



**Pillar 3 Risk  
Disclosures  
Arion Bank  
2025**

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# Declaration

The Board of Directors of Arion Bank is responsible for the Bank's risk management framework and for ensuring that satisfactory risk policies and governance for controlling the Bank's risk exposure are implemented. The Board reviews the status of risk management issues on a regular basis to assess the management and monitoring of the Bank's risks. It is the Board's assessment that the Bank has in place adequate risk management arrangements with respect to the Bank's risk profile and risk policy.

## Risk statement

Arion Bank is a strongly capitalized bank. It aims to excel by offering agile and reliable financial solutions which create future value for its customers, shareholders, and wider society. The Bank provides diverse and value-adding services for its customers, guided by the principles of sustainability and responsibility. Its application of digital solutions increases customer convenience and improves operating efficiency while simultaneously mitigating operational risk by reducing the need for manual input. The Bank is committed to supporting the economy and providing financing to households and corporates through challenging and uncertain times.

The Bank's business strategy is aligned with its risk appetite as set by the Board. This is achieved by monitoring and managing the Bank's risk profile at any given time against risk limits and targets derived from the risk appetite statement. The Board reviews and approves the Bank's risk policies and enterprise risk management architecture.

The Bank is well capitalized with a capital adequacy ratio of 22.5%, and CET1 ratio of 18.4% at the end of 2025, which is within the Bank's stated risk appetite and exceeds regulatory requirements.

Credit risk is one of the Bank's primary risk factors. The Bank's credit policy underpins its credit strategy as integrated in the business plan. Credit risk is managed in line with risk appetite metrics, which address credit quality, as well as single-name, sectoral, and geographical concentration risks. In line with its risk appetite, the Bank has maintained a low level of single-name concentration in recent years. This has been achieved in part through the strategy of originating loans before distributing them.

The Bank invests its own capital on a limited and selective basis in transactions, underwriting and other activities that involve market risk. Market risk is managed in accordance with the risk appetite and risk limit framework. At the end of 2025, total net equity position in the trading book and total equity position in the banking book was 1.7% and 2.5%, respectively, of normalized own funds.

The Bank follows a conservative approach to liquidity exposure, liquidity pricing and funding requirements. The Bank's funding profile supports its liquidity profile. Liquidity positions are managed on a day-to-day basis using internal limits and targets in line with risk appetite and regulatory standards. The Bank's liquidity coverage ratio was 199% at the end of 2025, while the regulatory requirement was 100%.

The Bank's business units are primarily responsible for managing their own operational risks with support from control functions. The Bank's operational risk framework integrates risk management practices into processes, systems, and culture. The framework was significantly enhanced in 2025 ahead of the Digital Operational Resilience Act entering into force. A new third-party risk management framework was also introduced, ensuring consistent evaluation and monitoring of key exposures.

The Bank has no tolerance for internal fraud and compliance breaches, and the risk appetite statement further attends to observation of standards of market integrity, good practice and conduct, and minimization of incidents and mistakes.

As with the financial sector generally, the incidence of attempted fraud against the Bank's customers continues to increase and become ever more sophisticated. The Bank relies on experienced internal and external experts for advising, implementing, operating, and monitoring security controls in use, and participates in several security risk- and fraud-focused forums for threat intelligence sharing, combined with the use of automated threat intelligence. Such intelligence sharing increasingly encompasses emerging threats to shared critical infrastructure, given heightened geopolitical tensions.

The Bank has integrated sustainability risk into its enterprise risk management framework, incorporating environmental, social, and governance factors in decision making and strategy. This is an area of rapid evolution, in which the Bank endeavours to reflect regulatory requirements and employ best practices with respect to ESG-related risk management. The Bank seeks to ensure that its activities and the services it provides do not adversely impact people or the environment and is committed to supporting the global effort to transition to a net zero carbon economy.

The Board of Directors of Arion Bank

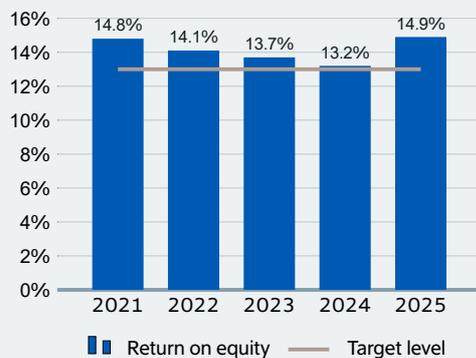
# Message from the CRO

The Icelandic economy experienced a continued deceleration in 2025, reflecting the prolonged effects of tight monetary policy and several one-off shocks. These include the partial shutdown of a major aluminium smelter and the bankruptcy of Play Air. Private consumption has nonetheless remained resilient, even as unemployment continues to edge higher and the housing market stays subdued—particularly in the segment for new residential construction.

Mortgage market conditions deteriorated notably in October following a Supreme Court ruling on variable interest rate terms at another financial institution. This decision constrained the supply of certain loan products—especially indexed mortgages, which typically offer lower monthly payments—across the financial system. However, a subsequent Supreme Court ruling in December affirmed the validity of Arion’s own consumer loan terms, upholding earlier lower-court decisions. While some uncertainty remains, the ruling effectively confirms the robustness of the Bank’s consumer lending framework.

The Central Bank reduced its key policy rate to 7.25% from a peak of 9.25%, though inflation has remained stubbornly high at around 4%. The unemployment rate has risen by approximately 0.25 percentage points annually over the past two years—and indeed since 2017 if the effects of the COVID-19 pandemic are excluded. This increase has largely been concentrated among foreign nationals employed in the construction and services sectors, which helps explain why private consumption has remained comparatively strong.

Figure Development of the Bank’s RoE



The Bank continues to achieve robust and stable earnings, with return on equity ranging from 13% to 15% since 2021. Customer lending grew by 8% in 2025, driven almost entirely by corporate loan growth. The cost of risk stood at 24 basis points for the year, compared with a 12-month expected loss of 27 basis points at the beginning of the year. Since 2023, IFRS 9 assumptions have incorporated expectations of elevated credit risk arising from higher interest rates and a slowing economy.

Funding conditions have continued to improve and in January 2026 the Bank issued senior preferred bonds in SEK and NOK at spreads ranging from 83 to 107 basis points – the tightest levels achieved since before the pandemic. Refinancing requirements in 2026 are relatively high, with ISK 146 billion of borrowings maturing, representing 30% of total issuance.

Geopolitical risk continues to rank high on the Bank’s agenda.

While the direct effects of U.S. tariffs have so far been limited, risks persist amid an exceptionally volatile global political environment. Increased geopolitical attention to Greenland and the Arctic brings developments closer to Iceland, presenting both potential risks and opportunities. The Bank conducts regular stress testing, the results of which consistently demonstrate strong financial resilience.

In November 2025, Moody’s Ratings affirmed the Bank’s A3 senior unsecured debt rating.

The revised capital framework under CRR3 was implemented in Iceland toward the end of 2025. Under the new regime, risk weights have generally increased for construction-related exposure, while capital requirements have declined for real estate backed lending and operational risk. Overall, the changes resulted in a reduction of the Bank’s total risk-weighted exposure amount by approximately ISK 55 billion, and capital relief of ISK 11 billion.

The Digital Operational Resilience Act (DORA) entered into force on January 1, 2026. The Bank’s preparations have been ongoing for several years and have included the rollout of a new group-wide operational risk framework, the adoption of a modern Information Security Management System, and the implementation of advanced ICT risk solutions. During 2025, a comprehensive framework for third-party risk management was implemented, and governance arrangements relating to ICT risk management and operational resilience were further strengthened. The reliance on shared core banking infrastructure provided by RB constitutes significant concentration

**Liquidity**  
Total LCR  
**199%**

**Capital adequacy**  
Total capital ratio  
**22.5%**

**Large exposures**  
No group exposure over 10% of Tier 1 capital  
**0.0%**

## CRO Message

risk to the Icelandic financial system. The Bank is therefore prioritizing the development of a comprehensive risk assessment and audit framework in 2026, in collaboration with other financial institutions.

The Bank maintains a strategic focus on fraud prevention and awareness throughout its operations. In 2025, while the incidence of online fraud in Iceland nearly doubled year-on-year, financial losses incurred by customers decreased materially. This trend highlights both the increasing sophistication of fraudulent activity and the enhanced maturity of the Bank's preventive and detective frameworks. As fraud typologies become increasingly diverse, the primary drivers of loss have shifted toward proximity fraud, non-delivery scams, and invoice manipulation. To counter these threats, the Bank has proactively engaged in public awareness initiatives, utilizing a combination of traditional media campaigns, educational seminars, and innovative engagements such as the "Arion Escape Room" and "True fraud cases".

In the summer of 2025, the boards of Arion and Kvika agreed to initiate merger discussions, with the objective of joining forces to form a leading financial institution in Iceland, supported by diversified revenue streams and robust growth potentials. By early 2026, the due diligence process for both parties was well underway, and pre-notification discussions with the Icelandic Competition Authority were approaching their final phase. Should the merger proceed, its implementation would be underpinned by strong governance arrangements and comprehensive risk oversight.

Úlfar F. Stefánsson,  
Chief Risk Officer

# Introduction

Arion Bank faces many risks arising from its day-to-day operations as a financial institution. The bank is small by international standards, but is classified as systemically important in Iceland, a small economy with its own currency subject to sectoral concentration, fluctuations in capital flows, and exchange rate volatility.

Managing risk and taking informed decisions is a crucial component of the Bank's activities and its responsibility towards society. Risk management is therefore a core activity within the Bank.

The key to effective risk management is a process of ongoing identification of significant risk, quantification of risk exposure, action to limit risk, and constant monitoring of risk.

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- 1.2 Structure and strategy
- 1.3 Regulatory framework

# 1 Introduction

## 1.1 Arion Bank at a glance

Arion Bank ('the Bank') is a well-balanced and diversified universal relationship bank operating in the Icelandic financial market. The Bank is listed on the Nasdaq Iceland and Nasdaq Stockholm regulated markets. The Bank is classified as a domestic systematically important institution (D-SII) in Iceland.

The Bank, whose roots date back to 1930, is built on strong heritage and infrastructure. Arion Bank is a strongly capitalized bank that provides a broad range of banking services to businesses, individuals, and the public sector. The Bank's purpose is to be a driving force in the success of its customers by offering smart and reliable solutions that promote financial health and create future value for society as a whole.

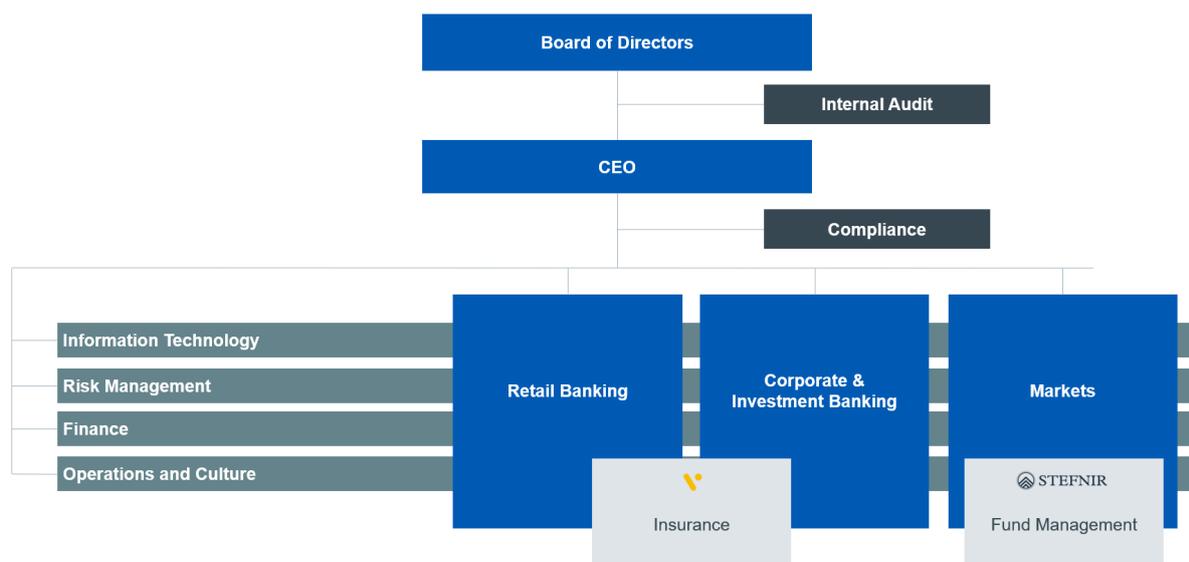
The Bank operates twelve branches across Iceland, thereof nine outside the capital area. The Bank is a leader in the development of digital solutions, improving customer convenience and increasing operational efficiency.

## 1.2 Structure and strategy

Arion Bank consists of three business segments: Retail Banking, Corporate & Investment Banking, and Markets. Furthermore, the Bank's strategic subsidiaries are important to its service offering: Stefmir is one of the largest fund management companies in Iceland and Vörður is the fourth largest insurance company in Iceland, providing both life and non-life insurance. This diverse service offering gives rise to a broad revenue base. The loan portfolio is well diversified between retail and corporate customers, and between different business sectors. The result is a good distribution of risk relative to the Icelandic economy.

In recent years, the Group (comprising the Bank and its subsidiaries) has emphasized its banc-assurance strategy, which entails integrating the operations of Arion Bank and Vörður with the aim to apply the Bank's distribution channels, thus creating a 'one-stop shop' with a broad range of financial and insurance products under a strong brand. The launch of Arion Rewards in 2025, a loyalty program that offers customers benefits and rewards for using the Bank's services, is an important step in this strategy.

Figure 1.1 Arion Bank's organizational chart



As part of the Bank's long-term vision, the Bank sees opportunities to actively participate in the growth of the Arctic region and its increasing importance in the global economy and the fight against climate change. In its activities outside of Iceland, the Bank's focus is on sectors that are familiar to the Bank, primarily segments that relate to the Iceland's knowledge and export industries.

# Introduction

The business is supported by four units within the Bank: Finance, Risk Management, Information Technology, and Operations & Culture.

The Group had 883 full-time equivalent positions at the end of the year, compared with 847 at the end of 2024.

The Bank's Annual and Sustainability Report 2025 provides further information about the Bank, such as strategy and vision, sustainability policy, and corporate governance.

## 1.3 Regulatory framework

Capital and risk management disclosure requirements for financial institutions are stipulated in the Basel Framework, which capsulizes the standards of the Basel Committee on Banking Supervision. The Basel Framework encompasses three complementary pillars:

- ◆ Pillar 1 – capital adequacy requirements
- ◆ Pillar 2 – supervisory review
- ◆ Pillar 3 – market discipline

In 2013, the EU Council adopted the CRD4/CRR framework, which consists of the Capital Requirements Directive No. 36/2013 and the Capital Requirements Regulation No. 575/2013. This regulatory framework represented the EU's first major step in implementing the Basel III reforms, intended to strengthen banking regulation, supervision, and practices, to improve banks' solvency, liquidity, governance, and risk management. The framework constitutes the cornerstone of the so-called European Single Rule Book for financial regulation.

In 2019, the EU Council adopted revised rules on capital requirements (CRD5/CRR2) and resolution (BRRD/SRM), and the latest reforms (CRD6/CRR3) were adopted in 2024 and generally applicable from 1 January 2025, thus finalizing the Basel III implementation in the EU.

The CRR was incorporated into the EEA Agreement in late 2019, but had been in effect in Iceland since 2016 through numerous legislative acts. In June 2021, CRD5/CRR2 was implemented through Act No. 44/2021 and Regulation No. 749/2021, while Bank Recovery and Resolution Directive II (BRRD2) provisions were excluded. The CRR, including CRR2, was fully transposed into national law in 2022 with Act No. 38/2022, amending Act No. 161/2002 on financial undertakings, along with pertinent BRRD2 provisions via Act No. 38/2022. BRRD2 was fully transposed into Icelandic law with Act No. 63/2023 and Regulation No. 700/2024 stipulates August 2027 as the end of the transitional period to reach full compliance.

The implementation of CRR3 in Iceland was completed with the passing of Act No. 102/2025 in December of 2025, amending the aforementioned Act on financial undertakings. The Q4 2025 results, this report, and the Additional Pillar 3 Risk Disclosures are all prepared on the basis of the new regulatory framework.

# Risk Management

Arion Bank is in the business of taking informed risk. Risk is primarily incurred from extending credit to customers, but the Bank is exposed to a range of other risk types such as liquidity risk, market risk, operational and compliance risk, sustainability risk, and business risk, all of which are inherent in the Bank's strategy, product range, and its operating environment.

The Bank promotes a corporate culture in which risk is everyone's business, and maintains an effective risk management framework which entails the identification and quantification of significant risks and risk exposures, risk monitoring, and actions and controls to limit risks.

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## 2 Risk Management

### 2.1 Internal controls and lines of reporting

The Bank is committed to the highest standards of corporate governance in its business. The Bank's governance framework adheres to regulatory requirements and recognized guidelines in force at each time. The ultimate responsibility for setting the Bank's risk and governance policies and for ensuring effective internal control and management of risk rests with the Board of Directors. The enforcement of the Board's policies is delegated to the Chief Executive Officer (CEO) who has in turn established governance procedures and a risk committee structure at management level. The CEO delegates decision-making responsibilities to Managing Directors, Chief Credit Officer (CCO) and others, as committee voting members, while assigning internal control responsibilities to the Chief Risk Officer (CRO) and the Compliance Officer.

