16.2 billion which equals around 2% of the government's total income in 2018



# Financials



# Highlights of the fourth quarter 2019

Arion Bank’s revised strategy and organizational changes are already showing results as earnings from continuing operations continue to improve, yielding 10.8% ROE in Q4

- NIM improves to 3%
- OPEX trends lower on the back of actions in Q3
- Revenues/RWA’s at 6.4% in Q4

Robust balance sheet management lowers RWA’s, funding costs and bank levy

- Sale of a ISK 48 billion mortgage portfolio to the Housing Financing Fund completed and the corresponding prepayment of legacy covered bond series
- Buy-back of outstanding senior bonds maturing in 2020
- Share buy-back initiated in October

Developments in discontinued operations of ISK 8 billion results in negative net earnings of ISK 2.8 billion and negative ROE of 5.8% in Q4

Considerable restructuring at Valitor at year end with the aim of generating a positive EBITDA. Sale process of the company continues

# Income statement 2019

The positive effect of the Bank's revised strategy in Q3 is not fully reflected in the full year numbers

- Strong growth in net interest income despite lower inflation mostly due to higher (average) interest bearing assets (1.8%) during most of 2019
- Other revenue items relatively strong and operating income increases by 4% from last year
- Operating expenses are under control as increase in salaries and related expenses is primarily due to redundancies in Q3
- The impairment line is volatile YoY. Impairments are modest in 2019 as the release of discount relating to a sale of a mortgage portfolio in Q4 partially offsets the loss from the bankruptcy of WOW air in Q1 and TravelCo in Q2. Impairments in 2018 were high, mainly due to bankruptcy of Primera Air in Q3 2018
- Effective tax rate is 21% compared with 31% in 2018, due to more favorable revenue distribution
- Net effects of discontinued operations are unusually extensive, mainly due to valuation changes at Stakksberg and operation and changes at Valitor. The effect of these on the Bank's capital position is minimal

| | 2019 | 2018 | Diff | Diff% |
|---|---|---|---|---|
| Net interest income | 30,317 | 29,319 | 998 | 3% |
| Net commission income | 9,950 | 10,349 | (399) | (4%) |
| Net insurance income | 2,886 | 2,590 | 296 | 11% |
| Net financial income | 3,212 | 2,302 | 910 | 40% |
| Share of profit of associates | 756 | 27 | 729 | - |
| Other operating income | 877 | 1,584 | (707) | (45%) |
| **Operating income** | **47,998** | **46,171** | **1,827** | **4%** |
| Salaries and related expenses | (14,641) | (14,278) | (363) | 3% |
| Other operating expenses | (12,222) | (12,000) | (222) | 2% |
| **Operating expenses** | **(26,863)** | **(26,278)** | **(585)** | **2%** |
| Bank levy | (2,984) | (3,386) | 402 | (12%) |
| Net impairment | (382) | (3,525) | 3,143 | - |
| **Net earnings before income tax** | **17,769** | **12,982** | **4,787** | **37%** |
| Income tax expense | (3,714) | (4,046) | 332 | (8%) |
| **Net earnings from continuing operations** | **14,055** | **8,936** | **5,119** | **57%** |
| Discontinued operations, net of tax | (12,955) | (1,159) | (11,796) | - |
| **Net earnings** | **1,100** | **7,777** | **(6,677)** | **(86%)** |



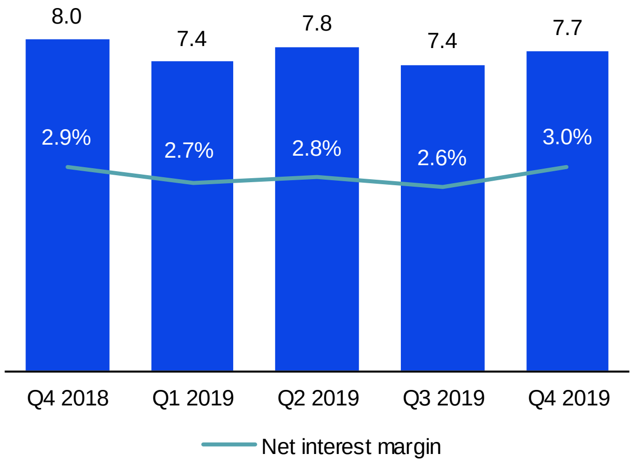
All amounts in ISK million

# Net interest income

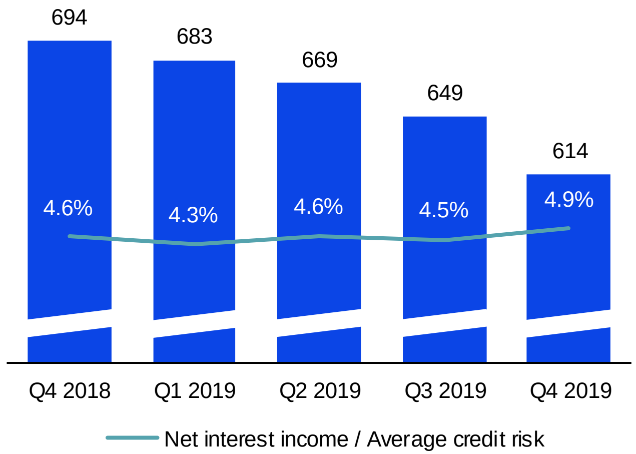
## Revised strategy reflected in positive development in NIM as well as ratio of net interest income to credit risk

- Net interest margin increses to 3% in Q4 in line with revised strategy of increased focus on returns rather than loan growth. Strong performance in light of:
  - Historically low policy rate
  - Lower inflation during the quarter (2.3% vs 4.2% in Q4 2018)
  - Issuance of Tier 2 subordinated bonds in 2019
- Reduction of wholesale funding in ISK and FX have positive effect on NIM as well as increased proportion of ISK in liquidity buffer
- Net interest income decreases 3% from Q4 2018 mainly due to 8% decrease in interest bearing assets
- Favorable development in Net interest income to average credit risk following increased focus on capital management and return on loan book
- Lower interest income from loans to customers and lower effect from inflation on Net interest income is largely offset by lower funding cost in deposits and borrowings
  - Prepayment of expensive funding and strong liquidity management supports NIM

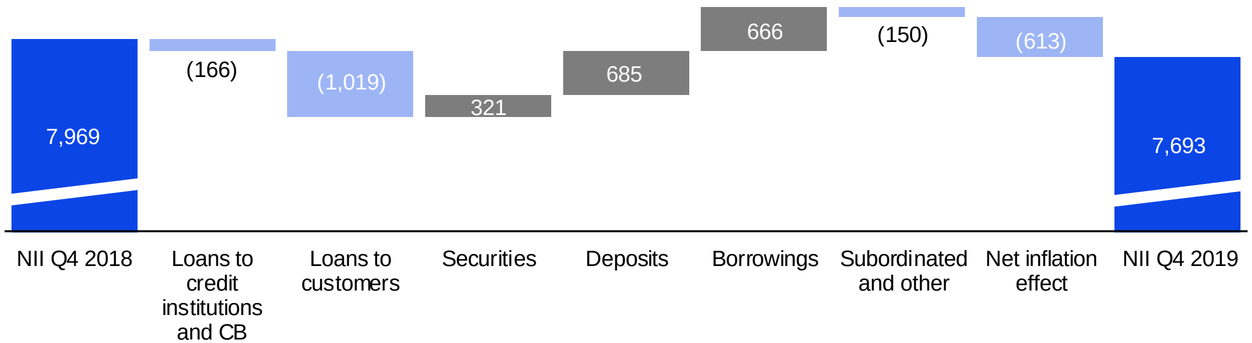
**Net interest income**




**Credit risk**




**Net interest income Q4 2018 vs Q4 2019** (ISK million)



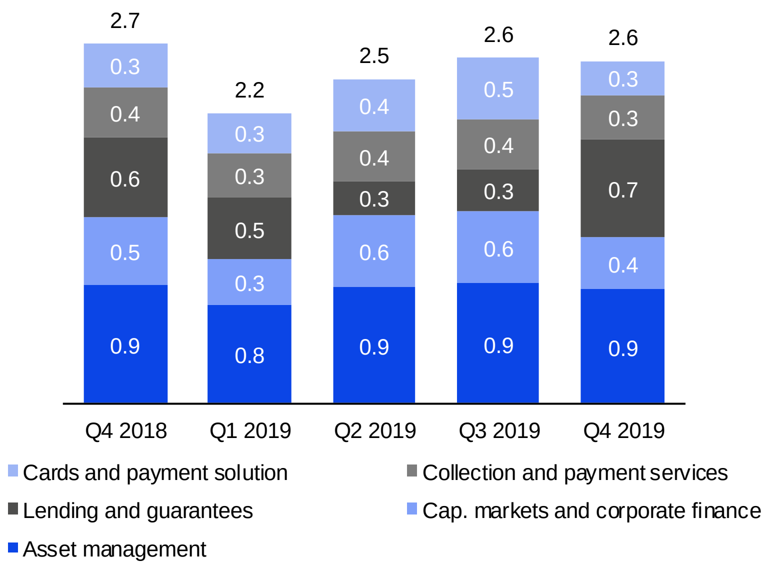



All amounts in ISK billion

# Net fee and commission and net insurance income

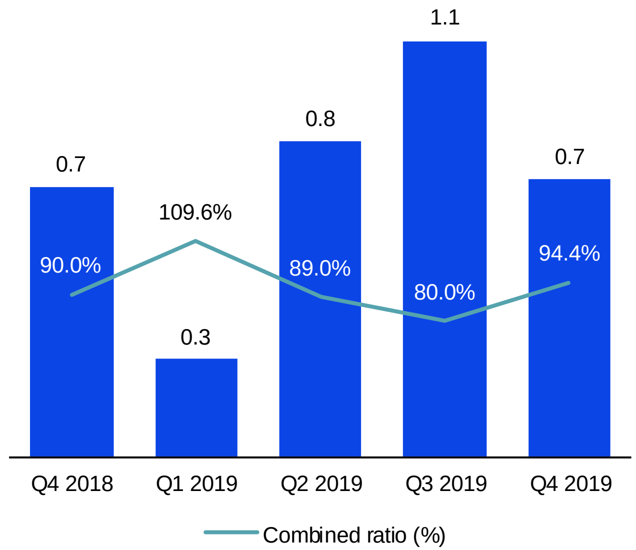
Stable net commission income with scope for improvement - net insurance income continues to trend positively

### Net fee and commission income




- Income from lending and guarantees increase from prior quarters, partly due to prepayment of loans and as capital velocity increases
- Income from asset management is very stable. Assets under management were ISK 1,013 billion at 30 September, an increase of 4.4% between years
- Revised strategy should support base for increased fee and commission income

### Net insurance income




- Decrease from Q3 mainly due to seasonality in non-life insurance. 2.7% increase in NII from Q4 2018
  - Earned premiums increased by 8% in Q4 YoY
- Volatility in non-life, often affected by weather conditions over the winter
- Strong Combined ratio is competitive in the domestic market



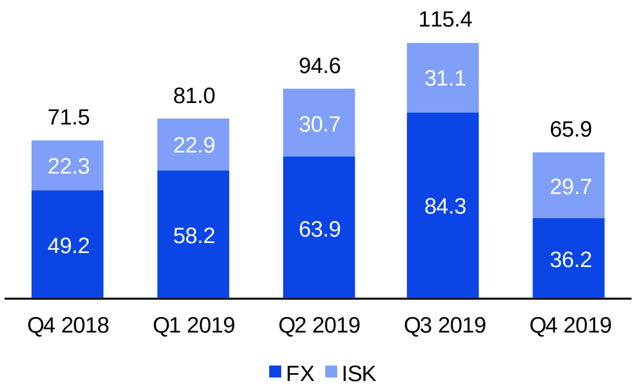
All amounts in ISK million

# Net financial income

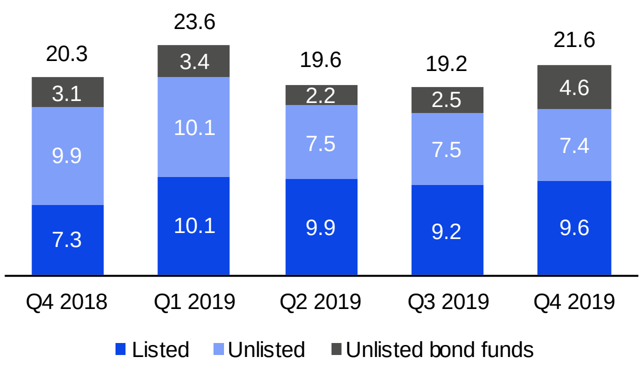
## Decrease in bond holdings as the Bank is managing liquidity and tax at year end

- Net financial income in Q4 was positively affected by:
  - Equity holdings measured at fair value as markets were favorable during the quarter
  - Realized gain on FX bond holdings sold in connection with prepayment of borrowings
- It was negatively affected by:
  - Premium on prepayments of borrowings
  - Net loss of fair value hedge of interest swap
- Bond holdings are mainly used for liquidity management
  - Decrease significantly due to prepayments of borrowings, both in ISK (CB 2) and FX (EMTN issued bond due in Q2 2020)
- Equity holdings are mainly strategic positions
- Total portfolio of Vördur is ISK 18.1 billion; ISK 11.4 billion of bonds and ISK 6.7 billion in equity instruments

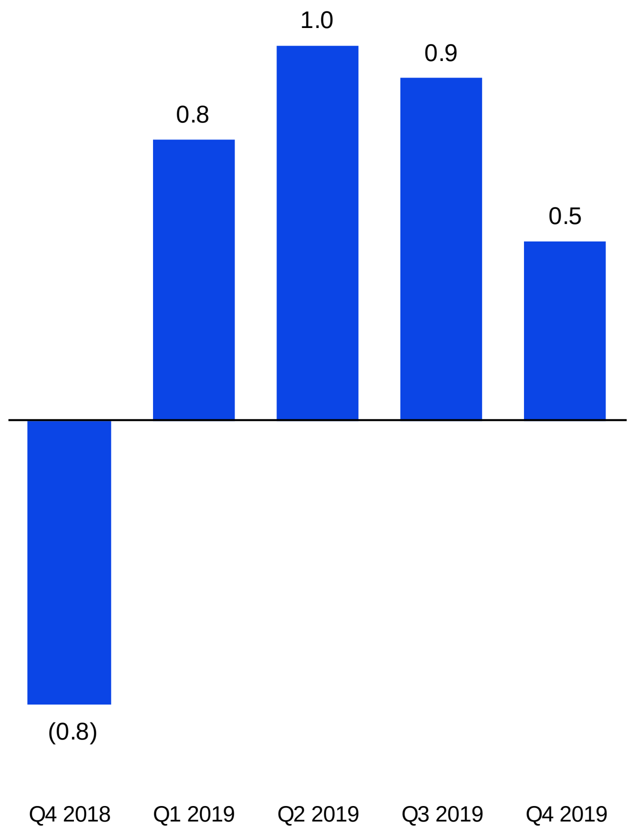
**Bond holdings**




**Equity holdings**




**Net financial income**





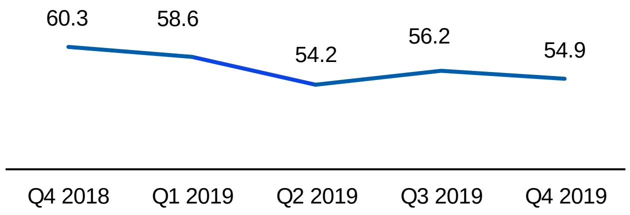

All amounts in ISK billion

# Total operating expenses

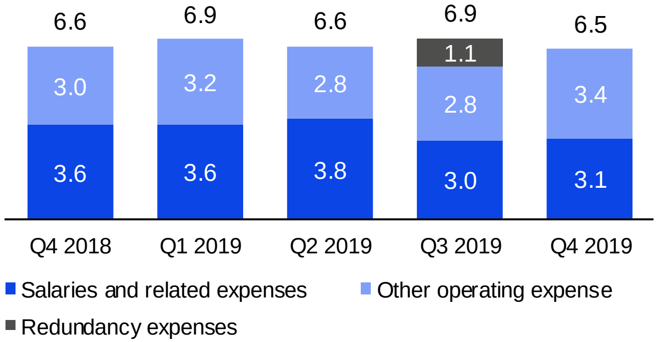
## Cost-to-income is trending towards target

- Number of FTE's reduced by 13.5% at the parent company from Q4 2018, mostly due to organizational changes at the end of Q3 with cost savings materializing in Q4
- Salaries and related expenses reduced by 14% from Q4 2018 while number of FTE's reduced by 11%. General wage inflation was 4.9% in the same period
  - Salaries and related expenses were affected by capitalized salaries which amounted to ISK 142 million in Q4 (nil in Q4 2018) relating to investment in the Sopra core system
- Other operating expenses increase year on year, due to IT and depreciation. Other items such as housing and office costs decrease

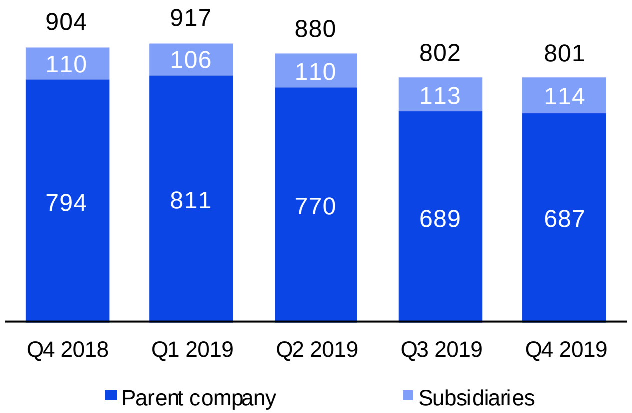
**Cost-to-income ratio (%)**




**Total operating expenses**




**Number of employees**



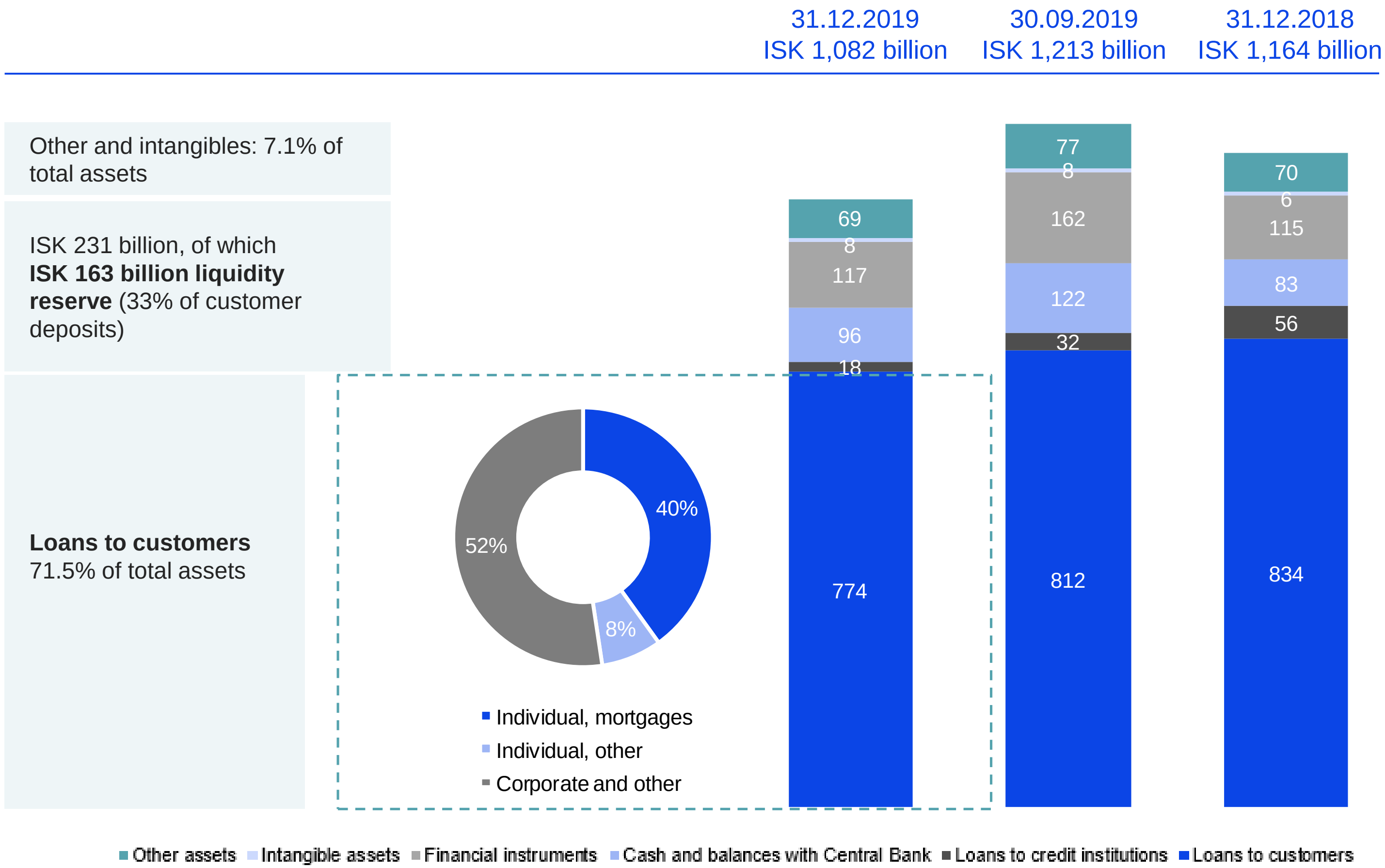



All amounts in ISK billion

# Balance sheet - Assets

## Balance sheet brought down in line with strategy as both loans and liquidity decrease

- The Balance sheet decreases by 10.8% from 30.09.2019
- Loans to customers decrease by 4.7% from 30.09.2019 and 7.2% from year-end 2018 in line with strategy of focus on returns over loan growth
  - ISK 48 billion mortgage portfolio sold during the quarter
- Decrease in financial instruments due to sale of bonds with proceeds used to prepay wholesale funding
- Very strong liquidity position despite dividend payment during Q1 2019, share buyback during Q4 and large prepayments of borrowings
  - Total LCR ratio is 188% and ISK LCR ratio is 158%
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX




[1]Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets



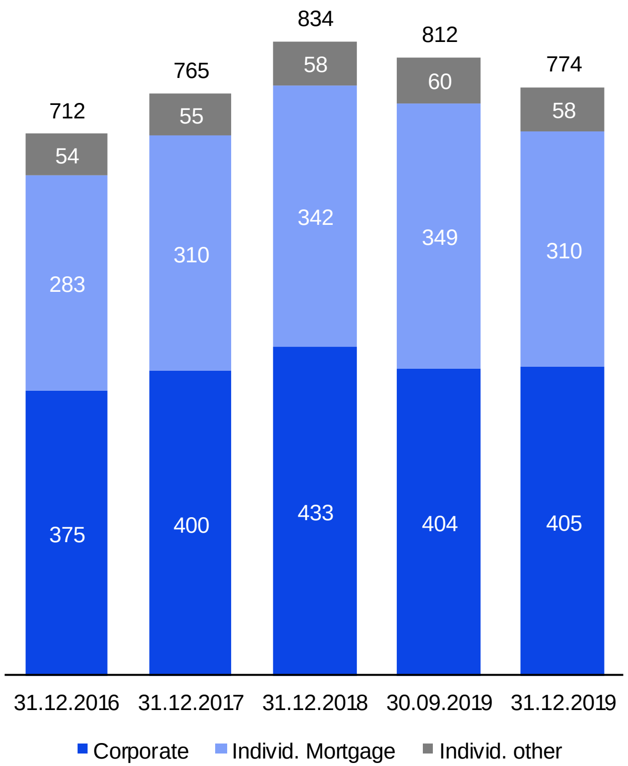
All amounts in ISK billion

# Loans to customers

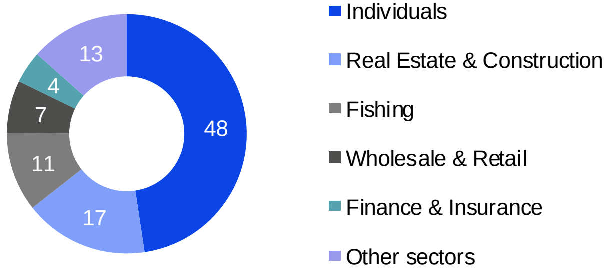
## Focus on profitability results in the loan book trending lower thus releasing RWA's

- Loans to customers reduce by 7.2% during 2019
- The loan book continues to be well balanced between individuals and corporates
- Loans to individuals reduced 8.0% during the year due to sale of ISK 48 billion mortgage portfolio
  - Loans to individuals increase slightly from YE 2018 taking into account sale of mortgage portfolio
- The corporate loan book reduction has released approx. ISK 45 billion of RWA's since YE 2018
  - Loans to corporates decrease by 6.5% from YE 2018 but stable from 30.09.2019
  - Good diversification between sectors in the corporate loan book
- Demand for new lending affected by temporary economic slowdown
  - Reflected in loan commitments, 32% decrease from YE 2018
- 87% Of the loan book was classified as stage 1 at YE 2019 compared with 92% at YE 2018
- The loan book is collateralized 89.8%, compared with 90.6%, at YE 2018

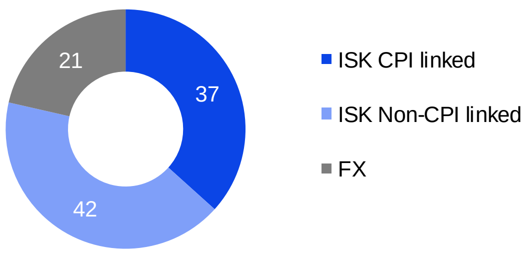
**Loans to customers**




**Loans to customers by sector (%)**




**Loans to customers by currency (%)**






All amounts in ISK billion

# Balance sheet – Liabilities and equity

## Deposits are increasing in the funding mix

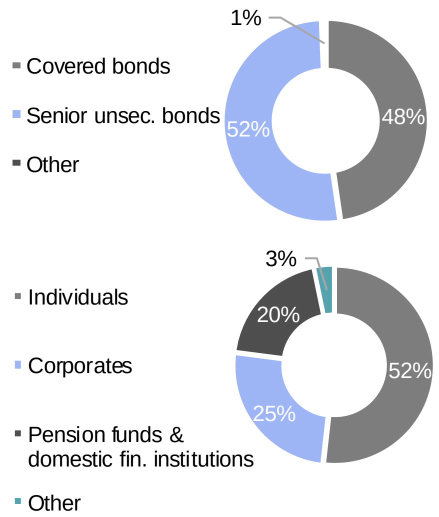
- Strong equity position and a very high leverage ratio despite capital release
  - Dividend payments of ISK 9.1 billion in Q1 2019
  - Share-buy back up to ISK 8.0 billion from 31 October
  - Proposed dividend payment of ISK 10 billion in March 2020.
- The Bank is a frequent issuer of covered bonds in the domestic market and a regular issuer of senior unsecured in the international market
  - Bank levy is calculated on year end position of liabilities and the Bank strategically seeks to limit large MM deposits at year end
- Deposits increased by 5.8% from YE 2018 but decrease 3.0% during the fourth quarter – continued focus on deposits going forward
- The Bank has issued a number of Tier 2 subordinated bonds in line with its capital strategy
- The funding mix is well balanced between deposits, covered bonds and senior unsecured bonds

**Equity**
CET1 ratio 20.4%
Leverage ratio 13.7%

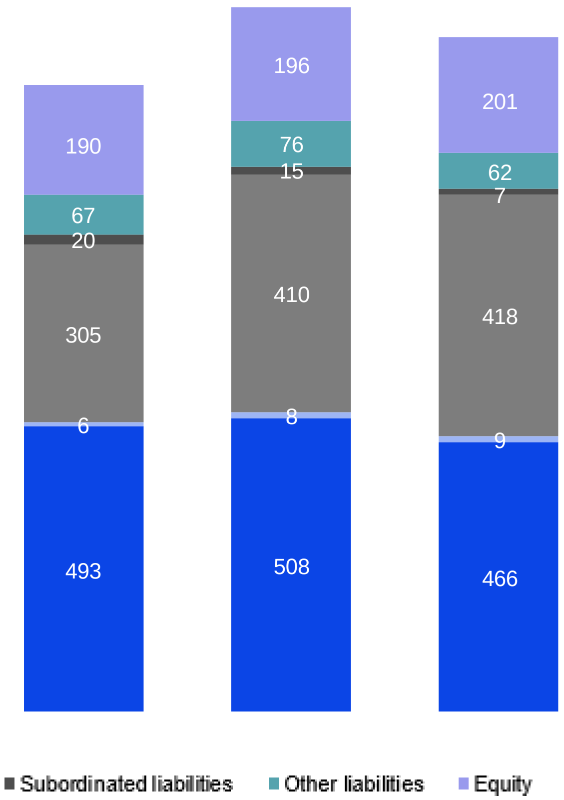
**Borrowings** (in ISK)
ISK 147 billion
EUR 117 billion
Other currencies 41 billion

**Deposits**
On demand 71%
Up to 3M 16%
More than 3M 13%

8.3% increase from YE 2018




| 31.12.2019 | 30.09.2019 | 31.12.2018 |
|---|---|---|
| ISK 1,082 billion | ISK 1,213 billion | ISK 1,164 billion |




[1] Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities



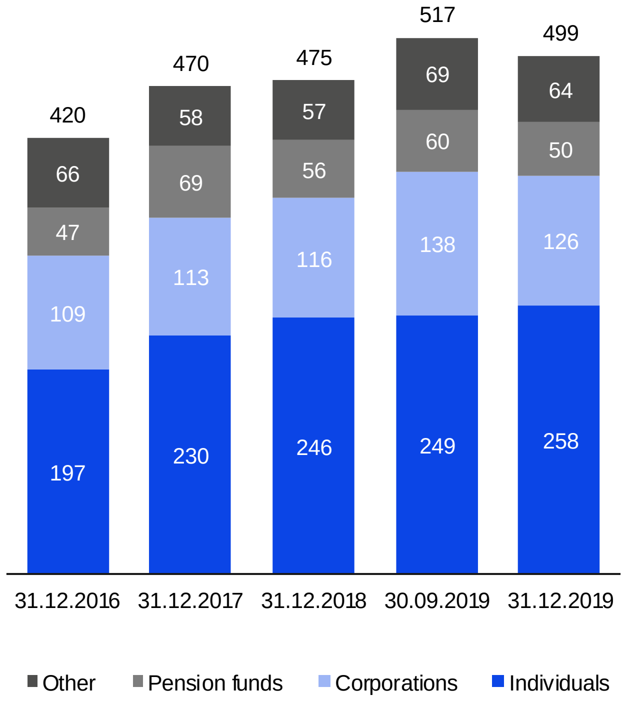
All amounts in ISK billion

# Deposits

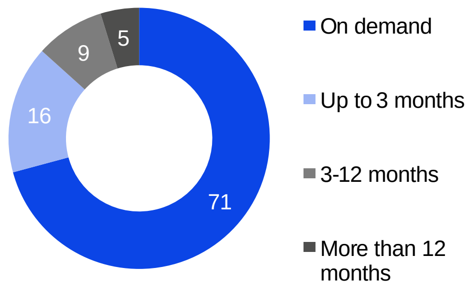
## Continued focus on deposits both from individuals and corporates

- Deposits represent 46% of the Bank's funding
- Deposits from individuals have grown significantly over the last few years
  - 4.8% growth from YE 2018
- Special emphasis on corporate deposits
  - 8.6% growth from YE 2018
- FX deposits increased significantly in the first 9M 2019 but decreased back to YE2018 level in Q4
  - The Bank was able to reprice large FX deposits during Q4
- The Bank will continue focusing on deposits from individuals and corporates as they provide long term stable funding

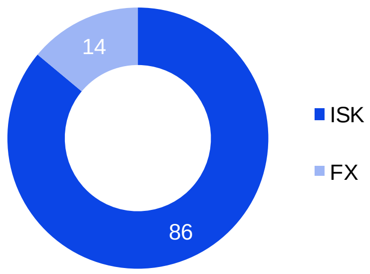
**Deposits and due to credit institutions and Central Bank**




**Maturity of deposits (%)**




**Deposits by currency (%)**





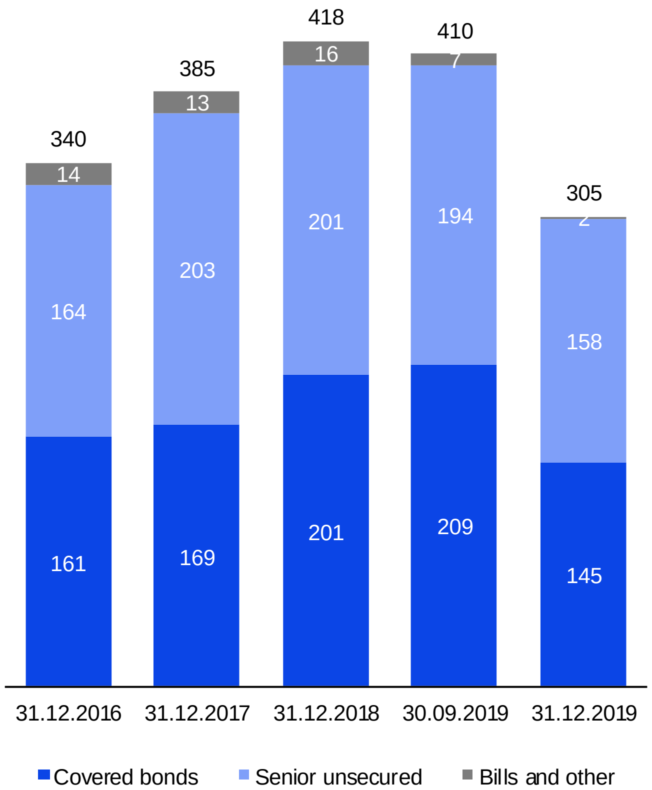

All amounts in ISK billion

# Borrowings

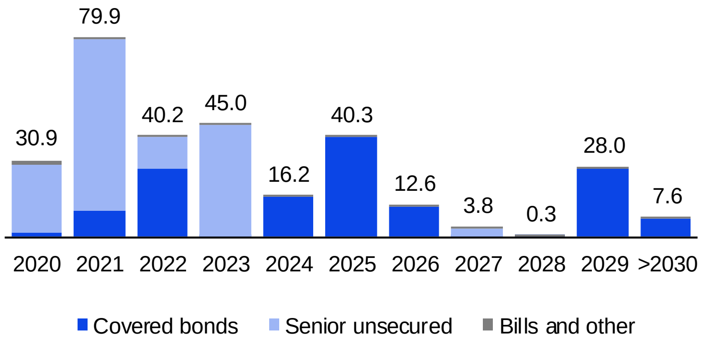
## Reduced wholesale activity in line with changed focus on the asset side