Acting within an authority delegated by the Board, the Board Risk Committee (BRIC) is responsible for the oversight and review of prudential risks and capital adequacy. The BRIC reviews the Bank's risk appetite at least semi-annually, see Section 2.4, and recommends changes to the Board when applicable. Its responsibilities also include reviewing the appropriateness and effectiveness of the Bank's risk management systems and controls, as well as considering potential implications of material regulatory changes.

Figure 2.1 Internal control structure



Internal Audit is responsible for the independent review of the risk management and control environment. Its objective is to provide reliable, valuable, and timely assurance to the Board and Executive Management on the effectiveness of controls, mitigating current and evolving material risks, and in so doing enhancing the risk culture within the Bank. The Board Audit Committee (BAC) reviews and approves Internal Audit's plans and resources, and evaluates the effectiveness of the function. The Chief Internal Auditor is appointed by the Board and accordingly has an independent position in the Bank's organizational chart.

The Compliance Officer and Compliance function operate according to a charter for compliance defined by the Board of Directors. The Compliance Officer reports to the CEO, with unhindered access to the Board. Compliance is responsible for the Bank's conduct and compliance risk frameworks, and supports the first line with respect to the management of the risks it oversees, including data protection. A separate unit within Compliance is responsible for the Bank's framework and approach to the prevention of money laundering and terrorist financing. The unit is headed by the Deputy Compliance Officer, who is also the Bank's Money Laundering Reporting Officer, in accordance with Icelandic law. Compliance submit quarterly compliance updates to the BRIC and annually to the Board of Directors.

The CRO and the Risk Management function operate according to a charter for Risk Management defined by the Board of Directors. The CRO is a member of the Executive Management Committee, chair of the Executive Risk Committee, and a non-voting member in other risk committees. The CRO reports to the CEO and has unhindered access to the Board. Section 2.6 outlines the organization of the Risk Management division.

A group-level risk assessment is periodically performed through the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP).

# Risk Management

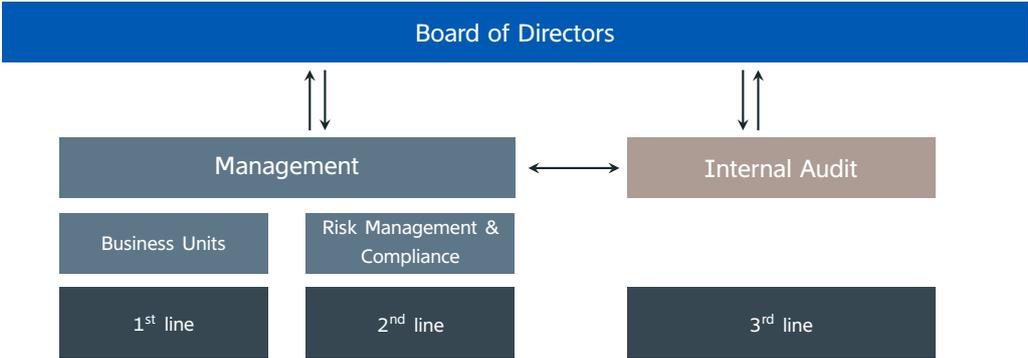
The Bank’s subsidiaries adhere to their respective ownership policies, approved by the Board of Directors, which stipulates among other things the Group’s internal control policy, risk appetite, and reporting mechanisms between the organizations. Individual subsidiaries are responsible for implementing their own risk management frameworks. The CEO, on behalf of the Board of Directors of Arion Bank, interacts with the boards of directors of individual subsidiaries. Through the group-level ICAAP and ILAAP, the CRO interacts with individual subsidiaries’ risk officers and consolidates the assessment of capital requirements for the Bank.

For further information on the Bank’s governance arrangements, refer to Corporate Governance Statement for the year 2025. The statement provides information on directorships held by Board members, on their background and expertise, and the considerations and suitability criteria used in the nomination process, including diversity.

## 2.2 Three lines model

The Bank applies the Three Lines Model for organizing the internal control system, as stipulated by its Internal Control Policy. All lines work together to contribute to the creation and protection of value, seeking alignment with the prioritized interests of stakeholders. Alignment of activities is achieved through communication, cooperation, and collaboration. This ensures the reliability, coherence, and transparency of information needed for risk-based decision making.

Figure 2.2 Three lines



### The role of the Board of Directors

The Board of Directors is ultimately accountable for the internal control system at Arion Bank. The Board ensures that appropriate structures and processes are in place for effective governance, in accordance with regulatory requirements and recognized guidelines.

The Board of Directors delegates authority and responsibility formally and provides resources to management to achieve the organization’s objectives, while ensuring legal, regulatory, and ethical expectations are met. It also determines the Bank’s risk appetite framework. The rules of procedure of the Board of Directors can be found on the Bank’s website.

For additional oversight, the Board of Directors appoints sub-committees with established charters.

### The role of management

Management comprises first and second line roles. Its responsibility is to achieve organizational objectives and manage risks by designing and implementing a control system.

First line roles are most directly aligned with the delivery of products and services and include the roles of support functions. They lead and direct actions and application of resources and have primary responsibility for maintaining appropriate structure and processes for the management of operations and risks.

Second line roles, i.e. the Risk Management and Compliance functions, support and facilitate the management of risk through complementary expertise, support, and monitoring, and through challenging the adequacy and effectiveness of risk management practices. Second line roles are separated from first line roles, and do not have first line responsibilities. In order to ensure adequate independence, the second line has direct access to the Board of Directors and BRIC.

# Risk Management

## The role of Internal Audit

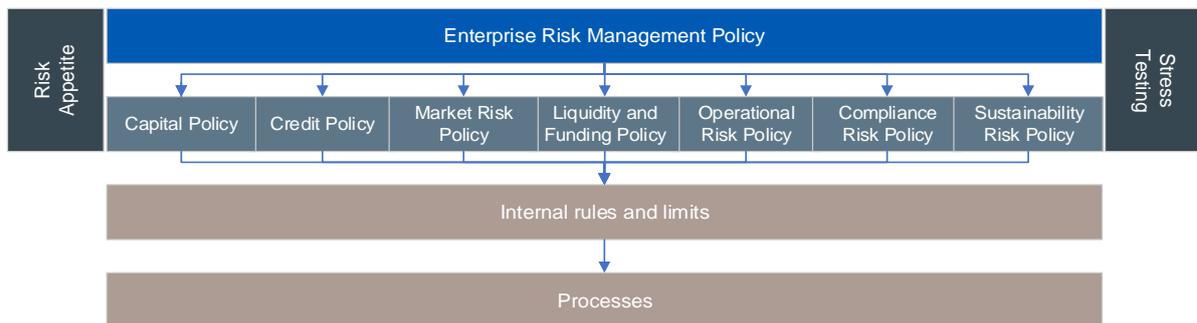
Internal Audit conducts independent and objective reviews of the Bank, its subsidiaries and pension funds administered by the Bank. Internal Audit communicates its results to management and reports its findings and recommendations to the Board Audit Committee and the Board of Directors. It operates in accordance with the IIA's Global Internal Audit Standards, the latest version of which was published in early 2025.

## 2.3 Risk policies

To ensure that existing and potential material risks are identified, monitored, and managed, the Bank has an Enterprise Risk Management Policy in place. The policy is annually reviewed and approved by the Board of Directors. The policy outlines the key aspects of the Bank's risk management procedures. The Bank recognizes that risk-taking is an integral part of its business activities and must therefore be managed in an effective manner and in line with the Bank's risk appetite, see Section 2.4.

The significant risks the Bank is exposed to are defined within the risk management policy. Seven primary risk stripes have been defined: credit, market, liquidity, operational, conduct and compliance, sustainability, and business risk. The Board sets a specific policy for activities related to each risk, with the exception of business risk which is addressed in the Bank's strategy and business plan process. The policies are reviewed and approved by the Board annually. The Bank's risk management policy and risk type policies are implemented through the Bank's risk appetite framework, stress testing framework, internal rules and limits, and processes. The policies for each risk type are discussed further in the following chapters.

Figure 2.3 Risk policies implementation



## 2.4 Risk appetite

A well-defined risk appetite framework is a key component of the Bank's enterprise risk management framework.

The purpose of the risk appetite is to provide a common framework to the Board and management to communicate, understand, and assess the types and level of risk that the Board is willing to accept in pursuit of the Bank's strategy. The risk appetite framework is reviewed and approved by the Board semi-annually.

The Bank's risk appetite is articulated through a risk appetite statement and translated into risk limits developed and maintained by the relevant risk committee. Ongoing compliance with risk appetite is monitored by Risk Management and Compliance. The Board and BRIC are promptly notified if any risk appetite metrics are exceeded. Internal and external limits are monitored by the second line functions in accordance with the Bank's procedures.

The Bank's risk appetite is taken into consideration and aligned with the Bank's strategic objectives, business plan, operations, recovery plan, and remuneration. Results of stress tests are incorporated into the review of the Bank's risk appetite and risk limits.

The Board's direct involvement in setting and approving appetite for the Bank's most material risk exposures is a key part of ensuring the timely and appropriate disclosure of risk through the Bank's hierarchy of governance. This is complemented by in-depth management information and reporting tailored to the intended audience.

# Risk Management

An overview of the Bank’s quantitative risk appetite metrics is shown in Table 2.1. The risk appetite statement includes qualitative criteria such as tolerance statements for various operational risk and regulatory compliance breaches, as well as sustainability risk metrics pertaining to the Bank’s own operations, i.e. on gender pay parity and green financing.

Table 2.1 Risk appetite metrics

Category	Risk metrics / risk factors
Capital adequacy	Capital adequacy ratios Leverage ratio MREL
Liquidity and funding risk	Liquidity coverage ratios Net stable funding ratio Wholesale funding over tangible assets Asset encumbrance ratio
Market risk	Foreign currency imbalance Interest rate risk and indexation risk Equity position in the banking book Equity position in the trading book, Value-at-Risk
Securities financing and counterparty credit risk	Uncollateralized exposure as per stress test
Credit risk	Sectoral and geographical concentrations Large exposures and single-name concentration Leveraged transactions Expected credit loss Share of higher-LTV residential mortgages Lending to foreign entities
Operational risk	Operational losses Single event relating to downtime in critical banking services KYC adequacy ratio Enhanced due diligence adequacy ratio Implementation level of CIS controls Critical third-party compliance with resilience standards
Sustainability risk	Ratio of loans under Sustainability Financing Framework Gender pay gap

## 2.5 Risk committees

The Bank operates several committees to manage risk. The structure of risk committees within the Bank can be split into two levels: board level and executive level. The committees define lines of responsibility and accountability within the Bank. They are charged with overseeing risk and the delegation of authority and forming a control environment for the Bank.

Figure 2.4 Risk committee structure



Board level risk committees are established by the Board and comprise members of the Board or external representatives nominated by the Board. An overview of the risk committees at Board level and their responsibilities is shown in Table 2.2.

# Risk Management

Table 2.2 Board level committees

Committee	Responsibilities
Board Audit Committee (BAC)	The BAC assists the Board in meeting its responsibilities in monitoring the effectiveness of the Bank's internal governance and controls and in meeting its external financial reporting obligations under applicable laws and regulations. The BAC supervises accounting procedures, the organization and function of the Bank's internal audit, and the auditing of the annual accounts and the Bank's consolidated accounts.
Board Risk Committee (BRIC)	The BRIC advises and supports the Board on the alignment of the Bank's risk policy, high-level strategy and risk appetite, and risk management structure. The BRIC assists the Board in meeting its responsibilities in ensuring an effective system of internal controls and compliance. The BRIC assesses whether incentives which may be contained in the Bank's remuneration system, including variable remuneration, are consistent with the Bank's risk policy.
Board Credit Committee (BCC)	The BCC operates under the authority of the Board, which has delegated to the Committee authority to approve certain material proposals regarding credit origination, debt cancellation, underwriting, and investments. The BCC can delegate specific authority to the CEO.

In addition to the three Board-level risk committees, the Board has established the Board Remuneration Committee (BRC) and the Board Tech Committee (BTC). The BRC's main role is to prepare a remuneration policy for the Bank. The policy is reviewed by the Board at least annually and submitted to the Annual General Meeting (AGM) for approval. The BTC's purpose is to assist the Board in overseeing the role of technology in executing the business strategy of the Bank, including major IT investments, IT strategy, and operational efficiency.

Executive level risk committees, which are primarily composed of the CEO and Managing Directors, or their designated representatives, are shown in Table 2.3.

Table 2.3 Executive level risk committees

Committee	Responsibilities	Chair
Executive Risk Committee (ERCO)	The ERCO oversees the implementation of risk policies and ensures that the Bank's limit framework adheres to risk appetite. The committee reviews the Bank's ICAAP, ILAAP, and stress testing, and approves economic scenarios, credit models, and specific provisions under IFRS9. The ERCO approves the rules and procedures of other risk committees, and defines credit rules for the ACC.	CRO
Arion Credit Committee (ACC)	The ACC makes decisions on credit cases within limits set by the BCC. ACC reviews reports concerning the credit portfolio and has an advisory role to the CEO on credit related matters. Risk Management is authorized to veto all decisions or escalate to the BCC for final approval.	CEO
Arion Composition and Debt Cancellation Committee (ADC)	The ADC deals with applications to reach composition with debtors, within limits set by the BCC.	CEO
Asset and Liability Committee (ALCO)	The ALCO is responsible for strategic planning relating to the development of the Bank's balance sheet as well as the planning of liquidity, funding, and capital activities, and decides on underwriting and investment exposures within limits set by the BCC. The CRO or their deputy is a non-voting participant in committee meetings and is authorized to escalate decisions relating to investments, divestments, and underwriting to BCC for final approval.	CFO
Operational Risk Committee (ORCO)	The ORCO oversees the operational and compliance risk management framework, which includes information security, financial crimes, regulatory compliance, and data management. The CRO, the Compliance Officer, and the Chief Security Officer are non-voting members.	CEO
Sustainability Committee (SUCO)	The SUCO promotes the consideration of environmental, social, and governance factors in the Bank's decision making and oversees regulatory implementation that relate to the sustainability agenda. The SUCO reviews risk assessments of ESG factors and climate risk impact and oversees ESG disclosures as well as the Bank's Green Financing Framework.	CEO

# Risk Management

## 2.6 The Risk Management division

The Risk Management division focuses on the identification, quantification, monitoring, and control of risk. The division facilitates informed decision making in all risk areas of the Bank by providing expertise and support. Risk Management ensures compliance with internal and external limits, and standards and regulations. Strong emphasis is placed on reporting risk to relevant stakeholders in a clear and meaningful manner.

The Risk Management division is divided into four departments: Credit Risk, Balance Sheet Risk and Models, Operational and Sustainability Risk, and Security.

Figure 2.5 The Risk Management Division



### Credit Risk

The unit Credit Risk monitors the Bank’s credit decision process and reviews and challenges, ex-ante, credit cases submitted to the ACC, where Risk Management has the power veto the committee’s credit decisions or escalate to the Board Credit Committee (BCC) for final approval. The unit advises on changes to the Bank’s credit rules.

Credit Risk is responsible for the approval of corporate credit ratings, performed by account managers, by challenging the qualitative input and verifying the quality of quantitative information used to produce the ratings. The unit is also responsible for supervising the valuation of collateral and validating the connectivity of related parties within the loan book.

The department is responsible for monitoring credit quality of loans on a single-name basis and determining appropriate levels of provisioning for non-performing loans.

### Balance Sheet Risk and Models

The unit Balance Sheet Risk and Models is responsible for analyzing, monitoring, and reporting on risks on a portfolio level, including credit risk, market risk, and liquidity risk. The department is also responsible for capital adequacy, credit modelling, and stress testing.

Within the scope of market risk are risks resulting from balance sheet mismatches, i.e. interest rate risk, foreign exchange risk, and risks arising from the Bank’s trading activities. The department interfaces with the Bank’s Treasury, Market Making, and Capital Markets and reports its analysis and stress testing results for market, funding, and liquidity risk to ALCO.

The department is responsible for the development of credit rating models, assessment of expected credit loss under IFRS9, the calculation of regulatory capital requirements, development of economic capital models, methodology for allocation of capital, and stress tests.

The department also provides various quantitative support to the Bank’s business units.

### Operational and Sustainability Risk

The unit Operational and Sustainability Risk is responsible for the internal control framework and supports the first line in managing operational risks. It seeks to ensure that internal processes and controls minimize the risk of loss as effectively as possible. The department develops and maintains tools for identifying, measuring, monitoring, and controlling operational risk, such as Risk and Control Self-Assessment (RCSA) and loss data collection.

The department is also responsible for supporting the Bank’s adherence to requirements and guidelines in the area of sustainability, and develop the Bank’s approach to assessing climate-related financial risks and risks related to social and governance factors.

### Security

Headed by the Bank’s Chief Security Officer (CSO), the unit supervises physical and information security management in the Bank’s second line. The unit is responsible for maintaining the Bank’s Information Security Management System (ISMS), which has been ISO 27001:2022 certified. The unit supports the first line in relation to external fraud. A new position of Chief Resilience

# Risk Management

Officer was established during the year, reflecting the importance of, and the Bank's focus on, operational resilience. The Chief Resilience Officer is responsible for the Bank's framework for operational resilience, which includes the identification of critical functions and the development of response and recovery plans.