- Continued emphasis on reduction of funding cost both through prepayments, buy-backs or other activities
- Reduced borrowings driven by prepayments and buy backs
  - ISK 60 billion of ISK Legacy covered bond issuance in 2019
  - Tender of €300 million of bonds maturing in June 2020. The Bank received offers of €258 million and all offers were accepted
- The Bank intends to issue EUR 300-500 million internationally through its EMTN program subject to funding needs and market conditions. The Bank will also issue smaller issues in other currencies
- Solid BBB+ credit rating from S&P but outlook changed mid 2019 from stable to negative for major Icelandic banks
- Arion Bank aims to issue approximately ISK 15-20 billion of covered bonds in 2020
- Legislative bill introducing **MREL** was presented to Icelandic Parliament in November 2019 - currently undergoing parliamentary procedure
- Arion will be subject to MREL requirements in the future

**Borrowings by type**




**Maturities of borrowings (%)**

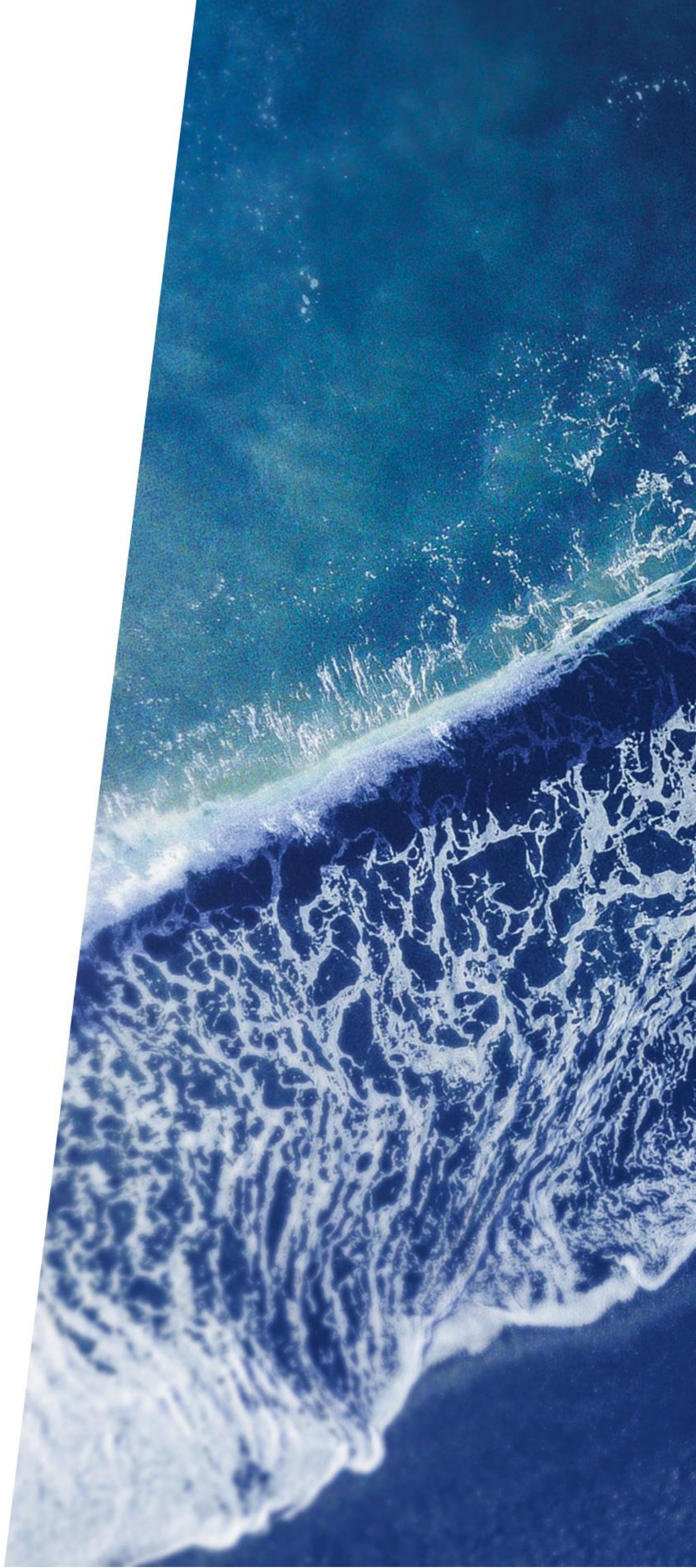



**Ratings - S&P (July 2019)**

| | | |
|---|---|---|
| Senior unsecured | BBB+ | A |
| Short term debt | A-2 | A-1 |
| Outlook | Negative | Stable |

All amounts in ISK billion

# Capital Position

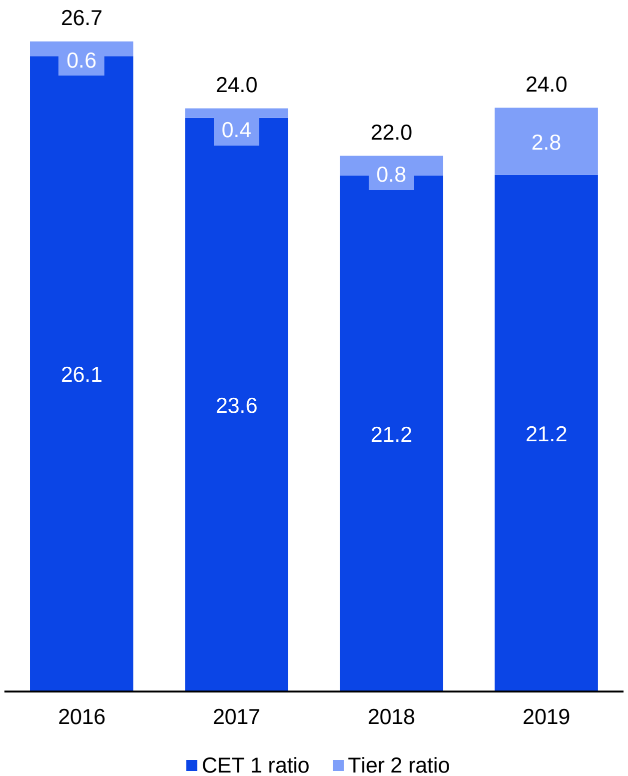


# Own funds

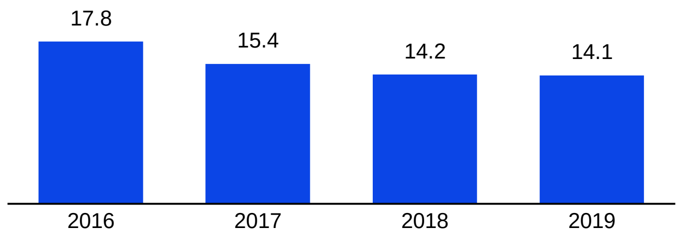
## Capital ratio remains very strong despite dividends, buy-back of own shares and impairment of held for sale assets

- Solid level of capital due to strong profit generation over recent years
  - Capital adequacy ratio increased by 200 bps from YE 2018
  - Arion has issued a total of ISK 20 bn of Tier 2 and fully utilize the Tier 2 layer
- Arion is considering the issuance of Additional Tier 1 (AT1) notes to further optimize its capital structure
- The Bank aims to lower risk weighted assets in the short term, mainly due to continued reduction of the corporate loan book
- Icelandic banks apply the standardized approach to RWAs
- The RWA density (measured as RWAs over total assets) remains very high when compared to banks across Europe
- Leverage ratio remains very strong in all respects

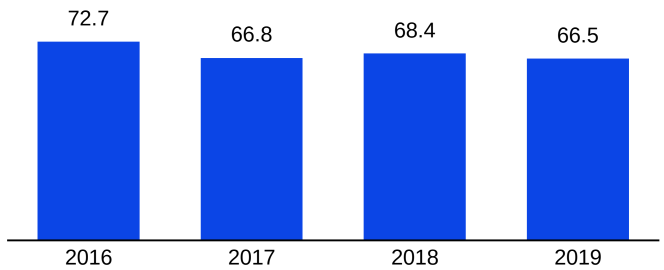
**Capital ratio (%)**




**Leverage ratio (%)**




**Risk weighted assets / Total assets (%)**





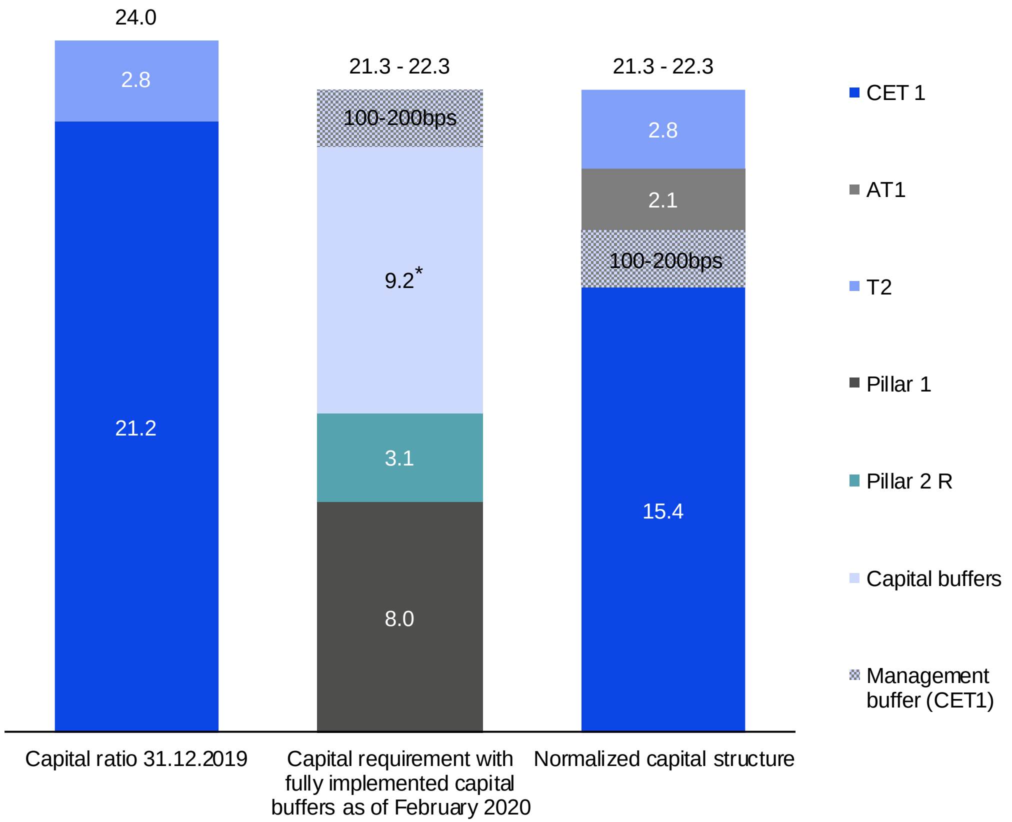

All amounts in ISK billion

# Capital adequacy

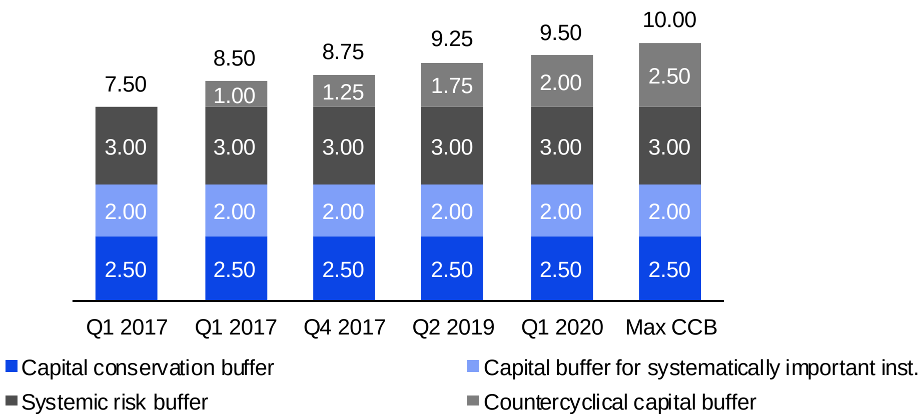
## The Bank's management buffer now communicated as a range from 100 to 200bps

- The Bank's total capital adequacy ratio was 24.0% as at 31 December 2019 foreseeable equity reduction of ISK 10.0 bn. is accounted for in the ratio
- The net increase in the capital ratio in the third quarter is nevertheless positive by 0.8%, primarily due to a reduction of risk-weighted assets (RWA) and new issuance of Tier 2 subordinated bonds
- The countercyclical capital buffer in Iceland increased by 0.5% in May 2019 and a further increase of 0.25% came into effect on 1 February 2020
- Based on the fully implemented capital buffers as at February 2020, the Group's total regulatory capital requirement is 20.3% of RWA
- Taking into account the Bank's internal management buffer of 1-2%, the Bank's total capital target range is 21.3-22.3% (CET1 16.4-17.4%)

**Own funds and capital requirements (%)**




**Development of capital buffers for systemically important banks in Iceland (%)**

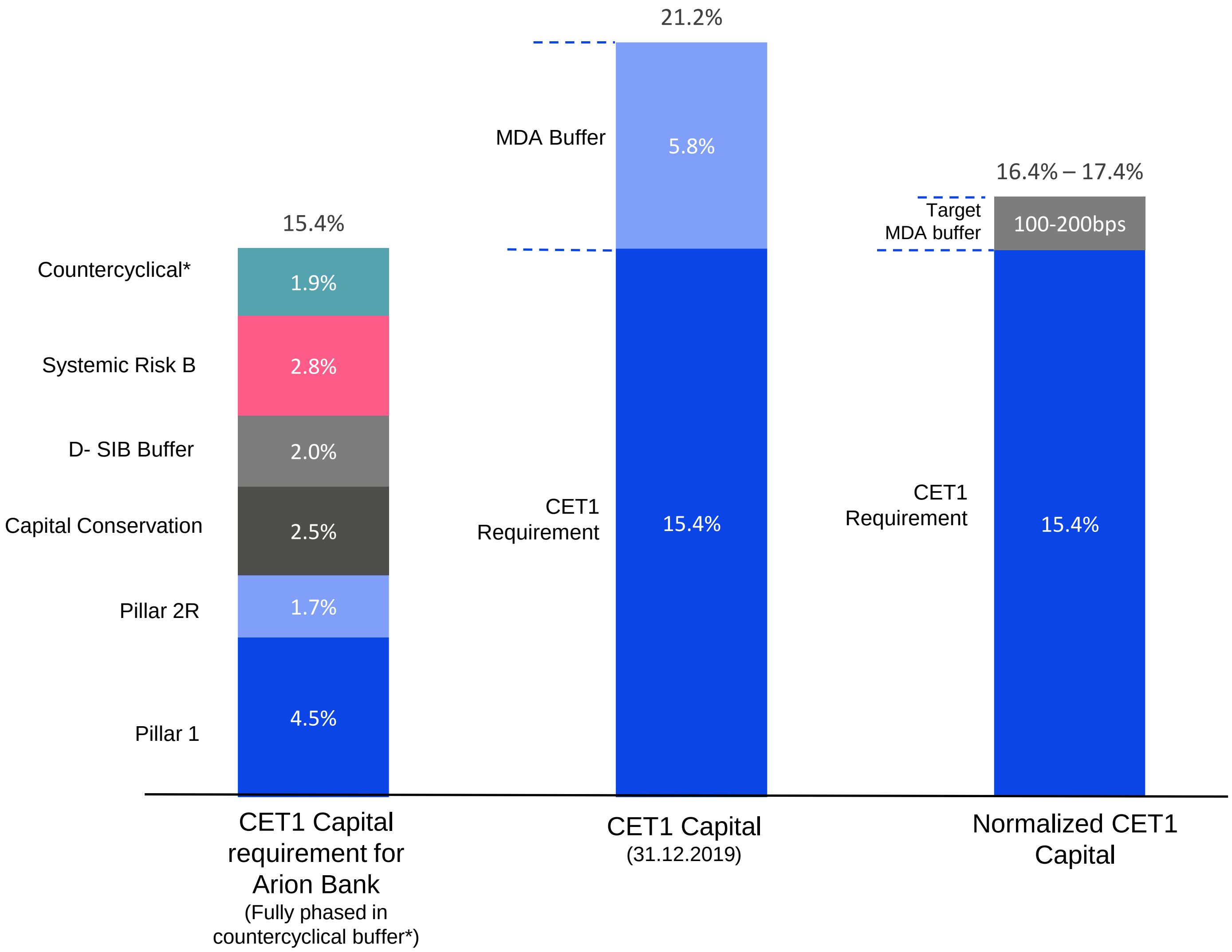



* Calculated Combined Buffer Requirement for Arion Bank is 9.2% (not 9.5% as on the graph to the left).
**Countercyclical capital buffer** is determined by calculating the weighted average of the corresponding buffer levels of each country for credit risk against counterparties residing in those countries.
**Systemic risk buffer** only applies to domestic exposures and is calculated using the same weighting method.

# Comfortable buffer to MDA

## High combined buffer requirement coupled with a strong MDA buffer

- Arion Bank's CET1 capital position is comfortably in excess of MDA requirements
- MDA buffer is 5.8% equivalent to ISK 41.7 bn.
- Arion's pillar 2R capital add-on, which is the result of the ICAAP/SREP, may comprise 56.25% CET1 capital, 18.75% AT1 capital and 25% Tier 2 capital
- CRD IV buffers have been implemented in Iceland
- It is management policy to voluntarily hold an additional management buffer of 1-2%

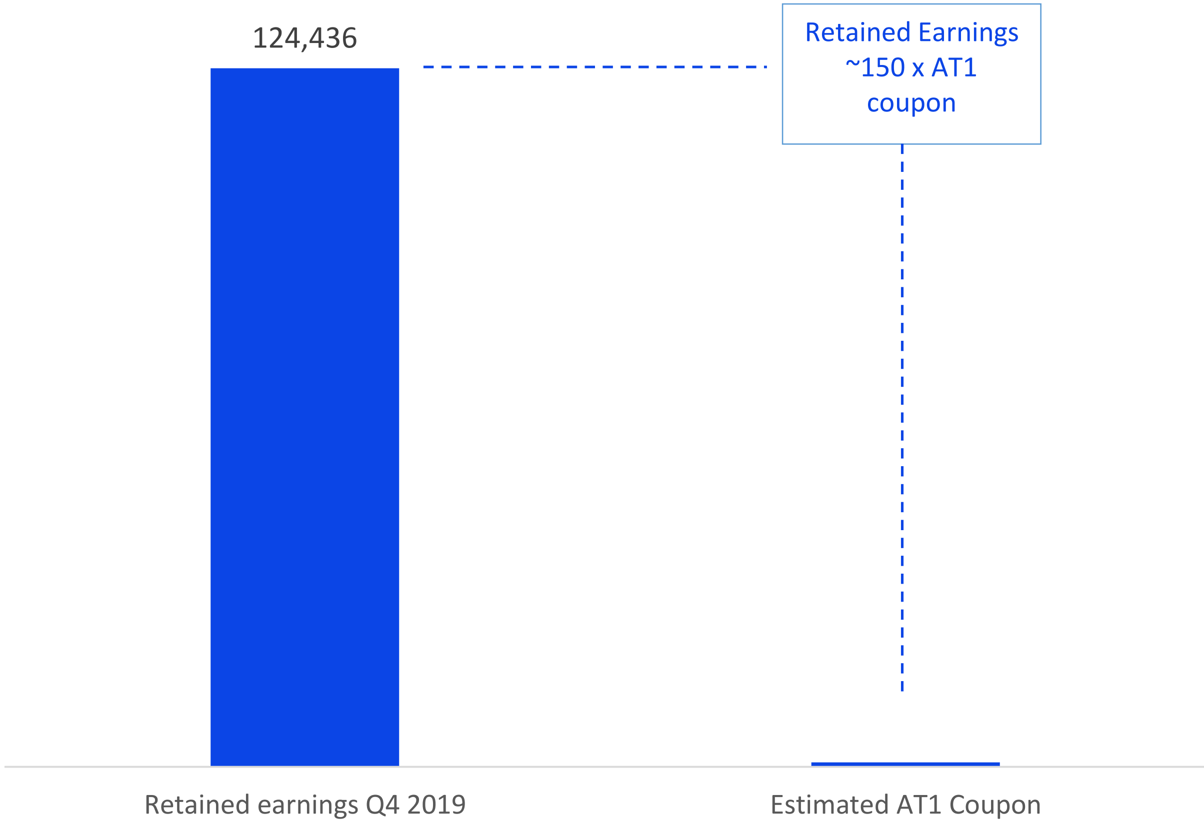



* Countercyclical buffer increased by 25bps in February 2020
Countercyclical capital buffer is determined by calculating the weighted average of the corresponding buffer levels of each country for credit risk against counterparties residing in those countries.
Systemic risk buffer only applies to domestic exposures and is calculated using the same weighting method.