## 2.7 Reporting

The Bank's aim is to provide accurate and transparent risk information to relevant stakeholders. Risk Management places a strong emphasis on risk reporting and on allocating adequate resources to ensure the fulfillment of the Bank's policy. Risk information is regularly reported to the Board of Directors and its sub-committees. The CEO, the CRO, and executive-level committees receive risk reports on a regular basis, ranging from daily monitoring reports to the Annual Report. The primary reporting within the Bank is shown in Table 2.4.

The Bank's Annual and Sustainability Report, Financial Statements, and Pillar 3 Risk Disclosures are all available on the Bank's website. Furthermore, the Bank delivers regular reports to the FSA; i.e. a monthly report on the Bank's loan portfolio quality, a quarterly report on the Bank's capital requirements (COREP) and large exposures; and annual reports on the Bank's Recovery Plan, ICAAP, ILAAP, and stress testing.

Table 2.4 Primary reporting within the Bank

Report	Contents	Frequency	Recipient
Credit risk report	A report containing analysis of the Bank's loan portfolio broken down by various risk factors. Overview of the largest exposures and sector distribution. Thorough analysis of the credit quality of the loan portfolio.	Monthly	ACC/ADC
Liquidity report	A report containing analysis of the Bank's Liquidity Coverage Ratio, information on deposit developments, secured liquidity, funding measures, and other relevant liquidity information.	Monthly	ALCO
Market risk report	A report containing analysis of key market risk developments, including information on foreign exchange, indexation and index risk, margin trading, and other relevant market risk information.	Monthly	ALCO
Operational risk report	An overview of relevant risk measures for operational and compliance risk, including a summary of deviation events, major IT incidents, loss data analysis, and net promoter score.	Monthly	ORCO
Sustainability risk report	Selected sustainability risk measures, including development of green products and gender equality	Monthly	SUCO
Risk report	An aggregate report containing the credit risk portfolio report, the liquidity and market risk report, and the operational risk report as well as information on the Bank's risk appetite, recovery indicators, ICAAP status, and other risk management concerns.	Monthly	Board BRIC ExCo ERCO
ICAAP	Evaluation of the Bank's total risk exposure and capital adequacy. The report is submitted for review and/or approval prior to onward submission to regulatory authorities.	Annually	Board BRIC ERCO
ILAAP	Evaluation of the Bank's total risk exposure and liquidity adequacy. The report is submitted for review and/or approval prior to onward submission to regulatory authorities.	Annually	Board BRIC ERCO
Recovery plan	A plan providing measures to be taken by the Bank to restore its financial position following a significant deterioration of its financial situation. A status report on recovery indicators is submitted monthly to the ALCO. The plan in its entirety is submitted annually to regulatory authorities.	Annually	Board BRIC ALCO
Internal bank-wide stress test	Evaluation of the impacts on the Bank's earnings and own funds, the Bank's capital and liquidity ratios, and other risk appetite metrics under various stress scenarios. The report is submitted for review and/or approval.	Annually	Board BRIC ERCO
Compliance updates	An aggregate report covering key events regarding both compliance risk and financial crime risk	Quarterly	BRIC
Compliance report	An annual report summarizing previous year with regards to both compliance risk and financial crime risk	Annually	Board BRIC

# Capital Management

The Bank employs various techniques to estimate adequate capital levels and to ensure that capital is fruitfully deployed. The Bank's ICAAP is the cornerstone of the Bank's capital adequacy assessment and is aimed at identifying and measuring the Bank's risk across all risk types and ensuring that the Bank has sufficient capital in accordance with its risk profile and strategy.

CET1 capital ratio

**18.4% (18.2%)**

Capital adequacy ratio

**22.5% (22.6%)**

Leverage ratio

**11.4% (12.2%)**

Contents

- 3.1 Governance and policy
- 3.2 Capital adequacy requirements
- 3.3 Capital management
- 3.4 Capital ratios
- 3.5 Leverage ratio
- 3.6 MREL
- 3.7 CRR3

# 3 Capital Management

## 3.1 Governance and policy

The Bank's capital policy and dividend policy are established by the Board of Directors based on recommendations from the BRIC. The policies are reviewed on an annual basis.

The Bank's CEO is responsible for carrying out the Bank's capital strategy in adherence to set policies. As established by the CEO, this responsibility is part of the principal authority of the Asset and Liability Committee (ALCO). The CRO is responsible for compliance with regulatory requirements and supervises the Bank's ICAAP and allocation of capital. The Bank's stress testing framework is integrated with the Bank's business planning process and ICAAP, and is used to assess whether capital levels are acceptable under stressed conditions.

The Bank's medium term target for Common Equity Tier 1 (CET1) ratio is to be 150 to 250bps above the regulatory requirement and maintain maximum utilization of Additional Tier 1 (AT1) and Tier 2 (T2) capital to meet Pillar 1 and Pillar 2 capital requirements. Relative to the total CET1 regulatory requirement of 15.3%, this implies a CET1 target of 16.8–17.8%.

The Bank's dividend policy is to pay out 50% of net earnings attributable to shareholders as dividend and in addition use special distributions to bring own funds towards the normalized composition. In line with this, the intention is to pay ISK 15.3 billion as dividends in 2026, representing 50% of 2025 net earnings. Additionally, a buyback of ISK 5 billion has been approved by the Board and the FSA. This represents a capital release following the adoption of CRR3. These amounts have been deducted from CET1 capital when calculating the capital ratios.

## 3.2 Capital adequacy requirements

An adequate amount of capital ensures that the Bank is able to absorb losses associated with the risks that are inherent in its operations without its solvency being jeopardized and allows the Bank to remain a going concern, even in periods of stress. The Bank's capital adequacy is determined in accordance with Act No. 161/2002 on Financial Undertakings, through which EU Capital Requirements Directive and Regulation have been adopted.

The Bank's calculation of REA is based on the standardized approaches for credit risk, including counterparty credit risk, and market risk and the basic approach for credit valuation adjustment risk. The total regulatory capital requirement is presented as a percentage of REA and consists of the items shown in the following table:

Table 3.1 Capital requirements

Source	Description
Pillar 1 requirement	The 8% minimum regulatory requirement
Pillar 2R requirement	The additional capital requirement determined by the Bank's own internal assessment of capital adequacy (ICAAP) and FSA's subsequent supervisory regulatory assessment process (SREP)
Combined capital buffer requirement	The aggregated capital requirement due to four capital buffers, the level of which is determined by law (capital conservation buffer) and by the FSA following guidance from the Financial Stability Council (buffers for systemic risk, systemically important financial institutions (SII), and countercyclical effects)

As part of the SREP, the results of internal or external bank-wide stress tests may result in non-binding additional capital guidance, defined as Pillar 2G.

The Pillar 1 requirement may be met with different capital instruments, restricted as follows, expressed as a percentage of REA:

- ◆ Common Equity Tier 1 (CET1) capital shall exceed 4.5%
- ◆ Tier 1 (CET1 and AT1) capital shall exceed 6%
- ◆ Total capital shall exceed 8%

The same proportion applies to the Pillar 2 capital add-on, i.e. it can be composed of 56.25% CET1 capital, 18.75% AT1 capital, and 25% Tier 2 capital. The combined capital buffer requirement is to be met solely with CET1 capital.

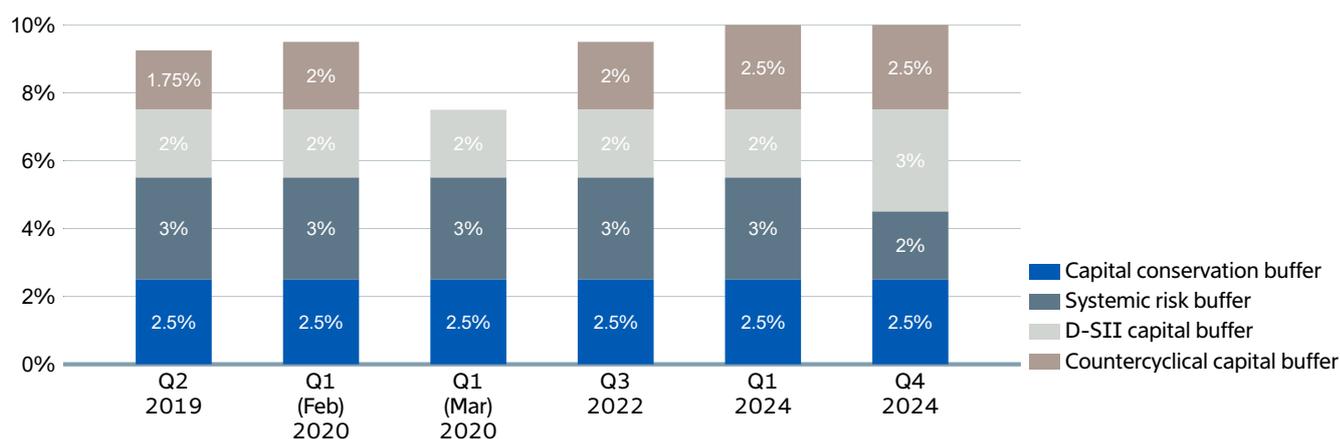
# Capital Management

## Capital buffers

Capital buffers were incorporated into Icelandic law with the adoption of CRD IV / CRR. The systemic risk buffer only applies to domestic exposures and is applied cumulatively with the D-SII buffer. The most recent change to the buffer levels was made in December 2024, when the systemic risk buffer for domestic exposures was lowered from 3.0% to 2.0% and the D-SII buffer was raised from 2.0% to 3.0%. The countercyclical buffer is currently set at 2.5%.

The development of the capital buffers is shown in the chart below. The requirements are presented as percentage of REA.

Figure 3.1 Implementation of capital buffer levels for Icelandic D-SIIs



The effective countercyclical capital buffer for the Bank is determined using the weighted average of the respective capital buffer levels in the countries where the Bank has exposure and the weighting is based on the percentage of the relevant REA in each country. The same method is used for the determination of the effective systemic risk buffer, where the buffer only applies to domestic exposures.

Given the Bank's geographic credit risk profile at year-end 2025, the effective combined capital buffer requirement for the Bank is 9.7%. Templates EU CCyB1 and EU CCyB2 show details regarding the calculation of the countercyclical buffer requirement.

Table 3.2 Arion Bank's capital buffer requirements at year-end 2025

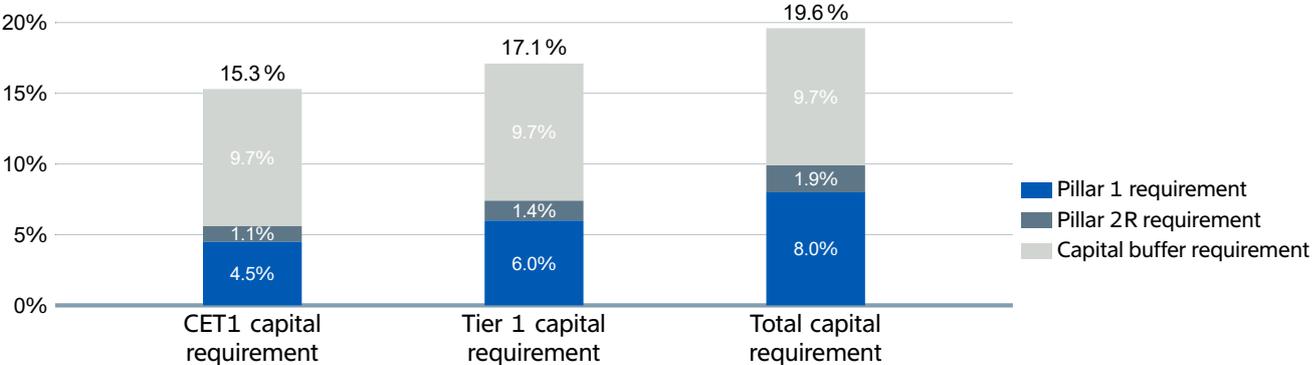
Capital buffer	Domestic exposures	Foreign exposures	Institution-specific rate
Capital conservation buffer	2.5%	2.5%	2.5%
Systemically important institution buffer	3.0%	3.0%	3.0%
Systemic risk buffer	2.0%	0.0%	1.8%
Countercyclical capital buffer	2.5%	CCyB of country	2.4%
<b>Total</b>	<b>10.0%</b>	<b>5.5%+CCyB</b>	<b>9.7%</b>
REA credit risk weight	91.8%	8.2%	

# Capital Management

## Arion's capital requirements

The Bank's total regulatory requirement, comprising Pillar 1, Pillar 2, and the capital buffer requirements, is 19.6%. The following figure shows how this requirement is broken down by type.

Figure 3.2 Arion Bank's own funds regulatory requirements with combined capital buffer requirements at 31 December 2025



## 3.3 Capital management

In addition to regulatory capital requirements, the Bank performs its own assessment of capital need and allocates capital to business units on a quarterly basis. The Bank's ICAAP and stress testing are key elements of the Bank's capital management framework and are performed on an annual basis. In addition to providing quantitative analysis, the processes are an important tool for management that give a deep understanding of the risks associated with the Bank's operations and business planning.

### Internal Capital Adequacy Assessment Process

The ICAAP is the Bank's internal assessment of its capital need. The ICAAP is carried out in accordance with the Act No. 161/2002 on financial undertakings with the aim to ensure that the Bank has in place sufficient risk management processes and systems to identify, measure, and manage the Bank's total risk exposure. The scope of ICAAP excludes insurance subsidiaries which perform their independent Own Risk and Solvency Assessment (ORSA).

The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and at ensuring that the Bank is sufficiently capitalized. The Bank's ICAAP report is approved annually by the Board of Directors, the CEO and CRO, and submitted to the FSA.

In addition to the above, the Bank uses the ICAAP to:

- ◆ Carry out a process to adequately identify and measure the Bank's risk factors.
- ◆ Carry out a process to monitor that the Bank's capital is adequate and appropriately used in relation to its risk profile.
- ◆ Review the soundness of the Bank's risk management systems and controls that are used to assess, quantify, and monitor the Bank's risks.
- ◆ Raise risk-awareness of all the Bank's activities and to provide a detailed view of the Bank's risk profile for management and the Board of Directors.

Managing Directors with their key personnel and key personnel from the Bank's subsidiaries participate in the process of identifying and evaluating high risk areas, and discuss their management of risk, in cooperation with Risk Management. The result from the identification phase serves as the basis for the risk assessment within the Bank's ICAAP. Risk categories identified for the operating segments are shown in Table 3.3.

# Capital Management

Table 3.3 Risk identification down to operating segment

Business Units	Credit risk	Market risk	Liquidity risk	Operational risk	Compliance risk	Sustainability risk	Business risk
Retail Banking	✓			✓	✓	✓	✓
Corporate and Investment Banking	✓			✓	✓	✓	✓
Markets	✓	✓		✓	✓	✓	✓
Treasury	✓	✓	✓	✓	✓	✓	
Other divisions and subsidiaries	✓	✓	✓	✓	✓	✓	✓

The Bank’s ICAAP methodology involves assessing key risks that are not believed to be adequately addressed under Pillar 1. For each risk factor, economic capital is assessed using internal models. If it exceeds the minimum 8% regulatory capital requirement, an add-on is applied. The main risks for which additional capital is required are:

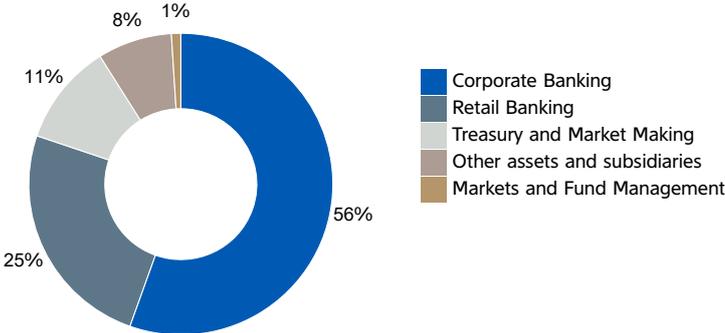
- ◆ Interest rate risk in the banking book (IRRBB) and indexation risk
- ◆ Single name concentration of credit risk
- ◆ Credit risk for segments of the loan portfolio
- ◆ Equity position risk

Following the ICAAP process, the FSA conducts the supervisory review and evaluation process (SREP). In that process the FSA sets the Pillar 2R capital requirement and may, on the basis of stress testing results, issue non-binding additional capital guidance, called Pillar 2G. The SREP of 2023, which was based on financial figures from 31 December 2023, resulted in a Pillar 2R capital requirement of 1.9% of REA.

## Capital allocation and capital planning

The Bank allocates capital to its business units based on capital requirements assessed under the ICAAP and SREP. The risk-adjusted performance of the business units is based on the Return on Allocated Capital (ROAC) and reported to ALCO. The ALCO conducts capital planning on a quarterly basis, based on the Bank’s rolling business plan for each business unit. Capital is allocated both based on current need and on the basis of a 3-month and 6-month forward horizons.

Figure 3.3 Allocated capital for Q4 2025, current need and 3-month and 6-month horizons



The focus of capital management at the Bank is to normalize the capital structure in the medium term and consequently maintain the Bank’s capitalization comfortably above the regulatory minimum, including the combined capital buffer requirement and the Pillar 2 requirement.

## Stress testing

Stress tests provide an important management tool for the Bank. The results of stress tests raise risk awareness and improve general understanding of the Bank’s operations and are to be considered for strategic, capital, and contingency planning. The results of stress tests are incorporated into the review of the risk appetite and the Bank’s limit framework.

# Capital Management

The Bank’s stress testing framework outlines the scope and responsibilities for stress testing in the Bank. Within the framework’s scope are the ICAAP and ILAAP, which are carried out in parallel, the Recovery Plan, as well as firm-wide and regulatory internal stress tests on the Bank’s business plan. The framework is aligned with EBA’s Guidelines on Stress Testing (EBA-GL-2018-04). Stress testing at the Bank consists of sensitivity analysis and scenario analysis.

Stress testing involves estimating the impact of the stress scenario on the Bank’s earnings and capital adequacy as well as the impact for the Bank’s liquidity ratios, other risk appetite metrics, and recovery indicators. Each business unit contributes to the estimation of its portfolio with the view of identifying the most important risk drivers and suggests relevant stressed scenarios.

Figure 3.4 The stress testing process at the Bank.

Scenario description - the story	Macro economic impact - time series	PD / LGD / IFRS9 stages	Micro economic impact - translation	Assumptions in business model altered - effects reported	Management actions
Cross department workshops, meetings and collaboration with the Chief Economist	Chief Economist, Risk Management, Finance	Risk Management	Finance, Chief Economist, Risk Management	Finance, Risk Management	Finance, Risk Management

Scenario analyses are carried out on the Bank’s business plan. The Bank’s Chief Economist contributes an economic base case projection as well as stressed projections that are used in the Bank’s capital planning and in preparation of the Bank’s five year business plan. The design of the bank-wide internal stress test is challenged and reviewed by the Executive Risk Committee and the Board Risk Committee.

One of the stressed scenarios carried out on the business plan is provided by the Central Bank in collaboration with the FSA. The Bank also performs various regularly scheduled stress tests and targeted ad-hoc stress tests.

## 3.4 Capital ratios

### Scope of consolidation and exposure amounts

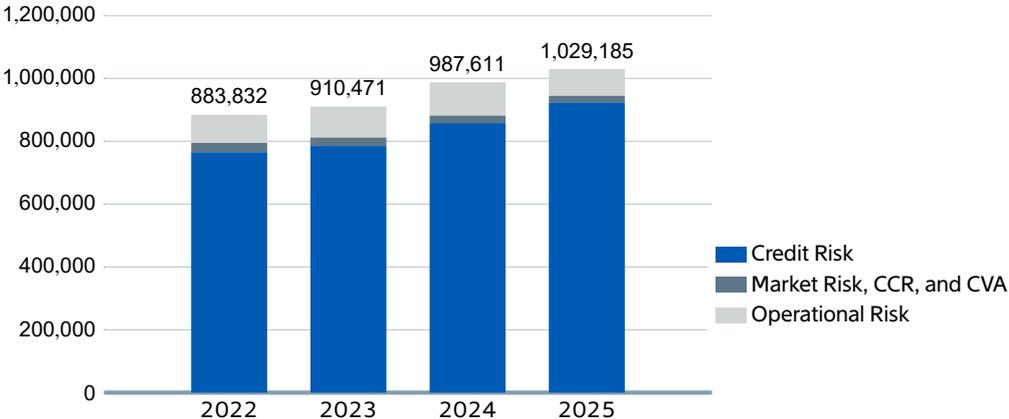
The Bank’s consolidated situation for prudential purposes and capital adequacy is different from the accounting consolidation. The Bank owns an insurance subsidiary, Vörður, which is fully consolidated in the Group financial statements. For prudential purposes, it is consolidated using the equity method and is excluded from supervision on a consolidated basis as stipulated by CRR. Vörður is supervised by the FSA and its solvency requirements are calculated in accordance with the Icelandic Insurance Companies Act.

For further details on the companies within the scope of consolidation, please refer to the template EU LI3 in the Pillar 3 Risk Disclosures. Template EU LI1 shows the difference in amounts between the carrying values in the financial statements and the carrying values under the scope of regulatory consolidation and a breakdown of the framework under which these amounts fall.

The main source of difference between the carrying values as reported in the financial statements and the exposure amounts for regulatory purposes are off balance sheet amounts which fall under the credit risk framework and potential future exposure for items under the counterparty credit risk framework. Template EU LI2 shows a reconciliation between these amounts.

# Capital Management

Figure 3.5 Development of REA [ISK m]



Credit risk accounted for 90% of the Bank’s REA at year-end 2025. The Bank’s REA for credit risk (excluding CCR) increased by ISK 64 billion in 2025. The increase is mainly due to loans to corporates which grew by ISK 98 billion during the year.

A breakdown of the Bank’s REA is shown in Note 47 of the Consolidated Financial Statements and in template EU OV1.

The Bank’s holdings of the own funds instruments of Vörður which are not deducted from own funds are instead risk weighed at 250%. Template EU INS1 shows these amounts. The Bank is not a part of a financial conglomerate and thus template EU INS2 does not apply to it.

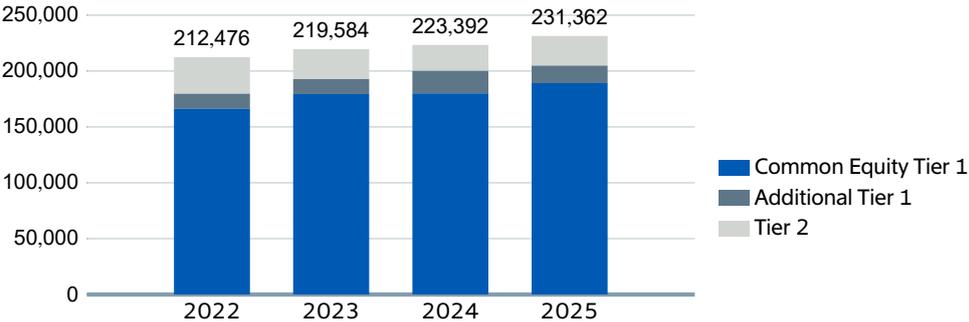
The Bank does not use the internal ratings based (IRB) approach for any exposures and it does not have any exposure to securitizations. EU templates related to these types of exposures are therefore omitted.

## Own funds

The Bank’s own funds are composed of Common Equity Tier 1, Additional Tier 1, and Tier 2 issuances and the size of each layer of own funds is presented net of regulatory adjustments.

CET1 capital before regulatory adjustments consists exclusively of equity issued by Arion Bank. The regulatory adjustments to CET1 are primarily the deduction of intangible assets and the deduction of foreseeable dividends. Other items are smaller.

Figure 3.6 Development of own funds [ISK m]



The Bank uses the simplified approach for the calculation of additional value adjustments and thus template EU PV1 does not apply.

The Bank’s Additional Tier 1 capital consists of a USD 125 million subordinated liability issued in 2024.

The Bank’s Tier 2 capital consists of subordinated liabilities issued in 2019 in EUR, in 2022 in ISK, in 2024 in SEK, and in 2025 in ISK, see Note 34 in the Consolidated Financial Statements. The contractual maturities range from 2031 to 2036 and each facility has a call option five years before the contractual maturity.

Template EU CCA provides further details on each of the Bank’s own funds and eligible liabilities instruments.

# Capital Management

Template EU CC1 presents the composition of the Bank’s own funds. The Bank’s own funds are reconciled with the balance sheet in the Group’s financial statements via template EU CC2 and cross references to the relevant rows in template EU CC1 are provided.

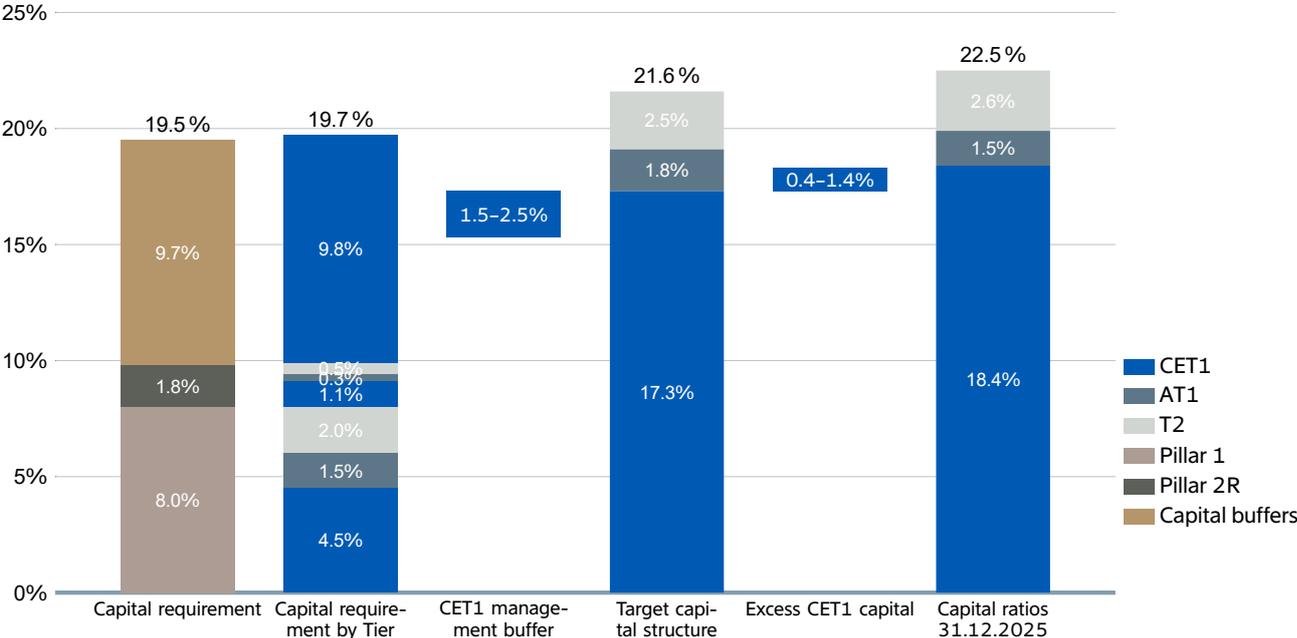
## Capital position

At year-end 2024, the Bank’s CET1 capital ratio was 18.4%, well above the CET1 capital requirement of 15.3%. The total capital ratio was 22.5%.

The following figure shows the Bank’s capital position and the capital requirement, along with a normalized capital structure.

The Bank’s own funds at 31 December 2025 take into account a foreseeable equity distribution of ISK 20.3 billion through dividends and share buyback. The Bank’s dividend policy is to pay dividends corresponding to 50% of net earnings each year. The foreseeable equity distribution at year-end 2025 is ISK 5.0 billion above the value which the dividend policy would dictate.

Figure 3.7 Arion Bank’s capital requirement, target capital structure and capital ratios.



The Bank’s CET1 ratio at the end of 2024 was 18.2%. This accounted for a capital reduction beyond the Bank’s dividend policy through a ISK 16 billion dividend payment and a share buyback of ISK 3 billion completed in Q1 2025. In Q2 2025 the Bank received permission for and executed a further share buyback of ISK 3 billion.

In December 2025, the Icelandic parliament passed an amendment to the Act on Financial Undertakings implementing CRR3 into Icelandic law. This led to an initial capital relief of around ISK 11 billion although some of this is due to transitional arrangements which will be phased out over time. Due to this, a further share buyback of ISK 5 billion has been approved by the Board and the FSA to be executed in Q1 2026. See Section 3.7 below for further details on CRR3. At year-end 2025, the CET1 ratio was 18.4%. This position is still above the Bank’s medium term target which is a CET1 management buffer of 150–250bps and supports the Bank’s issuer ratings from Moody’s which is A3 with stable outlook.

The template EU KM1 shows the development of key metrics related to own funds, REA, capital ratios, capital requirements, and the leverage ratio.

## 3.5 Leverage ratio

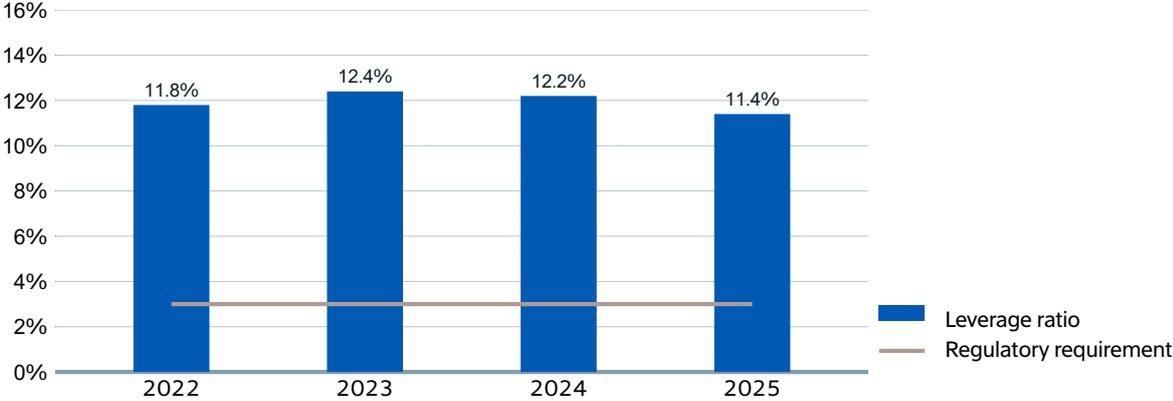
The leverage ratio is a complementary measure to the risk-based capital adequacy ratio. Leverage requirements are aimed to prevent banks from building up excessive leverage while possibly maintaining strong risk-based capital ratios. The leverage ratio is a simple measure, weighting the Bank’s Tier 1 capital against a measure of its total exposure.

At year-end 2025, the Bank had a strong leverage ratio of 11.4%, significantly higher than the 3% minimum prescribed by CRR. The ratio is exceptionally high in international context, and re-

# Capital Management

flects the particular case of the major Icelandic financial institutions, which are classified as systemically important while applying the standardized approach for credit risk. As such, Arion Bank has a very high combined capital buffer requirement of 9.7%, which is applied to a standardized REA. The Bank’s average risk-weight, the ratio of the risk-weighted exposure amount and the exposure measure for the leverage ratio, is 57% for the consolidated situation.

Figure 3.8 Development of the Bank’s leverage ratio



The Bank’s Tier 1 capital and the total exposure increased in 2025 but the rate of increase in Tier 1 was lower due to capital reduction. This led to a decrease in the leverage ratio. In light of the strong leverage ratio, the Bank’s management of the risk of excessive leverage is currently confined to the monitoring of the Board of Directors’ risk appetite for leverage.

For further details on the Bank’s leverage ratio, please refer to templates EU LR1, EU LR2 and EU LR3.

## 3.6 MREL

The Icelandic law on the resolution of credit institutions and investment funds, Act no. 70/2020, entered into force on 1 September 2020. This transposed the BRRD (2014/59/EU) into Icelandic law. BRRD II was transposed into Icelandic law with Act No. 63/2023, and Rules 800/2024 of the Central Bank of Iceland.

In October 2025, the Central Bank of Iceland’s Resolution Authority made a decision on the minimum requirement for own funds and other eligible liabilities (MREL), in accordance with Act No. 70/2020, based on year-end 2024 data.

The requirements are expressed as a fraction of total REA (MREL-TREA), and as a fraction of the total exposure measure (MREL-TEM). The requirement for MREL-TREA, which can only be met with eligible liabilities and own funds not used to fulfill the combined buffer requirement, was set at 19.8%, double the combined Pillar 1 and Pillar 2R requirement. The Bank’s MREL-TREA adequacy ratio at year-end 2025 was 32.4%. The MREL-TEM requirement was set at 6.0%, double the leverage ratio requirement per the CRR. The Bank’s MREL-TEM adequacy ratio was 24.2% at year-end 2025.

BRRD II introduces a subordination requirement for eligible liabilities, whereby a part of the MREL requirement must be met with own funds or liabilities that are subordinate to ordinary unsecured claims. As a consequence, a new class of securities has been introduced into the liability structure of institutions, the so-called senior non-preferred liabilities, which are senior to own funds issuances (T1 and T2), but subordinate to ordinary unsecured claims and senior preferred liabilities. The subordination requirement for the Bank according to the decision of the Resolution Authority is 13.5% of REA and will apply from August 2027.

In the MREL policy published by the Resolution Authority, it is pointed out that under certain circumstances the Resolution Authority can give a permission for liabilities which are not subordinated to be counted toward the subordination requirement. Firstly, according to CRR Article 72b(3), senior preferred liabilities may be counted towards the subordination requirement for up to 3.5% of REA. Secondly, according to CRR Article 72b(4), all senior preferred liabilities may be counted towards the subordination requirement provided that excluded liabilities which rank *pari passu* with the senior preferred liabilities do not exceed 5% of own funds and eligible liabilities. It should be noted that only one of these methods can be used at any given time and they are subject to further conditions and permission from the Resolution Authority.

# Capital Management

Template EU KM2 shows key metrics relating to MREL, while templates EU TLAC1 and EU TLAC3b show the MREL composition and creditor ranking, respectively.