# Distribution capacity

## Available Distributable Items (ADI) to cover discretionary distributions

- Arion Bank has a very comfortable ADI position, with an estimated circa 150x coverage ratio
- It is Arion Bank's current intention that, whenever exercising discretion to propose any distribution in respect of ordinary shares or AT1 instruments, it will respect the hierarchy of capital instruments and preserve the seniority of claims
- However the Bank's Board of Directors may depart from this policy at any time at its sole discretion
- Medium Term Target to maintain a pay-out ratio of circa 50% of net earnings attributable to shareholders

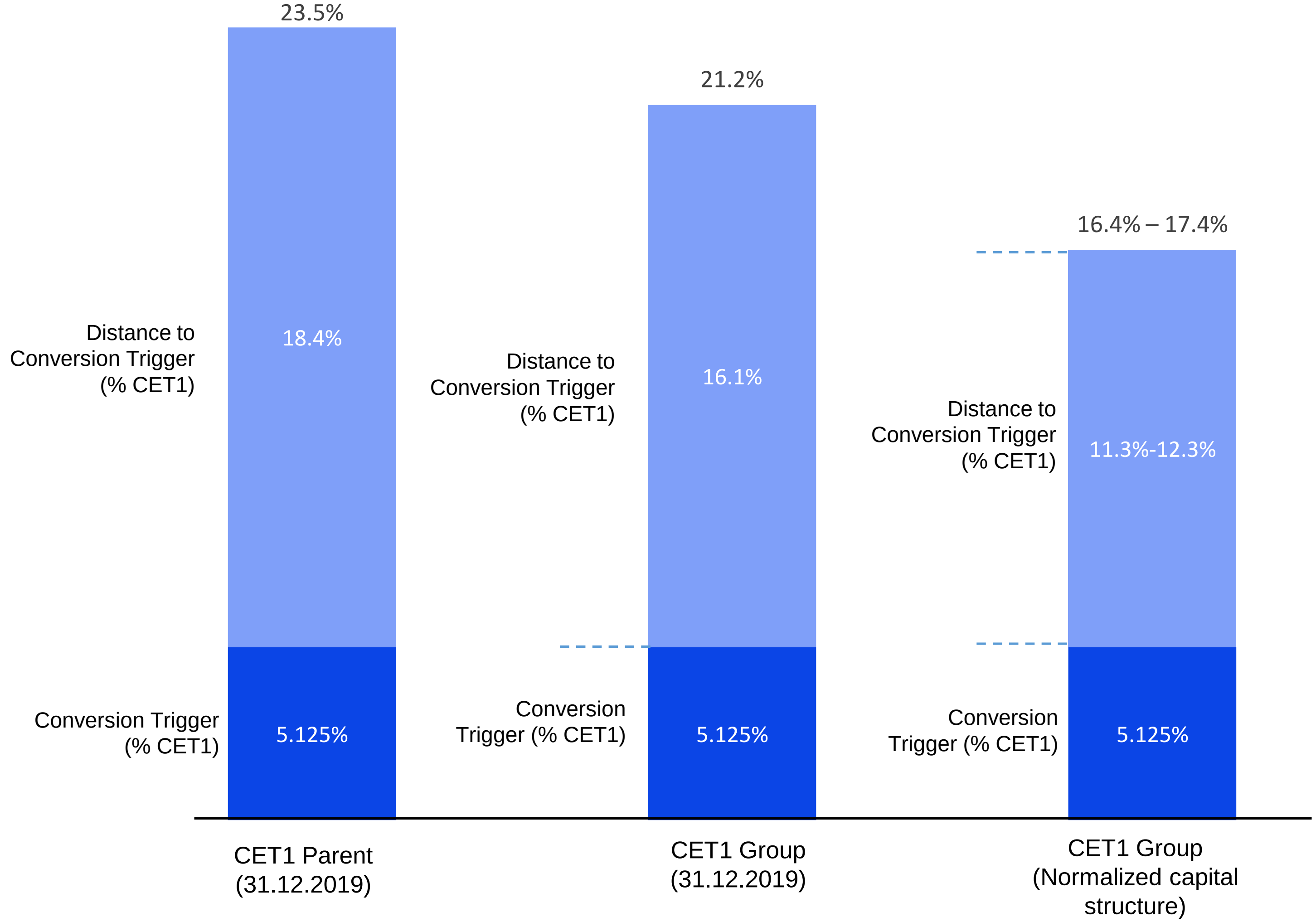



* Assuming all retained earnings per 31.12.2019 are distributable
** Illustrative annual coupon cost based on estimated new issue size and coupon

# Significant distance to Conversion Trigger

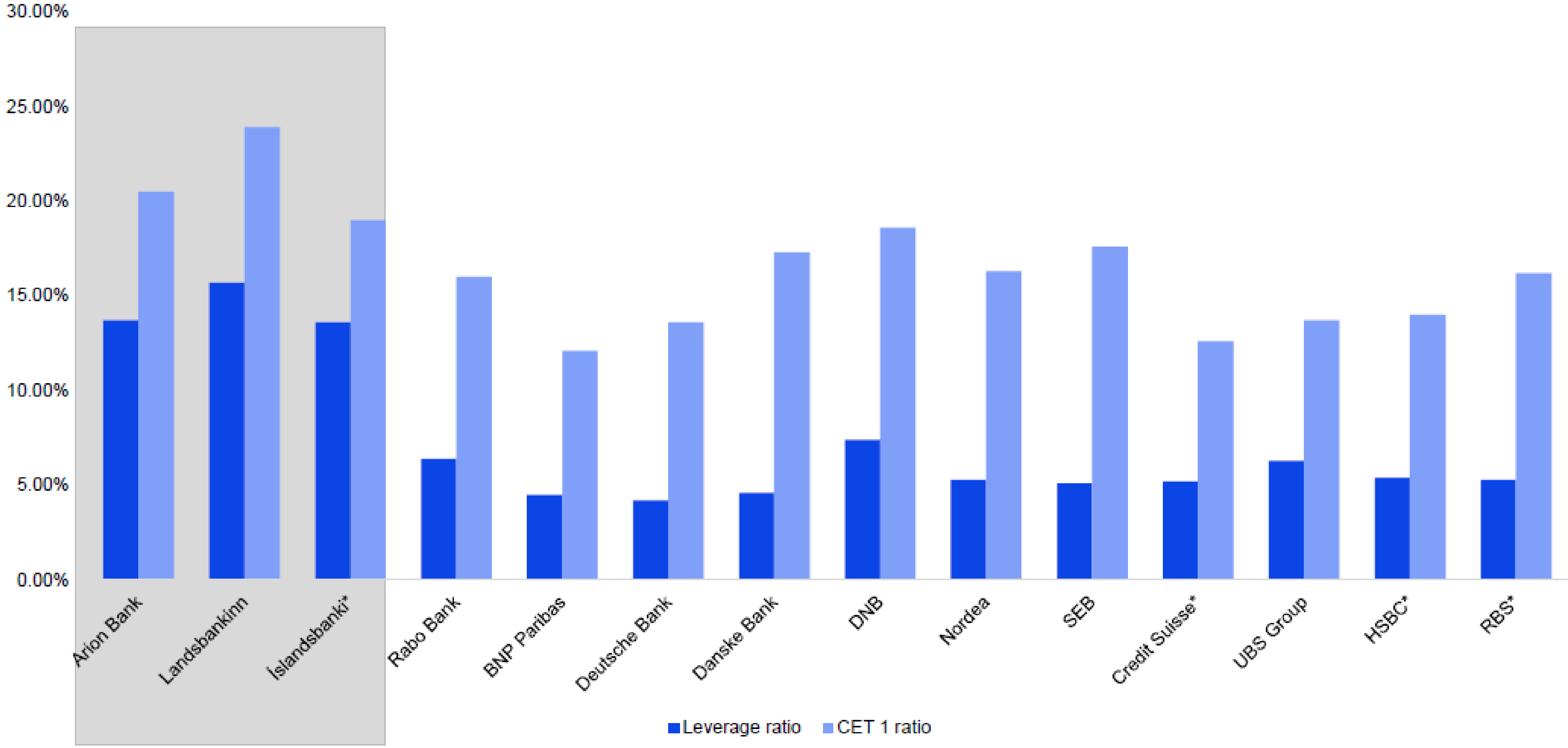
## CET1 distance to conversion trigger 16.1% at group level

- Conversion Trigger is set at 5.125%
- Based on FY 2019 RWAs of ISK 719,755 bn and CET1 capital of ISK 152,691 bn, Arion Bank's CET1 capital position is comfortably in excess of the conversion trigger
- Distance to Conversion Trigger:
  - Group level 16.1% (ISK 115.8bn)
  - Parent level 18.4% (ISK 132.3bn)
- It is management policy to voluntarily hold an additional management buffer of 1-2%



# Capital requirements are high

Icelandic banks apply the standardized approach to RWAs and capital buffers are fully implemented since February 2020



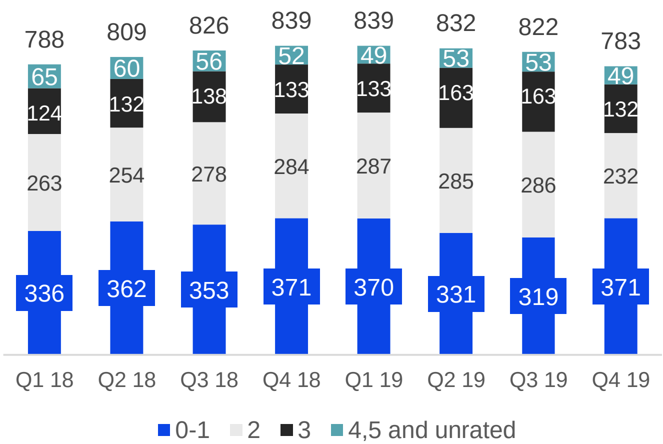

*Q3 19 numbers
Source: Bloomberg and annual reports

# Appendix

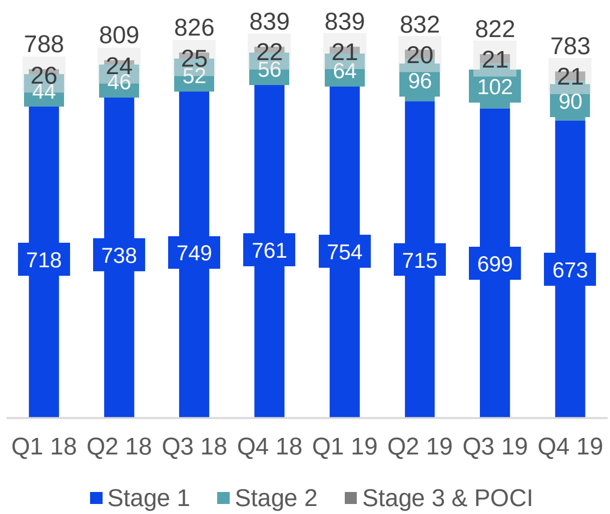
# Asset Quality

- The Bank uses internal credit rating models and external credit ratings if available to monitor credit risk
- The following graph show the gross carrying amount of financial instruments subject to the impairment requirement of IFRS 9 broken down by rating scale an stage allocation. Risk class 5 is the highest risk
- The Impairment loss allowance shows current loss allowance broken down by stage.
- To calculate the net book value, subtract the impairment loss allowance from the gross carrying amount.
- Collateral held against loans stable at a healthy level

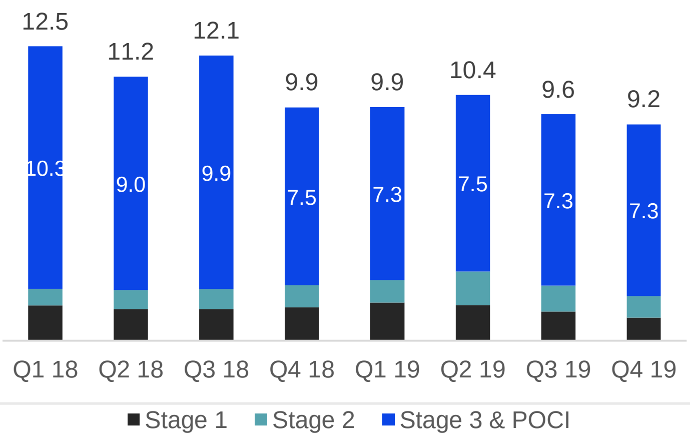
**Loans to customers Risk Classification**
Gross carrying amount



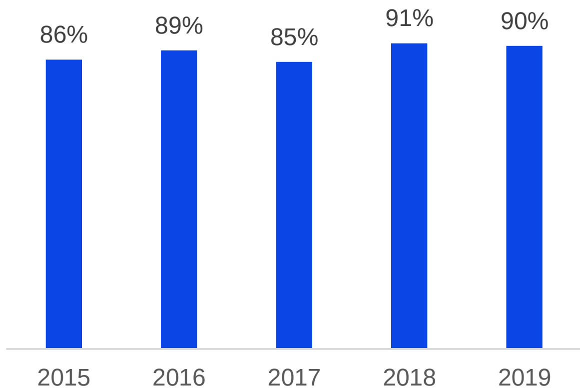

**IFRS 9 stages – Loans to customers**
Gross carrying amount




**Impairment loss allowance**




**Collateral held against loans**






All amounts in ISK billion
POCI : Purchased or originated credit impaired assets

# Significant held for sale assets

Assets in an active sale process but with a highly negative impact on net earnings