## 3.7 CRR3

Legislation to implement the finalized Basel III framework in the European Union (CRR3, (EU) 2024/1623) took effect in January 2025. The changes to market risk have however been postponed, at least until 2027 and possibly longer. CRR3 in Iceland took effect in December 2025.

For Arion Bank, the key changes to capital requirements are summarized in Table 3.4. Taken together, the changes resulted in an initial capital relief of around ISK 11 billion. Some of this relief is due to transitional arrangements which will be phased out over time.

Table 3.4 Impact of CRR3

Exposure type	Impact
Residential real estate	CRR3 brings increased risk sensitivity for real estate exposures. For exposures secured by residential real estate, previously a 35% risk weight applied to the part of the exposure below 80% LTV. This has been changed so that the part below 55% LTV receives 20% risk weight. Positions between 55% and 80% LTV no longer receive any risk weight benefit. For exposures secured by commercial real estate, a risk weight of 60% applies to the part below 55% LTV. Furthermore, the property valuation methods have been changed. Instead of using the most up-to-date valuation available, an average valuation over six and eight years must be used, for residential and commercial property respectively. However, at loan origination this constraint does not apply. Furthermore, there are transitional arrangements which allow valuations based on the CRR2 framework to be used initially.
IPRE	IPRE loans secured by real estate in Iceland can be risk weighted using the same method as other loans secured by real estate since the FSA has published loss rates for loans secured by real estate and they are below the limits set in CRR3.
ADC	Land acquisition, development and construction loans (ADC) is a separate asset class under CRR3. The risk weight will be 150% unless the loans are financing the construction of residential real estate and the loans have characteristics representing low risk, in which case the risk weight will be 100%. EBA has issued guidelines quantifying these low risk characteristics, in particular setting the lower limit for equity contribution as a fraction of the property value at completion at 25%. The Central Bank of Iceland has adopted the EBA guidelines with the deviation that until the end of 2027, this lower limit will be set at 20%.
Equity	The treatment of equity exposures is overhauled in CRR3. These exposures are no longer eligible for an IRB approach and the standardized risk weight will generally be 250% in the new framework. For investments for short-term resale purposes and investments which are acquired in anticipation of significant short-term capital gains the risk weight will be 400%. There is a five-year transition period for these changes.
Off-balance sheet exposures	The credit conversion factor (CCF) for off-balance sheet exposures has changed. Loan commitments which received either 20% or 50% risk weight based on duration now generally receive 40% CCF. Also, certain unconditionally cancellable commitments which previously received 0% CCF will receive 10% CCF after an eight year transitional period.
Operational risk	Due to the small size of the Bank, capital requirements for operational risk fall into the lowest bracket in CRR3. Also, a limit has been introduced on the extent that interest income contributes to operational risk REA.
Market risk	Changes to the market risk framework have been postponed until 2027 and revisions to the framework could take place before the new framework takes effect.

# Credit Risk

Credit risk is defined as the current or prospective risk to earnings and capital arising from the failure of an obligor to discharge an obligation at the stipulated time or otherwise to perform as agreed. Credit risk arises anytime the Bank commits its funds to loans, guarantees, or other credit instruments, resulting in capital or earnings being dependent on counterparty, issuer, or borrower performance.

Risk exposure amount (ISK)

**901.9 bn (814.4 bn)**

Credit REA density

**52.6% (53.0%)**

Problem loans (% of loan portfolio)

**2.4% (2.3%)**

Cost of risk

**24 bps (9 bps)**

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- 4.1 Governance and policy
- 4.2 Credit risk management
- 4.3 Credit risk exposure
- 4.4 Collateral management
- 4.5 Credit rating
- 4.6 Portfolio credit quality
- 4.7 Counterparty credit risk

## 4 Credit Risk

Loans to customers are the primary source of credit risk but credit risk is also inherent in other types of financial assets, such as loans to credit institutions, bonds, derivatives, and in commitments and guarantees such as unused credit lines or limits. Credit risk is inherent in business units connected to lending activities, as well as trading and investment activities, i.e. Corporate and Investment Banking, Retail Banking, Markets, and Treasury within Finance.

Table 4.1 Sources of credit risk

Source	Description
Loans to customers	The loan portfolio is the Bank's main asset. Loans to customers comprise loans to individuals and loans to corporates which, for the purpose of this report, include loans to municipalities and public sector entities. Types of instruments include collateralized loans such as property loans, construction loans, mortgages, vehicle loans and loans against listed and unlisted securities, and uncollateralized short and long term loans such as overdrafts and cashflow loans.
Commitments and guarantees	The Bank often commits itself to ensuring that funds are available to customers as required. The most common commitments to extend credit are allowances on checking account overdrafts, credit cards, and credit lines. Commitments and guarantees are unused amounts and are classified as off-balance sheet exposures.
Balances with the Central Bank and loans to credit institutions	The Bank maintains cash and balances with the Central Bank in the form of certificates of deposits, mandatory reserve deposits, and other balances. Furthermore, the Bank holds money-market deposits and deposits in nostro accounts with credit institutions. Such exposures form a significant part of the Bank's liquidity buffer.
Bonds and debt instruments	The Bank trades and invests in bonds and debt instruments, both listed and unlisted. High quality bonds form a significant part of the Bank's liquidity buffer.
Financial derivatives	Counterparty credit risk arises from forward contracts, swaps, and options. The exposures are subject to position limits, hedging requirements, and collateral requirements. Eligible underlying market factors are interest rates, foreign exchange rates, securities, and commodities. The Bank also uses derivatives for market risk hedging and engages in securities lending. See further information in Section 4.7.
Equity risk in the banking book	Equity risk in the banking book arises primarily from investment in positions that are not made for short-term trading purposes and assets repossessed as a result of credit recovery, i.e., restructuring or collection.

### 4.1 Governance and policy

The Bank's credit risk policy and credit risk appetite are established by the Board of Directors and reviewed on an annual basis.

According to the policy, the Bank offers various forms of credit to individuals and organizations, and maintains a diversified loan portfolio composition to avoid excessive risk concentration. The Bank favors long-term relationships and sustainable development with an emphasis on innovative and export-driven companies. The Bank is active in the financing of real estate and, as such, facilitates home ownership and real estate development. The Bank finances and supports market transactions and market activities of its clients and thus promotes efficiency and liquidity in financial markets.

The Bank's risk appetite framework further specifies the desired level of risk exposure through qualitative and quantitative statements. The framework addresses credit quality, collateral coverage, portfolio composition, and single-name, sectoral, and geographical concentrations. It is ensured that the Bank's credit strategy and business model conform to its credit risk policy and risk appetite.

In accordance with the credit risk policy, the Bank's CEO has set up a credit risk framework, which outlines underwriting rules, responsibilities, and authorizations. At the management level, the Arion Credit Committee (ACC) is the principal authority for credit origination and credit management, and the Arion Composition and Debt Cancellation Committee (ADC) is responsible for debt cancellation, debt restructuring, and composition agreements. The ACC and the ADC are chaired by the CEO or respective delegates. Risk Management attends all committee meetings and is authorized to reject or escalate decisions.

# Credit Risk

The ACC and the ADC operate within limits set by the Board of Directors, which is the Bank’s supreme authority in matters relating to credit risk exposures. The Board delegates credit decisions that exceed the authority of the ACC and the ADC and do not require risk appetite exemptions to the Board Credit Committee (BCC).

The Executive Risk Committee, chaired by the CRO, approves changes to the credit framework and ensures alignment with the Bank’s risk appetite and credit risk policy. The BCC reviews the credit framework on an annual basis

Figure 4.1 Credit approval hierarchy



## 4.2 Credit risk management

Credit risk management entails diversification of risk, well-informed lending decisions, good oversight of portfolio performance, and the identification of weaknesses to facilitate timely recovery.

To ensure well-informed lending decisions, borrowers’ key risk and performance indicators are analyzed and made available to the credit committee. Credit applications address certain elements that serve as the basis for a decision, such as the customer profile, financial analysis of the customer, repayment ability, proposed collateral, credit rating of the customer including ESG assessment, and connected clients and their total exposure. The credit is assessed on its own merit and in the context of the Bank’s detailed credit framework and criteria. Various controls ensure that a loan is only disbursed following a thorough review of all documents and the registration of all relevant information regarding the loan and collateral in the Bank’s systems.

During the repayment phase, the credit portfolio is closely monitored by the first and second line. Credit risk metrics are aggregated monthly, based on consistent criteria, to analyze the credit quality, expected loss, collateral coverage, single-name, sectoral and geographical concentrations, and early warning indicators. Credit risk maintains a watch list based on the aforementioned metrics, according to specified thresholds. For the purpose of measuring credit risk and facilitating manual and automatic credit decisions, Risk Management maintains statistical and expert judgement models that assess the likelihood of default and the liquidation value of collateral. Ad-hoc stress test are additionally performed to identify credit risk related to specific sectors or other concentration matrices.

Risk Management performs periodic reviews of the loan book, which entails analysis of individual exposures in cooperation with the first line. The process ensures continuous monitoring of credit risk, with the aim of identifying early warning signs, problem loans, and sector development. Specific impairments are determined as part of the process.

Monthly credit risk reports are sent to the ACC, the BRIC, and the Board of Directors.

## 4.3 Credit risk exposure

The Bank is exposed to credit risk from both on-balance sheet exposures and off-balance sheet exposures. The tables in this section do not include exposures on the Bank’s trading books or counterparty credit risk (CCR) exposures unless otherwise stated.

By far the largest source of credit risk REA is loans to customers. This exposure mostly falls into the exposure classes Corporates, Retail, and Secured by mortgages. The Bank’s credit risk-weight density, or REA density, measured as REA relative to EAD, decreased in 2025, from 53.0% to 52.6%. For further breakdown see templates EU CR4 and EU CR5.

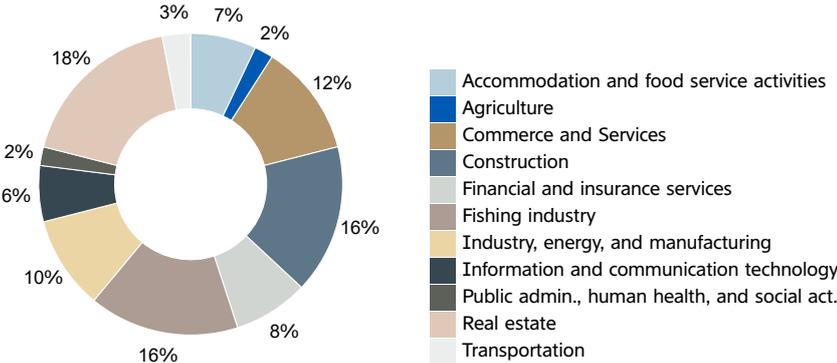
# Credit Risk

## Credit risk exposure by sector

The Bank's loan book is diversified with regard to individuals and industry sectors. Credit exposure to individuals represents 48% of loans to customers, of which 90% are mortgage loans.

Real estate activities is the largest industry sector comprising 18% of loans to corporates or 9% of the Bank's total net credit risk exposure. According to the Bank's analysis, the sector distribution of the corporate loan book mirrors the sector distribution of credit from all lenders in the Icelandic economy, in line with the Bank's risk appetite. The Bank's sector diversification is as good as can be expected for a bank which primarily operates in Iceland.

Figure 4.2 Sector distribution of loans to corporate entities



Arion Bank monitors the risk associated with the tourism industry. The Bank has not modified its standard industry classification to incorporate a separate tourism sector, opting instead to monitor the exposure internally alongside the standard sectors. To define the tourism industry, the Bank has adopted a classification from the Central Bank of Iceland which identifies, primarily, 19 activities from ISAT08 as core tourism activities. According to this definition, the Bank's exposure to the tourism industry was 9% of loans to customers at the end of 2025, compared to 7% in 2024. The tourism exposure draws mainly from sectors: Accommodation and food service activities (37%), Real estate activities (25%), and Construction (15%).

For EBA standardized disclosures of credit risk exposure by sectors please refer to template EU CQ5.

## Credit risk exposure by geographic area

The Bank is predominantly exposed to credit risk in Iceland. The total net exposure is 89.9% towards counterparties domiciled in Iceland, 5.7% towards counterparties domiciled in the Nordic countries, 3.5% in rest of Europe, and 0.8% in North America.

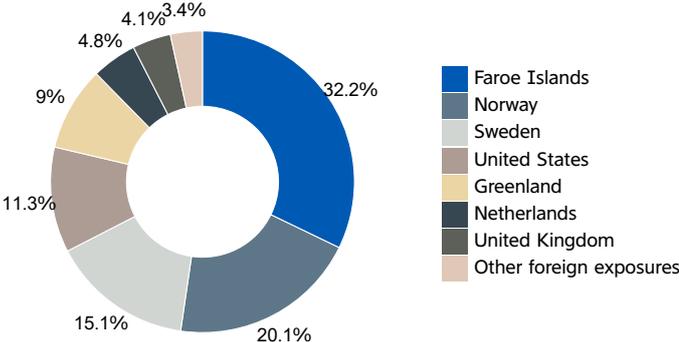
The majority of the 10.1% foreign credit exposures is due to liquid assets in foreign currencies, which includes short term deposits and money market loans at credit institutions, and sovereign bonds, the counterparties of which have high grade or upper medium grade credit ratings from certified external credit agencies (ECAI).

The geographic distribution of the total net exposure to credit institutions, central governments, and central banks is 47.7% towards counterparties in Iceland, 19.9% towards counterparties in the Nordic countries, 28.1% towards counterparties in the rest of Europe, and 2.3% towards counterparties in North America.

Lending to foreign corporates increased from 7.6% in 2024 to 9.8% in 2025 of total corporate lending. Figure 4.3 shows the distribution by country, but the majority consists of loans to companies in the Arctic region. The increase reflects the Bank's drive to increase its activity in the region in recent years, primarily in segments that relate to Iceland's knowledge and export industries.

# Credit Risk

Figure 4.3 Geographic distribution of loans to corporates



For EBA standardized disclosures of credit risk exposure by geographic area please refer to template EU CQ4.

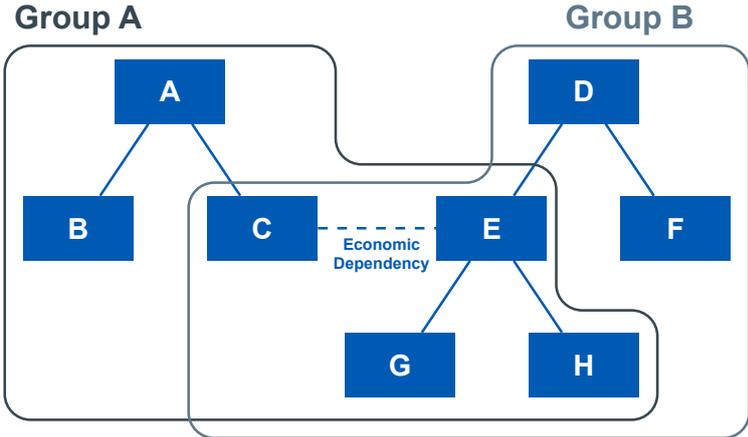
### Connected clients and large exposures

A large exposure is defined as an exposure to a group of connected clients which exceeds 10% of the Bank’s Tier 1 capital. According to the CRR, the legal maximum for individual large exposures, net of eligible collateral, is 25% of Tier 1 capital.

The Bank seeks to limit its credit concentration risk through diversification of the loan portfolio by limiting large exposures to groups of connected clients. No single large exposure shall exceed limits expressed in the Bank’s risk appetite without a special exemption granted by the Board of Directors.

The Bank connects clients according to internal rules that comply with the Act on financial undertakings No. 161/2002 and relevant EBA guidelines. The internal rules define criteria that comply with the regulatory conditions and describe the roles and responsibilities related to the interpretation and maintenance of connected clients. The Bank evaluates the relationship of customers with respect to both control and economic dependencies. Economic dependencies between two companies within different groups of connected clients do not necessarily combine these groups into one. This relationship is illustrated in Figure 4.4.

Figure 4.4 Connected clients



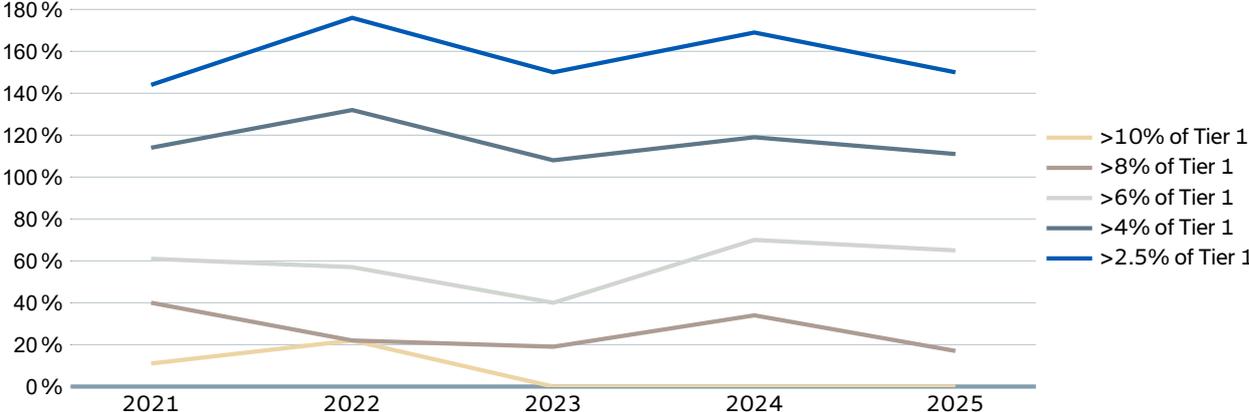
Account managers are responsible for maintaining and reviewing party relations both prior to the granting of a loan and during its lifetime. Risk Management monitors the party relations and manages the Bank’s relationship database.

A large exposure is the sum of group exposures, net of eligible collateral, exceeding 10% of Tier 1 capital. The Bank had no large exposure at year-end 2025, as was the case at year-end 2024.

The sum of group exposures exceeding 2.5%, net of eligible collateral, decreased from 169% to 150% of Tier 1 capital, see Figure 4.5. Furthermore, the sum of group exposures exceeding 8% decreased from 34% to 17% of Tier 1 capital. Figures for 2025 are not directly comparable to previous years due to the implementation of CRR3, which expands the eligibility criteria for commercial real estate collateral.

# Credit Risk

Figure 4.5 Total of net exposures to groups of connected clients (excluding loans to financial institutions)



## Equity positions in the banking book

Exposure limits for equity positions in the banking book are defined in the Bank’s risk appetite statement. Equity in the banking book primarily comprises investments that are not made for short-term trading purposes and assets repossessed as a result of credit recovery, i.e. restructuring or collection.

Table 4.2 Equity exposure in the banking book

31 December 2025 [ISK m]	Book value
Investments in associates	760
Equity instruments	4,718
Investments in funds	926
<b>Total equity exposure in the banking book</b>	<b>6,403</b>

31 December 2024 [ISK m]	Book value
Investments in associates	749
Equity instruments	2,298
Investments in funds	1,627
<b>Total equity exposure in the banking book</b>	<b>4,675</b>

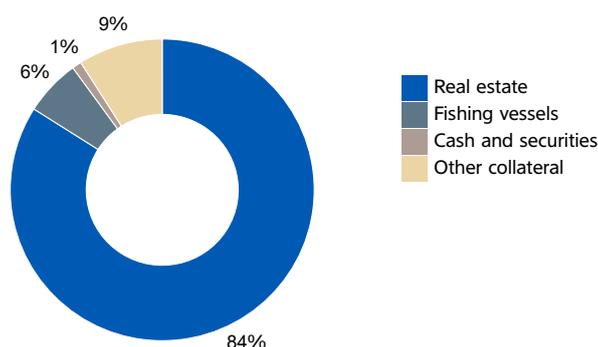
## 4.4 Collateral management and valuation

The Bank’s initial valuation of a collateral takes place during the credit approval process. Credit rules outline the acceptable levels of collateral for a given counterparty and exposure type. The collateral obtained by the Bank is typically one of the following:

- ◆ Cash and securities: Cash, treasury notes and bills, asset backed bonds, listed equity, and funds that consist of eligible securities
- ◆ Real estate: Residential property, commercial real estate, and land
- ◆ Vessels: Ships with assigned fishing quota and other vessels
- ◆ Other collateral: Fixed and current assets including vehicles, equipment, inventory, and trade receivables

## Credit Risk

Figure 4.6 Collateral by type



In addition to securing collateral, mitigation of credit risk is achieved through the use of guarantees, master netting agreements and credit support annexes, and applicable terms and conditions.

Collateral valuation standards and guidelines have been set by the ACC to ensure coordinated collateral value assessment. Risk Management reviews the standards and guidelines for appropriateness and opines on individual cases as needed.

The standards and guidelines cover the following subjects:

- ◆ Agriculture
- ◆ Fishing vessels and fishing quota
- ◆ Inventory, trade receivables, and other movable assets
- ◆ Project financing
- ◆ Real estate
- ◆ Securities

The Bank operates a collateral management system to consolidate the Bank's collateral data. Table 4.3 shows the collateral held by the Bank for loans to customers, broken down by sector. Collateral held at year-end is to the largest extent real estate collateral, which makes up 84% of the total collateral. Loans to customers were secured by collateral conservatively valued at ISK 1.17 trillion, which results in a collateral coverage ratio of 88.5% compared to 91.6% at the end of 2024.

Table 4.3 Collateral for loans to customers. The collateral value is capped by book value.

31 December 2025 [ISK m]	Cash and securities	Real estate	Fishing vessels	Other collateral	Total collateral	Unsecured ratio % 2025	Unsecured ratio % 2024
Individuals, Mortgages	134	576,297	0	0	576,431	0.1%	0.1%
Individuals, Other	27	13,409	28	14,604	28,068	55.8%	49.6%
Real estate activities	2,168	118,383	11	294	120,856	4.1%	1.3%
Construction	222	98,010	6	2,886	101,124	6.4%	6.4%
Fishing industry	1,294	26,435	58,230	13,314	99,273	7.6%	2.2%
Commerce and services	1,554	36,263	1,063	25,114	63,994	26.5%	18.2%
Accommodation and food service activities	34	44,842	0	206	45,082	3.6%	2.1%
Financial and insurance activities	9,528	18,072	4,069	20,174	51,843	11.5%	23.7%
Industry, energy, and manufacturing	532	32,288	0	18,288	51,108	26.9%	7.5%
Transportation	40	1,223	2,208	9,038	12,509	30.2%	3.8%
Information and communication technology	275	1,606	0	6,810	8,691	78.5%	67.4%
Public sector	8	2,678	11	104	2,801	75.3%	74.5%
Agriculture and forestry	0	12,541	21	569	13,131	3.9%	2.0%
<b>Total</b>	<b>15,816</b>	<b>982,047</b>	<b>65,647</b>	<b>111,401</b>	<b>1,174,911</b>	<b>11.5%</b>	<b>8.4%</b>

# Credit Risk

Figures 4.7 and 4.8 show the mortgage portfolio broken down by loan to value bands based on the gross carrying amount of the mortgages. In Figure 4.7, a prime mortgage exposure to a particular borrower appears in a single bar in the chart (whole-loan approach). In Figure 4.8 however, an alternative representation of the loan to value profile is shown, where each exposure is split into pieces and each piece is placed into the appropriate loan to value band. A single exposure can therefore be spread between several bands on the bar chart with the loan-splitting approach.

The value of real estate is based on observed market value for two years from purchase, and is then replaced by an estimated value based on a third-party statistical model, which is updated on a monthly basis. The upward shift in the LTV in Figure 4.7 is primarily driven by the current interest rate environment, which incentivises low-LTV borrowers to refinance with pension funds offering competitive rates. Simultaneously, the LTV reduction for indexed loans is dampened as inflation is relatively high while real estate price appreciation has been comparatively moderate over the past year.

Figure 4.7 Loan to value of mortgage loans [ISK m], whole-loan approach

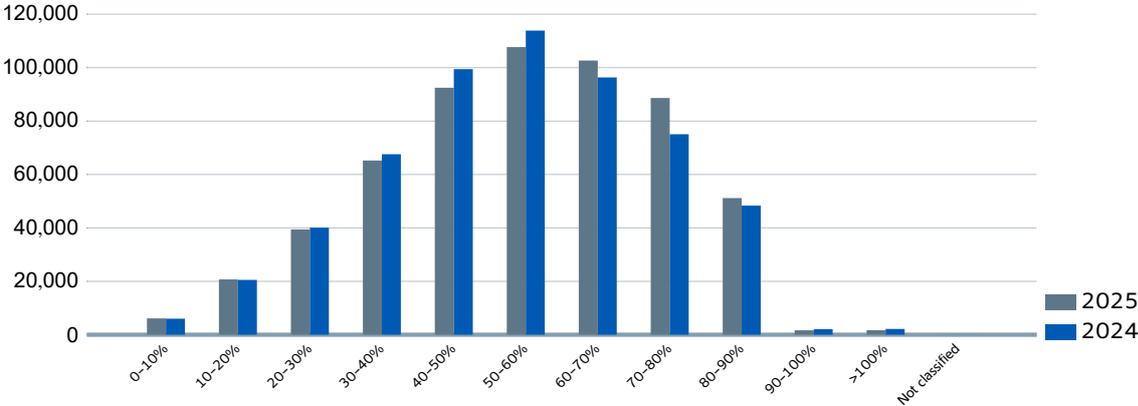
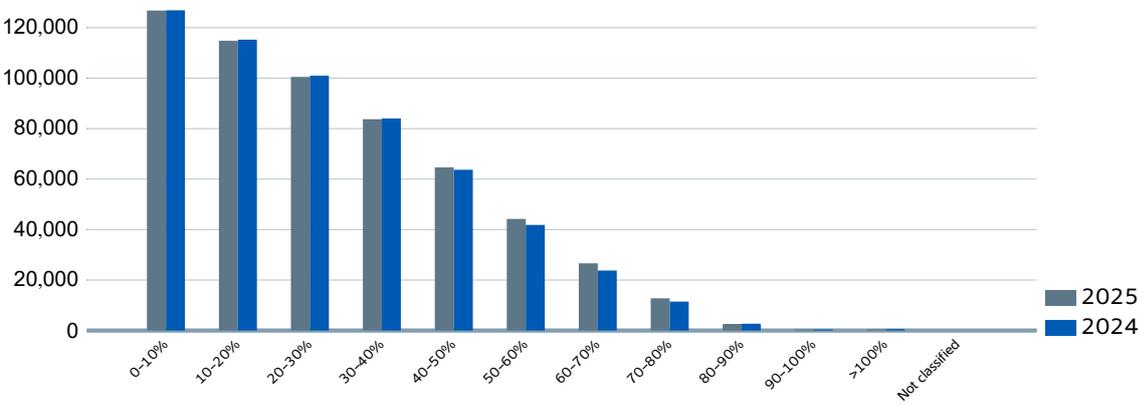


Figure 4.8 Loan to value of mortgage loans [ISK m], loan-splitting approach



At year-end 2025, 90.5% of mortgages, by value, had a loan-to-value ratio below 80%, compared to 91% at the end of 2024, according to the whole-loan approach. However, according to the loan-splitting approach, 99% of mortgages had loan-to-value ratio below 80%. According to the loan-splitting approach, 89% of mortgages were below 55% loan-to-value, compared to 90% at the end of 2024. The 55% mark is relevant for REA calculation under CRR3, see Section 3.7. The mortgaged properties are primarily located in the Capital Area or 69% of the portfolio, by value.

## 4.5 Credit rating

As outlined in Chapter 3, the Bank uses the standardized approach to calculate capital requirements for credit risk. Nevertheless, it is the Bank’s policy to apply sophisticated credit rating models to monitor the development of credit risk and to estimate customers’ default probability. These estimates are used extensively within the Bank as they play a role in both the manual and automatic evaluation of loan applications, portfolio monitoring, calculation of loss allowance, and

# Credit Risk

internal economic capital calculations.

The Bank applies different credit rating models to different types of borrowers and exposures. The Bank has also created separate application versions of some of the models in order to rate new exposures and loan commitments.

Table 4.4 Probability of Default models

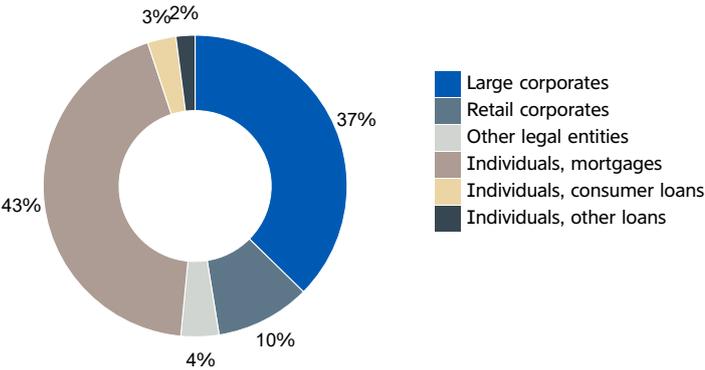
Model for:	Description
Large corporates	Defined as corporate clients with a) exposure over ISK 500 million or b) exposure over ISK 300 million and related exposure over ISK 500 million. The hybrid model is based on quantitative information drawn from financial statements as well as qualitative data entered by account managers, reviewed and approved by risk management.
Retail corporates	Defined as corporate clients with a) exposure below ISK 300 million or b) exposure between ISK 300 million and ISK 500 million, and related exposure below ISK 500 million. The model is statistical, runs automatically, and uses quantitative internal and external information found to be predictive of default.
Other legal entities	The Bank has different models for other legal entities – holding companies, construction financing, state related entities and municipalities, unions, etc.
Individuals, mortgages	Applied to all mortgages, for which there are standard loan collateral agreements. The model is statistical, runs automatically, and is based on historical behavior and characteristics of the customer and the exposure.
Individuals, consumer loans	Applied to all consumer loans – credit cards, overdrafts, etc. The model is statistical, runs automatically, and is based on historical behavior of customers and characteristics of the customer and the exposure.
Individuals, other exposures	The Bank has different models for other smaller exposure portfolios to individuals – car loans, guarantees, loans for work purposes, and other loans.

The Bank’s probability of default (PD) models are developed within Balance Sheet Risk and Models, a department within Risk Management, while the validation of the models is performed independently by another department in Risk Management, Operational and Sustainability Risk.

## Credit exposure by rating

Table 4.5 shows the portfolio’s rating status, by exposure. A default rating grade (DD) is assigned to an exposure when it has been in arrears for over 90 days or the customer is deemed unlikely to pay.

Figure 4.9 Distribution of exposure by rating model applied



Around 1.9% of the portfolio, by exposure, was assigned a default rating at the end of 2025, which is the same ratio as at the end of 2024. Active PD values are translated into an internal rating scale of letters from AAA to CCC-. The scale is shown in Table 4.6. The Bank has standardized six risk classes that categorize the internal rating scale, shown in the same table.

# Credit Risk

Table 4.5 Breakdown of rating status by exposure

Rating Model	2025			2024		
	% Active credit rating	% DD	% Unrated	% Active credit rating	% DD	% Unrated
Large corporates	97.9%	1.8%	0.3%	97.3%	2.4%	0.3%
Retail corporates	95.2%	4.8%	0.0%	95.6%	4.4%	0.0%
Other entities	99.1%	0.2%	0.7%	99.9%	0.0%	0.1%
Individuals, mortgages	98.5%	1.5%	0.0%	98.7%	1.3%	0.0%
Individuals, consumer loans	99.6%	0.4%	0.0%	99.3%	0.7%	0.0%
Individuals, other exposures	98.0%	2.0%	0.0%	97.7%	2.3%	0.0%
<b>Total</b>	<b>98.0%</b>	<b>1.9%</b>	<b>0.1%</b>	<b>98.0%</b>	<b>1.9%</b>	<b>0.1%</b>

Table 4.6 Rating scale

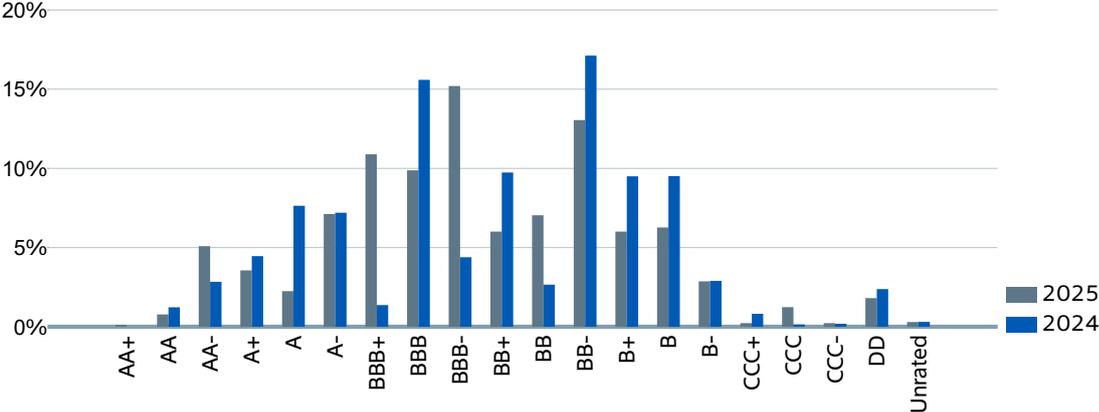
Risk class	Rating	Lower PD	Upper PD
0	AAA-A-	0.000%	0.17%
1	BBB+	0.17%	0.26%
	BBB	0.26%	0.41%
	BBB-	0.41%	0.64%
2	BB+	0.64%	0.99%
	BB	0.99%	1.54%
	BB-	1.54%	2.40%
3	B+	2.40%	3.73%
	B	3.73%	5.80%
	B-	5.80%	9.01%
4	CCC+	9.01%	14.00%
	CCC	14.00%	31.00%
	CCC-	31.00%	99.99%
5	DD	100.00%	100.00%

The rating distributions of each of the four largest portfolios are discussed below.

## Large corporates

The exposure-weighted average PD for the large corporate portfolio was 1.6% at year-end 2025, which was a 0.1 percentage point decrease from year-end 2024. In terms of exposure, approximately 29% have been upgraded to a better credit rating, while 15% have been downgraded. The migration analysis does not cover defaulting customers or customers that were previously unrated (e.g. new customers), or rated by the model for retail corporates.