**Valitor Holding** is an international payments platform, with operations primarily in Iceland, the UK and the Nordic countries, and comprizes both card acquiring services and card issuing services. Valitor became a subsidiary of Arion Bank in 2010 when the Bank had acquired 52.94% shareholding in Valitor and following further investments Arion Bank held 100% shareholding in Valitor in Q1 2015. Valitor was categorized as held for sale in Q4 2018. At the year-end 2019 **the net value of Valitor was ISK 6.5 billion**

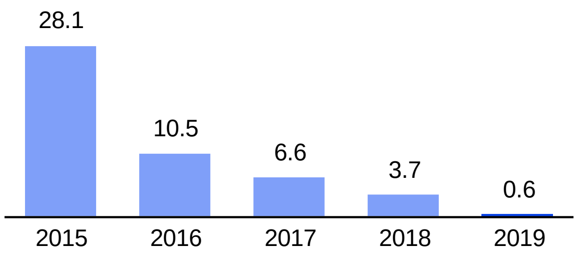

**Stakksberg's** operation comprises a silicon production plant which commenced operations in 2016. In 2017 Arion Bank acquired the company United Silicon as a result of a loan restructuring process. Following Stakksberg took over the operations of United Silicon. At the year-end 2019 **the net value of Stakksberg was ISK 2.8 billion (EUR 21.0 million)**

# Going forward

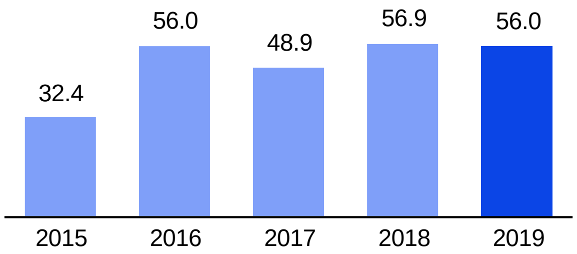
- Continued emphasis on measures to reach financial targets
- The macroeconomic developments are of concern both locally and globally
- Sales process of Valitor continues but is taking more time than originally anticipated
- The Bank aims to issue AT1 in Q1

# Key financial indicators - annual

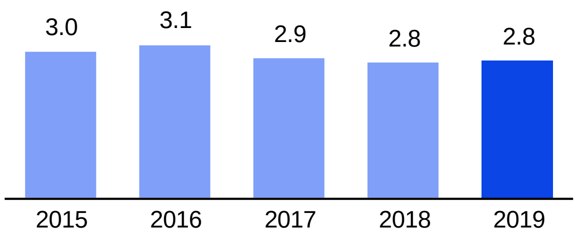
Return on equity (%)



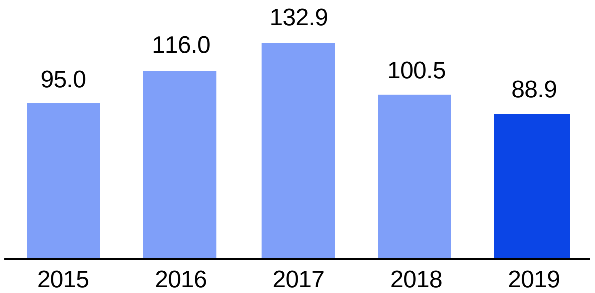

Cost-to-income ratio (%)



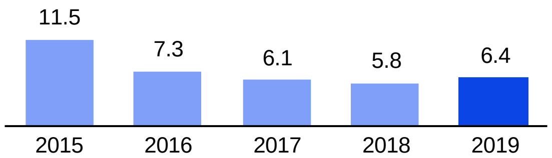

Net interest margin (%)



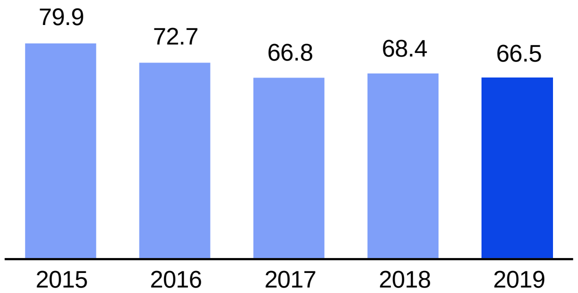

CPI imbalance (ISK billion)




Operating income / RWA (%)

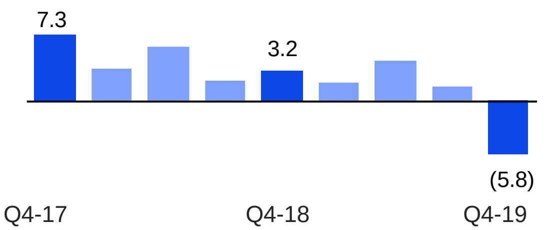



Risk weighted assets / Total assets (%)

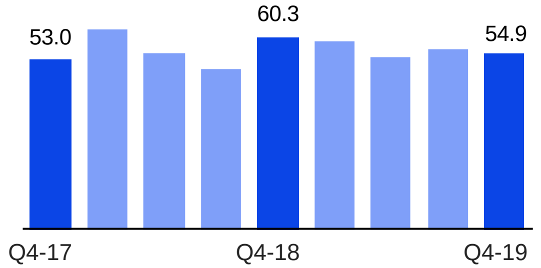


# Key financial indicators - quarterly

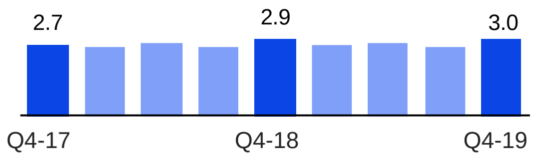
Return on equity (%)



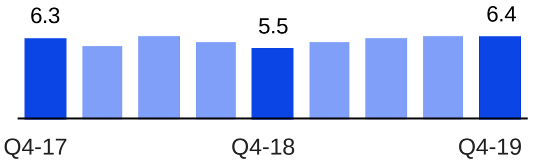

Cost-to-income ratio (%)



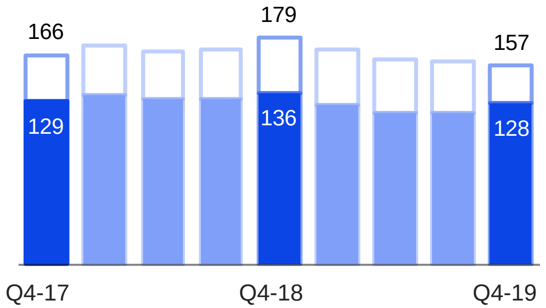

Net interest margin (%)



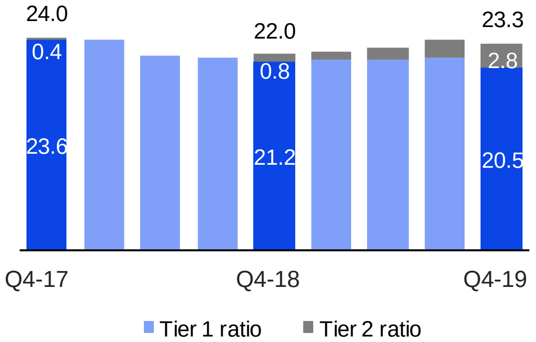

Operating income / RWA (%)



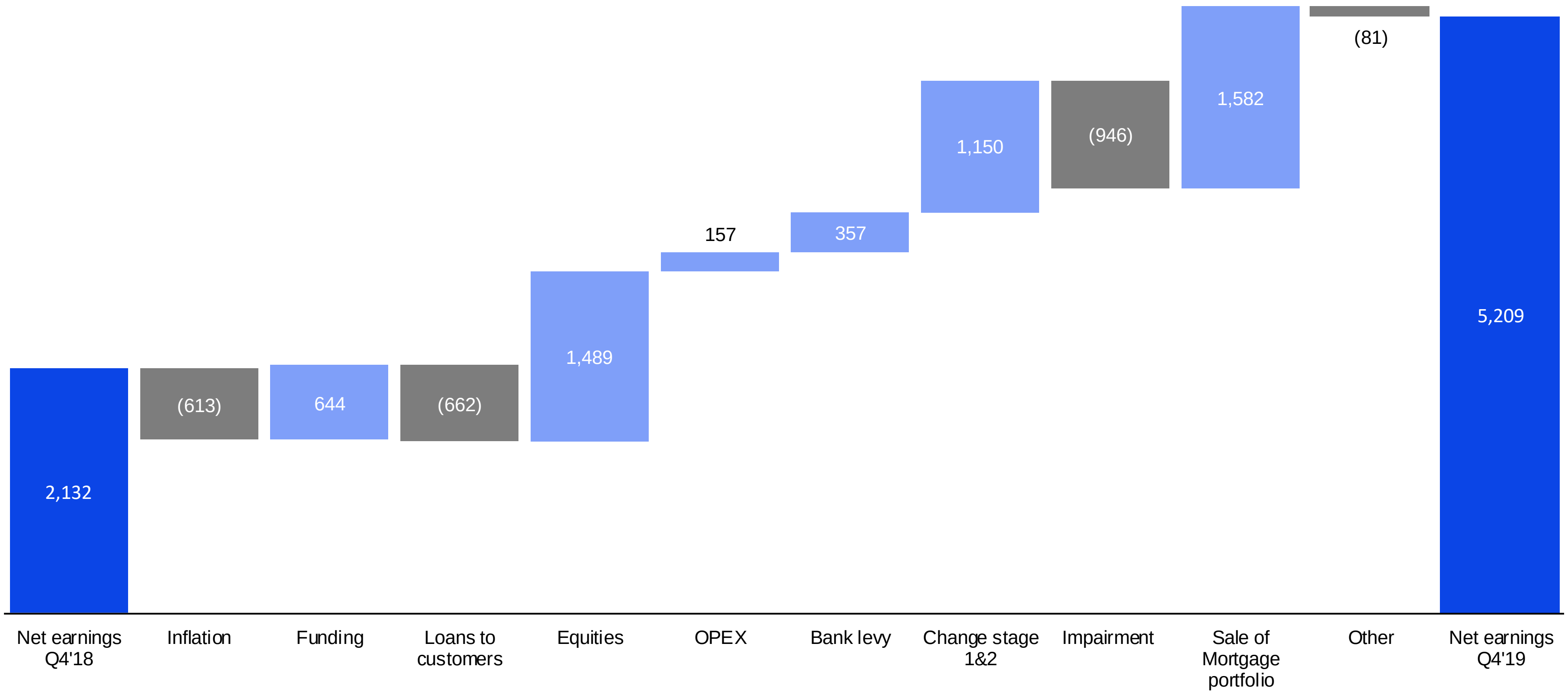

Loans-to-deposits ratio (%)
(without loans financed by covered bonds)




Capital ratio (%)



# Net earnings from continuing operations Q4'18 vs. Q4'19



# Income statement Q4 2019

Net earnings from continued operations improve markedly but discontinued operations have significant negative effect