Figure 4.10 Distribution of exposure by rating for large corporates

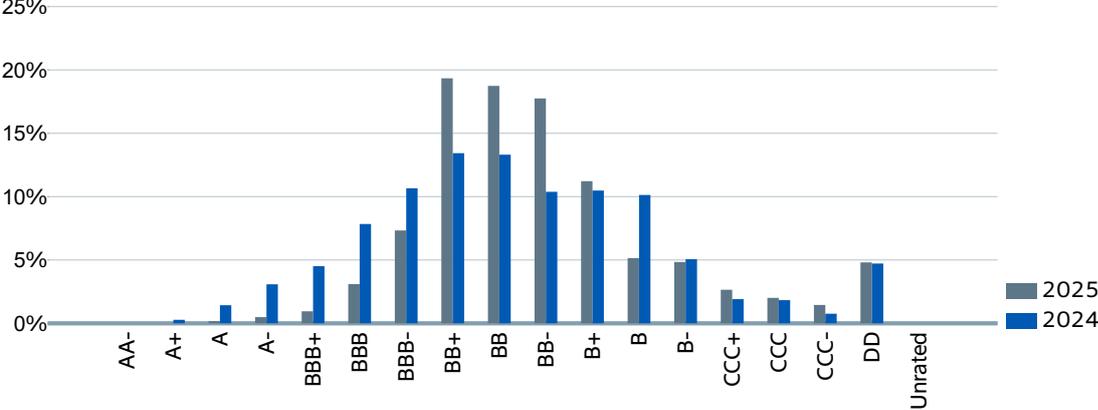


# Credit Risk

## Retail corporates

The exposure-weighted average PD was 3.3% at year-end 2025, compared to 3.0% at year-end 2024. In terms of exposure, 18% have been upgraded to a better rating whereas 13% have been downgraded. The migration analysis does not cover defaulting customers or customers that were previously unrated.

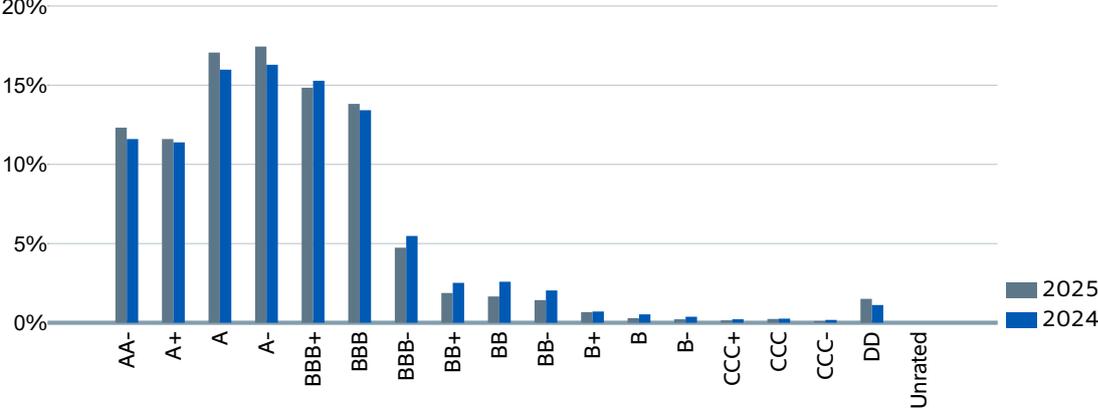
Figure 4.11 Distribution of exposure by rating for retail corporates



## Mortgages to individuals

The exposure-weighted average PD for the mortgage portfolio was 0.4% in year-end 2025, compared to 0.5% in year-end 2024. In terms of exposure, approximately 14% of mortgages have been upgraded to an improved credit rating and 11% have been downgraded. The migration analysis does not cover defaulting customers or customers that were previously unrated.

Figure 4.12 Distribution of exposure by rating for mortgages to individuals

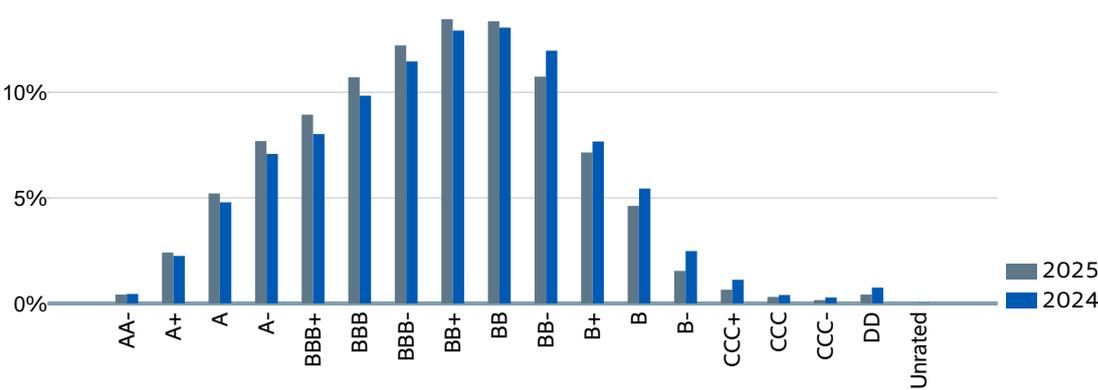


## Consumer loans

Figure 4.13 shows the consumer loans (overdrafts, credit cards, and unsecured short-term loans) portfolio broken down by rating. In terms of exposure, approximately 15% of mortgages have been upgraded to an improved credit rating and 20% have been downgraded. The migration analysis does not cover defaulting customers or customers that were previously unrated.

# Credit Risk

Figure 4.13 Distribution of exposure by rating for consumer loans



## Model performance

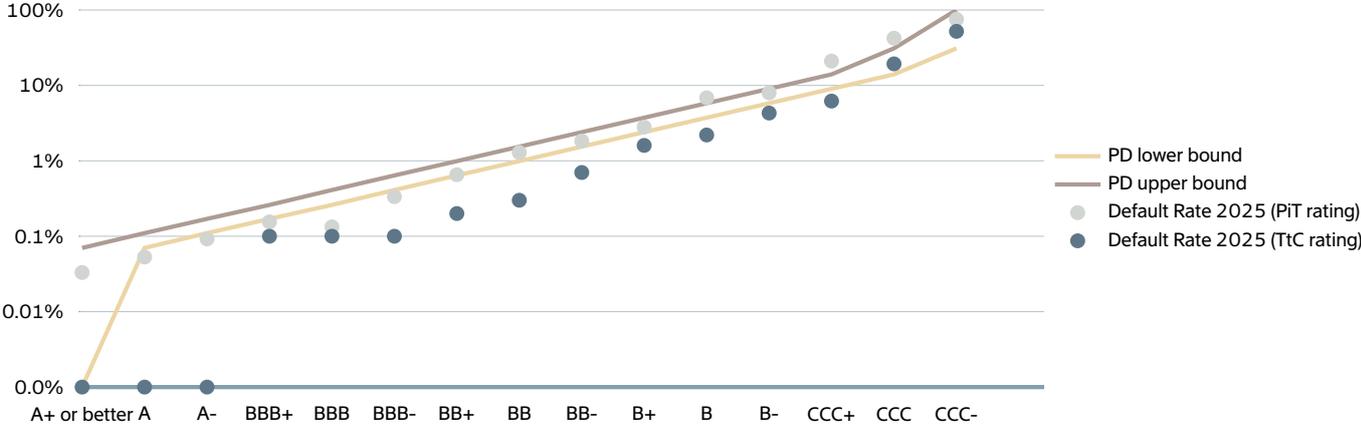
At year-end 2025, the discriminatory power of the four rating models with the largest exposure is in line with or exceeds the Bank’s internal requirements and the prediction accuracy is satisfactory. The comparison values for the average PiT (point-in-time) PD estimates at the end of 2024 and observed default rates in 2025 are shown in the following table.

Table 4.7 Model performance

Model portfolio	Average PiT PD, end of 2024	Average TtC PD, end of 2024	Avg. observed default rate in 2025
Mortgages	0.4%	1.5%	0.6%
Consumer Loans	0.8%	1.6%	0.9%
Large Corporates	2.4%	5.2%	4.4%
Retail Corporates	2.3%	4.6%	2.0%

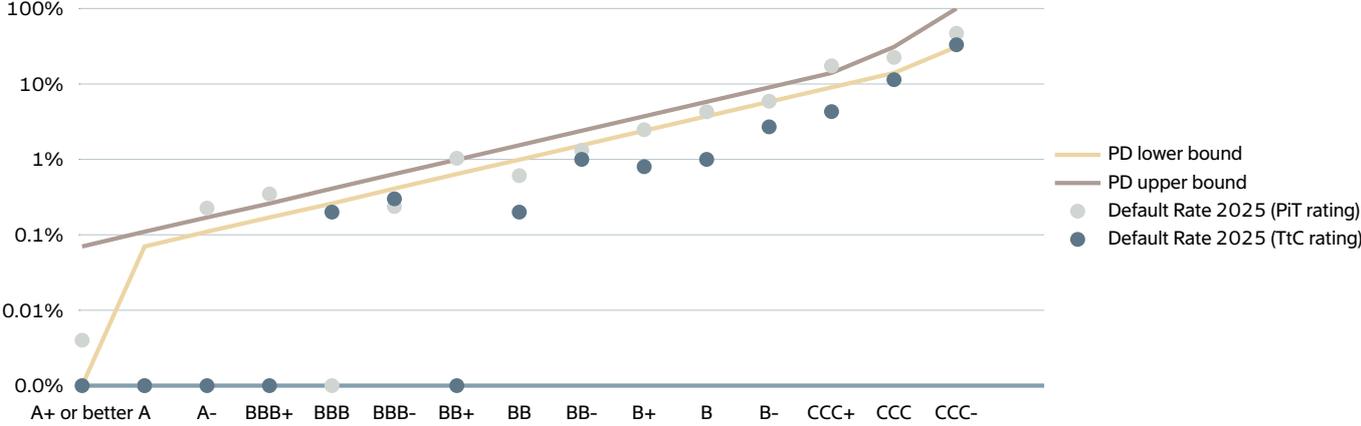
In Figures 4.14 and 4.15, the actual default rate for each grade in 2025 is compared to the PiT and TtC (through-the-cycle) probability of default at the end of 2024 for individuals (Mortgages and Consumer loans) and corporates (Large and Retail corporates), respectively. The dots representing PiT ratings are a measure of model performance but the TtC dots that are generally below the PD bands are indicative of a benign credit environment. In the figures, the highest-rated rating classes are grouped together due to their relatively low exposure.

Figure 4.14 Comparison of actual default rate in 2025 and predicted default probability – Individuals



# Credit Risk

Figure 4.15 Comparison of actual default rate in 2025 and predicted default probability – Corporates



## 4.6 Portfolio credit quality and provisions

The Bank places great emphasis on monitoring and reporting the quality of its loan portfolio. Asset quality is regularly aggregated and assessed in terms of sector concentration, single-name concentration, product type, and credit rating. Credit risk metrics are assessed and reported on a monthly basis.

### Problem loans

The Bank has implemented EBA Guidelines 2016/07, which provide a further explanation and details of the definition of default in Article 178 of the CRR. The Bank’s implementation complies with the guidelines and is suited to the Bank’s size and procedures. The guidelines require the Bank to consider the co-debtor group for a facility and a cross-default mechanism if the obligor is in default on a large obligation.

The definition can be divided into three types of default; unlikely to pay, 90 days past due and cross-default, and probation with or without forbearance. Default is considered on an obligor level for companies. For individuals, default is considered on the level of each PD model and cross default on an obligor level applies when the exposure in default is significant.

For 90 days past due, the amount in arrears must be above a relative threshold of 1% and an absolute threshold of ISK 15,000 for retail exposures and ISK 75,000 for other exposures.

The Bank’s definition of problem loans is aligned with IFRS9. Problem loans are defined as loans in Stage 3 and the problem loans ratio is calculated based on the gross carrying value of loans. At year-end 2025, the problem loans ratio for the Bank is 2.4% of the loan portfolio and has increased since the end of 2024 from 2.3%.

At year-end 2025, 66% of problem loans are, by value, loans to corporates and 34% to individuals.

Figure 4.16 Development of problem loans (Group)

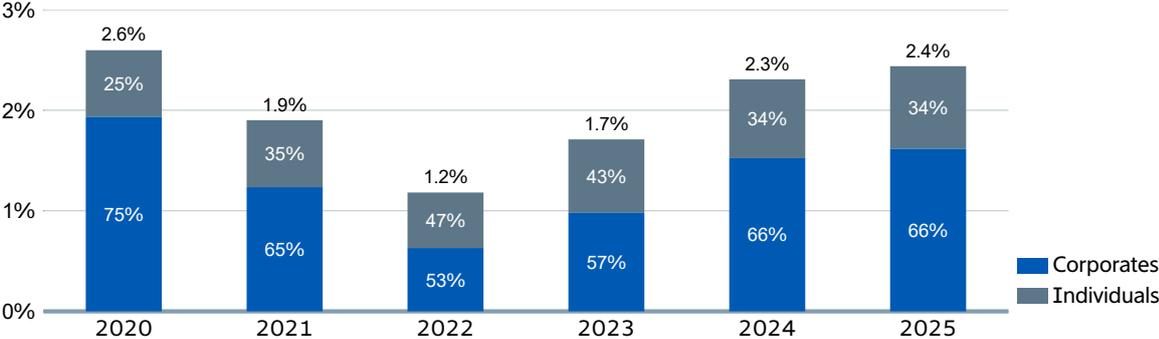
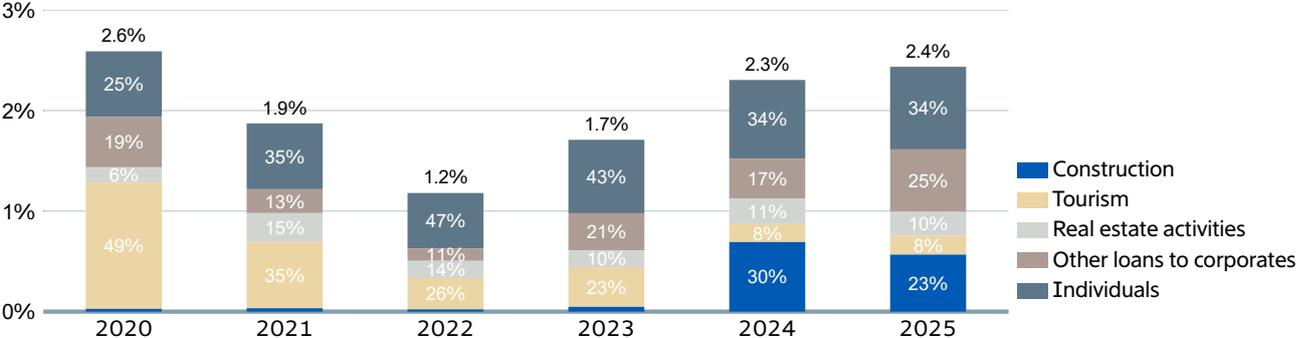


Figure 4.17 illustrates the development of problem loans by sector over the period 2020–2025. The year 2020 shows a pronounced spike in the tourism sector, which is directly attributable to the effects of the COVID-19 pandemic. This situation improved considerably in subsequent

# Credit Risk

years as economic activity recovered and various government and bank-led support measures were introduced to assist companies during the period of social restrictions. As a result, problem loans in the tourism sector declined steadily after 2020. As of 2024 however, the increase to problem loans has been predominantly in the construction sector, which is adversely impacted by increased financing and constructions costs, amid a slowdown in the real estate market.

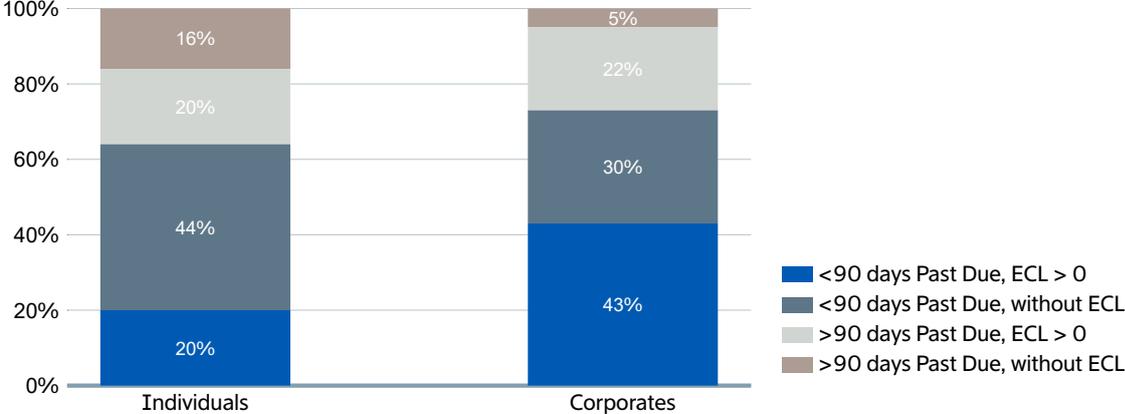
Figure 4.17 Development of problem loans by sector (Group)



In light of this development, the Bank has performed comprehensive stress tests on its exposures to residential real estate development projects. The analysis focuses on two primary variables; discount on sale prices of newly developed units, and time delay in sales resulting in accumulated interest, both of which erode the equity of borrowers. The scenario analysis shows a considerable equity buffer for the vast majority of projects, which can therefore sustain a protracted period of low rates of sales and/or discounts from market prices.