- Net interest income decreases slightly as inflation is low and loan book is reduced in line with strategy
- Other revenue items holding up well and operating income 7% up from last year
- Operating expenses are 2% down from last year as the restructuring in Q3 is yielding results
- The Bank levy is unusually low in Q4 as the Bank was able to decrease the liability side of the Balance sheet before year end
- Positive net impairments are mostly due to the release of discount on mortgage portfolio which was sold during the quarter
- Negative effects from discontinued operations
  - Impairment on intangible assets at Valitor of ISK 4 billion in addition to operating loss and cost in the sale process of the company during 2019 of ISK 1.6 billion
  - Valuation change in assets at Stakksberg of ISK 2.4 billion, due to difficult market conditions with lower market price resulting in some plant closures internationally

| | Q4 2019 | Q4 2018 | Diff% | Q3 2019 | Diff% |
|---|---|---|---|---|---|
| Net interest income | 7,693 | 7,969 | (3%) | 7,382 | 4% |
| Net commission income | 2,615 | 2,746 | (5%) | 2,639 | (1%) |
| Net insurance income | 723 | 704 | 3% | 1,087 | (33%) |
| Net financial income | 489 | (774) | - | 934 | (48%) |
| Share of profit of associates | 6 | 11 | (45%) | 30 | - |
| Other operating income | 200 | 294 | (32%) | 272 | (26%) |
| **Operating income** | **11,726** | **10,950** | **7%** | **12,344** | **(5%)** |
| Salaries and related expenses | (3,076) | (3,584) | (14%) | (4,130) | (26%) |
| Other operating expenses | (3,367) | (3,015) | 12% | (2,810) | 20% |
| **Operating expenses** | **(6,443)** | **(6,599)** | **(2%)** | **(6,940)** | **(7%)** |
| Bank levy | (357) | (765) | (53%) | (809) | (56%) |
| Net impairment | 1,203 | (573) | - | 484 | 149% |
| **Net earnings before income tax** | **6,129** | **3,013** | **103%** | **5,079** | **21%** |
| Income tax expense | (923) | (881) | 5% | (1,278) | (28%) |
| **Net earnings from continuing operations** | **5,206** | **2,132** | **144%** | **3,801** | **37%** |
| Discontinued operations, net of tax | (7,981) | (516) | - | (3,040) | 163% |
| **Net earnings** | **(2,775)** | **1,616** | **(272%)** | **761** | **(465%)** |



All amounts in ISK million

# Key figures

| **Operations** | **2019** | **2018** | **2017** | **2016** | **2015** | **Q4 2019** | **Q3 2019** | **Q2 2019** | **Q1 2019** | **Q4 2018** |
|---|---|---|---|---|---|---|---|---|---|---|
| Net interest income | 30,328 | 29,319 | 28,920 | 29,900 | 26,992 | 7,704 | 7,382 | 7,808 | 7,434 | 7,969 |
| Net commission income | 9,955 | 10,349 | 10,211 | 13,978 | 14,485 | 2,620 | 2,639 | 2,478 | 2,218 | 2,746 |
| Operating income | 47,942 | 46,169 | 46,863 | 54,546 | 87,055 | 11,670 | 12,344 | 12,220 | 11,708 | 10,950 |
| Operating expenses | 26,863 | 26,278 | 22,893 | 30,540 | 28,247 | 6,443 | 6,940 | 6,618 | 6,862 | 6,599 |
| Net earnings | 7,255 | 7,776 | 14,421 | 21,738 | 49,677 | 3,380 | 761 | 2,096 | 1,018 | 1,616 |
| Return on equity | 3.7% | 3.7% | 6.6% | 10.5% | 28.1% | 6.9% | 1.6% | 4.3% | 2.1% | 3.2% |
| Net interest margin | 2.8% | 2.8% | 2.9% | 3.1% | 3.0% | 3.0% | 2.6% | 2.8% | 2.7% | 2.9% |
| Return on assets | 0.6% | 0.7% | 1.3% | 2.1% | 5.0% | 1.2% | 0.2% | 0.7% | 0.3% | 0.5% |
| Cost-to-income ratio | 56.0% | 56.9% | 48.9% | 56.0% | 32.4% | 55.2% | 56.2% | 54.2% | 58.6% | 60.3% |
| Cost-to-total assets | 2.3% | 2.3% | 2.1% | 3.0% | 2.9% | 2.2% | 2.3% | 2.2% | 2.3% | 2.2% |
| **Balance Sheet** | | | | | | | | | | |
| Total assets | 1,088,765 | 1,164,326 | 1,147,754 | 1,036,024 | 1,011,043 | 1,088,765 | 1,213,155 | 1,233,419 | 1,222,695 | 1,164,326 |
| Loans to customers | 775,054 | 833,826 | 765,101 | 712,422 | 680,350 | 775,054 | 812,481 | 821,731 | 829,246 | 833,826 |
| Mortgages | 372,938 | 365,820 | 329,735 | 298,971 | 190,008 | 372,938 | 372,938 | 369,583 | 366,381 | 365,820 |
| Share of stage 3 loans, gross | 2.5% | 2.6% | - | - | - | 2.5% | 2.5% | 2.4% | 2.5% | 2.6% |
| Problem loans | - | - | 1.0% | 1.6% | 2.5% | - | - | - | - | - |
| RWA/ Total assets | 69.4% | 68.4% | 66.8% | 72.7% | 79.9% | 69.4% | 62.2% | 63.1% | 64.4% | 68.4% |
| Tier 1 ratio | 21.6% | 21.2% | 23.6% | 26.1% | 23.4% | 21.6% | 21.6% | 21.4% | 21.3% | 21.2% |
| Leverage ratio | 12.8% | 14.2% | 15.4% | 0.0% | 0.0% | 12.8% | 12.8% | 13.3% | 13.5% | 14.2% |
| Liquidity coverage ratio | 246.4% | 164.4% | 221.0% | 171.3% | 134.5% | 246.4% | 246.4% | 198.0% | 213.0% | 164.4% |
| Loans to deposits ratio | 157.2% | 178.9% | 165.5% | 172.9% | 145.0% | 157.2% | 159.9% | 162.8% | 169.1% | 178.9% |



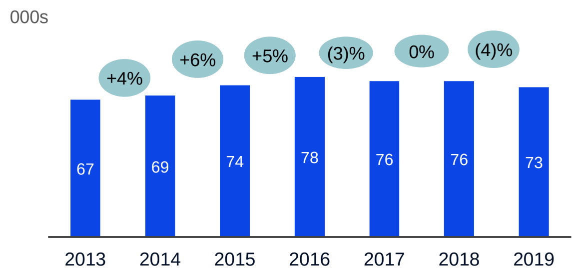
All amounts in ISK million

# Digital services are changing customer behavior

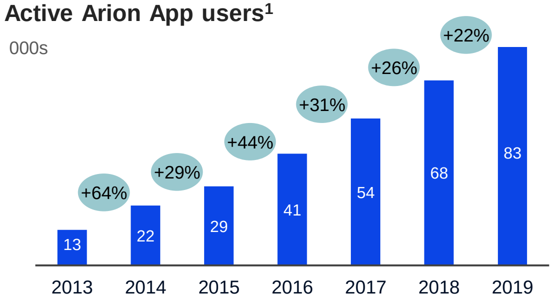
## The Bank's digital journey has increased revenues and reduced costs

- The growth in active Arion Bank app users was 22% in 2019
- Visits to traditional branches continue to trend down - decreased by 46% since 2013
- New digital branches continue to drive increased customer usage with more visits than traditional branches
- Total branch space decreased by almost half since 2014
- Digital sales ratio 68% for core products
  - Credit cards, current accounts and savings accounts
- Overdraft applications now 84% digital
- Car loans 100% digitally processed at the car dealers
- Mortgage credit assessments more than 94% digitally processed through Arion Bank's website

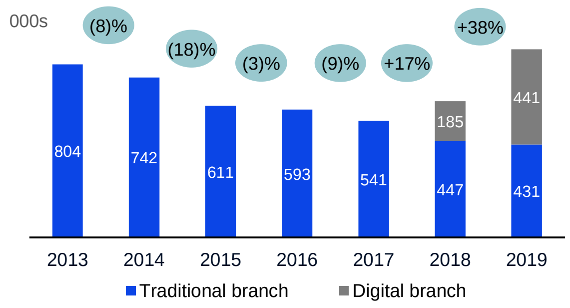
**Active online bank users[1]**



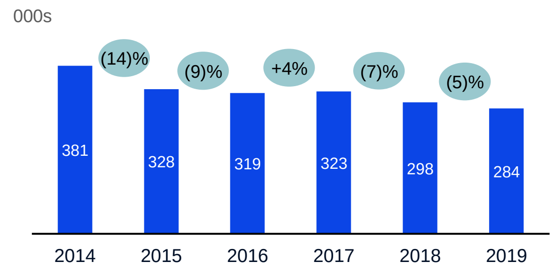

**Active Arion App users[1]**



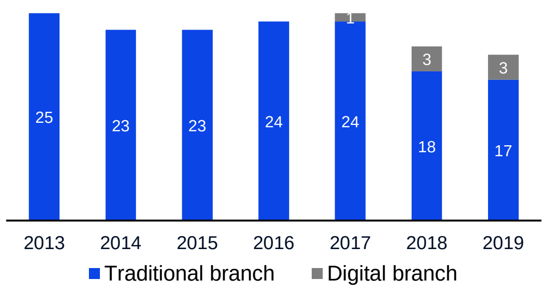

**Number of visits to branches[2]**




**Number of calls to the call centre**




**Number of branches[2]**






Source: Company information

1. 90 day active online users/individuals and 90 day active app users,
2. Data: Qmatic ticketing system for traditional branches and Mobotix camera counting system for digital branches. Two different methods.

# Arion Bank focuses on sustainable and responsible banking

## International and domestic commitments

- A founding signatory of the **UN PRB** and will strategically align its business with the **Sustainable Development Goals** and the **Paris Agreement** on Climate Change
- UN Principles for Responsible Investment, **UN PRI**
- UN **Global Compact**
- Festa and City of Reykjavík's **Declaration on Climate Change**

## Arion Bank's Environment and Climate Policy

- Set in December 2019
- Contribute to Iceland's efforts to meet its **international agreements**
- Focus on financing projects on **sustainable development and green infrastructure**
- We will **evaluate our loan portfolio** according to green criteria, set ambitious targets and adopt a policy on loans to individual sectors **and evaluate our suppliers**

## Gender Equality

- First bank in Iceland to gain the **equal pay symbol** from the Ministry of Welfare
- **UN Women and UN Global Compact** Women's Empowerment Principles
- **Albright:** In **25th place** out of 333 listed companies in Sweden which are setting a good example in terms of **gender diversity in management teams and at board level**

## Corporate Governance

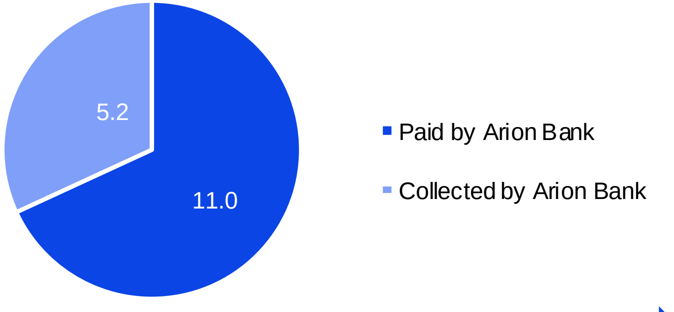
- Center for Corporate Governance's recognition of **Excellence in corporate governance**
- Since 2015 Arion Bank has been recognized as a company which has achieved excellence in corporate governance following a formal assessment based on **guidelines on corporate governance issued by the Icelandic Chamber of Commerce**

## Reporting

- Global Reporting Initiative standard, **GRI Core**
- **ESG reporting guide** for the Nasdaq Nordic and Baltic exchanges
- UN Global Compact **progress report**
- Sustainalytics **ESG rating**
- UN **sustainable development goals**

## Tax footprint 2019 (ISK bn)

Arion Bank's (parent company) total tax contribution in 2019 amounted to ISK 16.2 billion which equals around 2% of the government's total income in 2018



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