The breakdown of problem loans by status is shown in Figure 4.18. Around 43% of problem loans carry no expected credit loss (ECL) due to acceptable collateral cover.

Figure 4.18 Breakdown of problem loans by status



## Impairment and provisions

Provisions for credit loss are made according to the IFRS9 three-stage expected credit loss model. For credit impaired loans, Stage 3 provisions are made based either on a portfolio level assessment or by individual assessment of credits, depending on the size of the exposure and other factors which affect whether an individual assessment is warranted. For loans that are not impaired, provisions are either made for a 12-month expected credit loss (Stage 1) or a lifetime expected credit loss (Stage 2). Expected credit loss calculations are based on the borrower's probability of default (PD), loss given default (LGD), and the exposure at default (EAD).

For corporate exposures, a cross-default approach is applied, i.e. if a corporate borrower has one impaired credit then all exposures to this borrower are moved to Stage 3 and classified as risk class 5 (DD rating). For individuals, the same applies within each credit model portfolio and a default in one portfolio can result in a default in other portfolios if the defaulting exposure is significant.

The level of detail for credit monitoring depends on the size of the exposure, where factors such as delinquency by the borrower, forbearance measures, and the internal credit rating (see Section 4.5) are considered. For larger borrowers, interviews with account managers are also conducted.

For further information on the measurement of impairment, see Note 59 on Expected credit

# Credit Risk

losses in the Bank's Consolidated Financial Statements for 2025.

## Past due exposures

Figures 4.19 and 4.20 show the development of past due exposures from year-end 2017 for individuals and corporates at facility level and cross-default level. Until 2020 cross-default at obligor level is shown, but since the introduction of a new definition of default, it is more relevant to study exposure in Stage 3. In order to show the effects of this change in perspective, both values are shown for two years. Stage 3 exposures for loans to individuals continued to increase in 2025, but Stage 3 exposures for corporates decreased after a significant increase since 2022.

Figure 4.19 Development of past due exposures to individuals

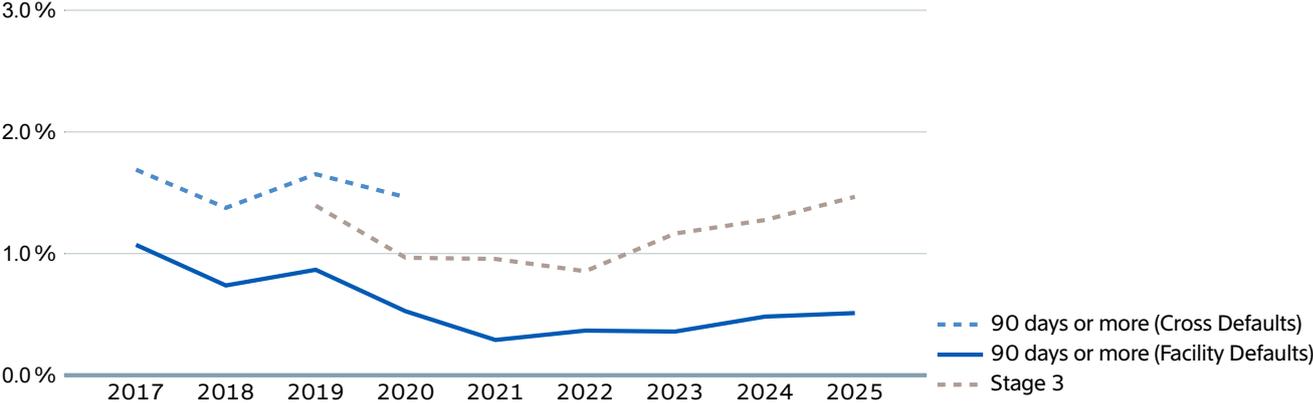
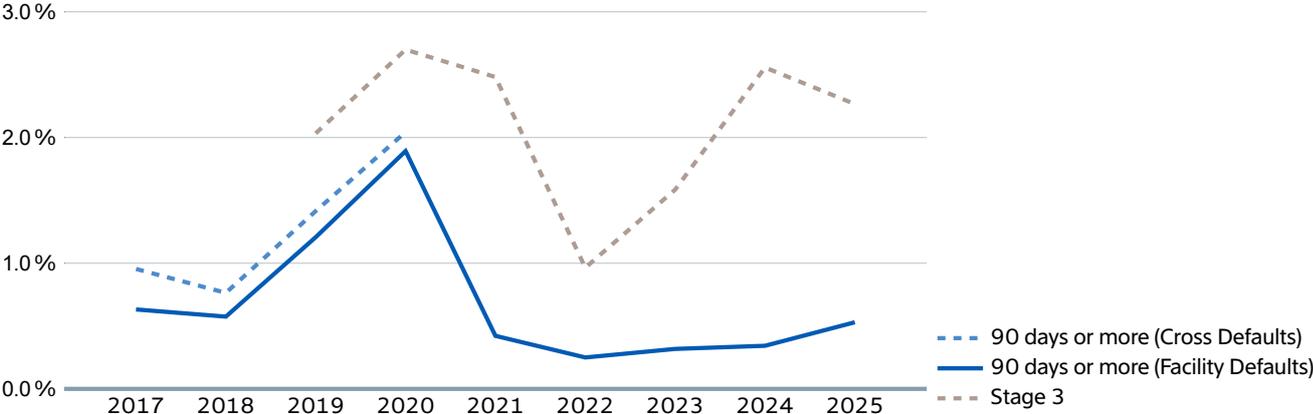


Figure 4.20 Development of past due exposures to companies, parent company



Loans to customers that are 90 days or more past due were 0.52% of the total loan book at year-end 2025 when measured at facility level. The ratio of loans in Stage 3 was 1.9% of book value at the year end 2025, unchanged from year-end 2024. The ratio of loans in Stage 3 was 1.5% for individuals and 2.3% for corporates.

Template EU CQ3 shows credit quality by past due days.

## Moratoria and forbearance

The Bank has adopted the definition of forbearance in Article 47b of the CRR. According to the definition, an exposure is considered forborne if concessions, such as modification of terms or debt refinancing, have been granted due to the client's current or expected financial difficulties and those concessions would not have been granted in the absence of those financial difficulties.

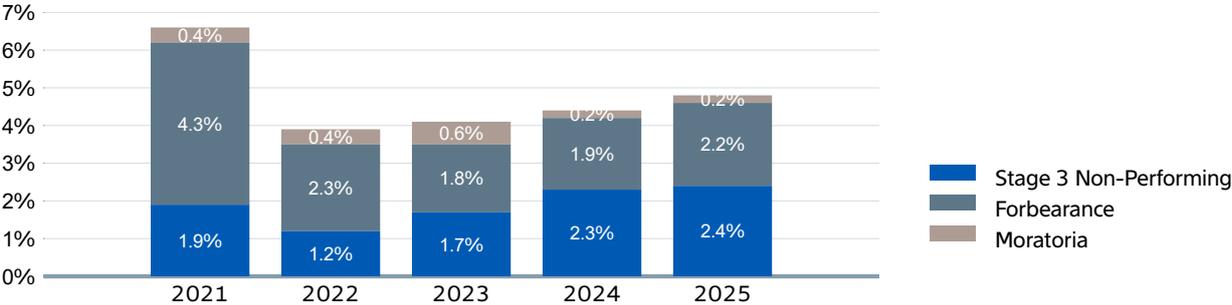
The Bank is willing to consider forbearance measures in situations when a client is unable to comply with terms and conditions due to financial difficulties if there is a realistic possibility that the terms and conditions can be met again. This is especially considered in cases when the Bank and the client have enjoyed a long-standing business relationship.

The decision to apply a forbearance measure is subject to the Bank's credit granting mechanism, as described in Section 4.1, and for potential forbearance cases there is, as a part of the relevant employee's or credit committee's decision, a determination of whether the measure constitutes forbearance.

# Credit Risk

Credit quality of forborne exposures is shown in templates EU CQ1.

Figure 4.21 Development of Default, Forbearance, and Moratoria. Shown as percentage of total gross carrying amount



In Figure 4.21 moratoria due to summer holiday, maternity leave, job loss and moratoria due to volcanic eruptions in Grindavík in the year 2023 are all listed under Moratoria.

The gross carrying amount of Stage 3 exposures increased from 2.3% in 2024 to 2.4% in 2025 and the gross carrying amount of forborne loans increased from 1.9% in 2024 to 2.2% in 2025 mainly due to increase in Transportation and Information and communication technology sectors. The decrease in moratoria from 0.6% in 2023 to 0.2% in 2024 is primarily due to fewer people needing moratoria because of job loss. Additionally, the moratorium related to the events in Grindavík ended in 2024.

For further information, see Note 44 on forbearance in the Bank’s Consolidated Financial Statements for 2025.

## Expected credit loss

The 12-month expected credit loss (ECL) is defined as the amount of credit loss that the Bank expects, on average, over the next twelve months. The Bank accounts for expected credit loss according to the IFRS9 three stage model. In addition, the Bank holds capital to be able to meet unexpected loss.

The Bank has developed an ECL model for IFRS9 calculations. This model is also used for impairment predictions in the annual budget and the pricing of credit where credit spreads take into account the exposure’s expected loss, cost of capital, and operational cost.

Expected credit loss is calculated using the formula  $ECL = PD \cdot LGD \cdot EAD$  where each credit exposure’s ECL is derived from the facility’s probability of default (PD), loss given default (LGD), and the predicted amount of the exposure at default (EAD). For additional information about the estimation of PD see Section 4.5. For impairment calculations, ECL values are calculated in several different scenarios and the impairment is based on the weighted average ECL.

The main components of LGD are:

- ◆ the cure-rate of the exposure, which describes the probability that the customer returns to a non-defaulting status, without a write-off and any loss occurring for the Bank, within 18 months from the default event
- ◆ the collateral gap of the defaulted exposure, with haircuts based on historical evidence and expert judgment
- ◆ assessment of recoveries of defaulted non-collateralized exposures, conditional on non-cure

The main components of EAD are:

- ◆ the expected outstanding amount at a given time based on the repayment schedule
- ◆ the expected prepayment to be made based on historic values

Table 4.8 shows the 12-month Expected Loss rate for different customer and exposure classes for exposures in Stage 1 and Stage 2. The PD and LGD values are weighted by the corresponding exposure, taking off-balance sheet items into account. The ECL values shown are impacted by the IFRS9 macro-economic forecasts.

## Credit Risk

Table 4.8 Expected credit loss by exposure type

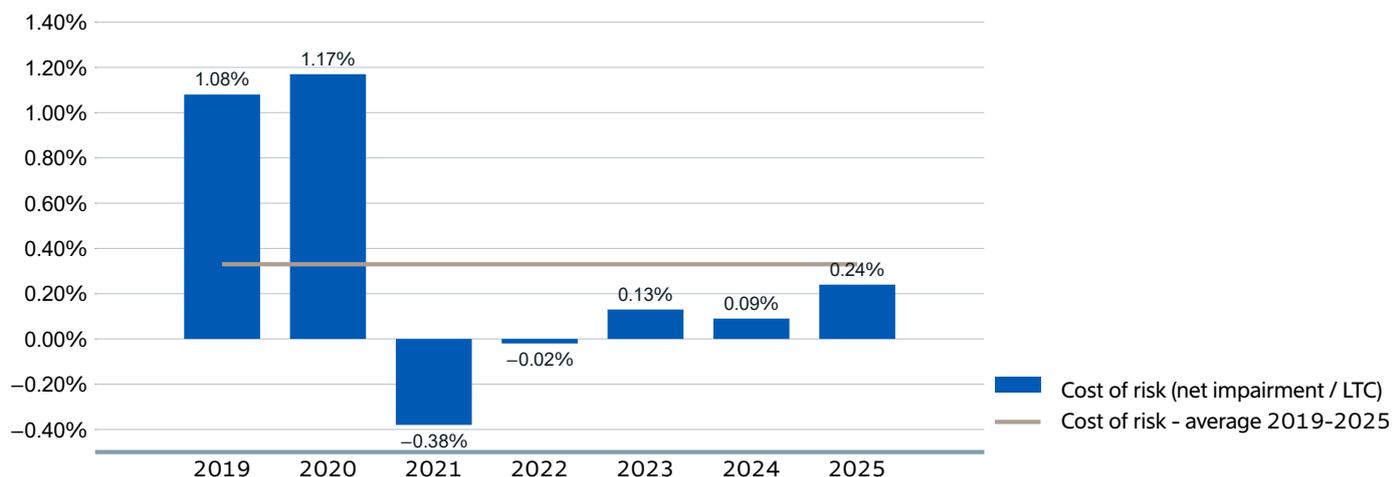
31 December 2025	PD	LGD	EL
Corporates - Large	1.6%	14.8%	42 bps
Corporates - Retail	3.2%	8.9%	63 bps
Corporates - Other	2.1%	22.0%	66 bps
Individuals - Mortgage loans	0.4%	1.7%	5 bps
Individuals - Other	1.2%	35.0%	87 bps
Weighted average	1.3%	10.2%	30 bps

31 December 2024	PD	LGD	EL
Corporates - Large	1.7%	10.1%	39 bps
Corporates - Retail	2.9%	8.8%	59 bps
Corporates - Other	2.5%	20.8%	78 bps
Individuals - Mortgage loans	0.5%	1.8%	5 bps
Individuals - Other	1.3%	32.0%	80 bps
Weighted average	1.3%	8.0%	30 bps

To provide a long-term view on the Bank's credit losses, the so-called cost of risk measure can be calculated. This is defined as the net impairment from the income statement divided by the average book value of loans to customers at the beginning and the end of the year. Since macro-economic forecasts affect the calculation of the impairment under IFRS9, this measure is rather volatile in the short term but such volatility is averaged out over a longer time horizon.

Figure 4.22 shows the development of the cost of risk for the years 2019–2025 for the parent company, along with the average value. The average is 0.33%. The cost of risk measure is shown for the parent company to better reflect historical credit losses, as in some cases the Bank takes over and consolidates a failed company, after which further losses do not go through the Group's net impairment line.

Figure 4.22 Cost of Risk development



### 4.7 Counterparty credit risk and credit valuation adjustment risk

Counterparty credit risk is the risk of the Bank's counterparties in derivative transactions, securities financing transactions, securities lending, or repurchase agreements defaulting before the final settlement of the contracts' cash flows. Credit valuation adjustment risk is the risk that changes in the credit spread of a counterparty in a derivative transaction cause a fair value loss.

The Bank offers financial derivative instruments to investors. Table 4.9 shows derivative trading activities currently permitted. The derivative instruments are classified according to primary risk factor and type of derivative instrument.

# Credit Risk

Table 4.9 Permitted derivative trading activities

Primary risk factor	Swaps	Forwards	Options
Interest rate	✓		
Foreign exchange	✓	✓	✓
Securities		✓	✓
Commodities	✓	✓	✓

To limit and control the counterparty credit risk and credit valuation adjustment risk associated with derivatives trading, the Bank requires collateral and sets limits on customer's total exposure. Generally, collateral is required to cover potential future losses on a contract. Should the net-negative position of the contract fall below a certain level, a call is made for additional collateral. If extra collateral is not supplied within a tightly specified deadline, the contract is closed. The margin-call process is monitored by Risk Management. These exposure limits are generally client-specific and may refer specifically to different categories of contracts. These limits further ensure that the Bank's exposure to wrong-way risk in derivatives contracts is limited.

The Bank would not have to post any additional collateral in the hypothetical scenario that its credit rating was downgraded by one notch.

Note 2.5 in the Bank's Consolidated Financial Statements provides a breakdown of the aggregate underlying notional and fair value by derivative type.

Value changes are made in response to changes in interest rates, exchange rates, security prices, and commodity prices. Counterparty credit risk arising from derivative financial instruments is the combination of the replacement cost of instruments with a positive fair value and the potential for future credit risk exposure. The REA for counterparty credit risk is calculated using the standardized method. This accounts for the replacement cost, potential future exposure, and the credit mitigation from collateral. For further information see e.g. Templates EU CCR3 and EU CCR5 in the Bank's Pillar 3 Additional Disclosures for 2025.

The Bank's exposure to credit valuation adjustment risk is limited and collateral mitigates it further. The Bank therefore does not hedge this risk. Capital requirements for credit valuation adjustment risk are calculated using the basic approach and are shown in Template EU CVA1 in the Bank's Pillar 3 Additional Disclosures for 2025.

# Market Risk

Market risk is defined as the current or prospective risk that changes in financial market prices and rates will cause fluctuations in the value and cash flow of financial instruments.

The risk arises from balance sheet imbalances on the banking book and trading positions in bonds, equities, currencies, derivatives, and any other commitments depending on market prices and rates.

The primary market risk factors are interest rate risk, indexation risk, equity risk and foreign exchange risk.

Risk exposure amount (ISK)

**15.8 bn (15.8 bn)**

Trading book 10-day 99% VaR (ISK)

**519 mn (323 mn)**

Indexation imbalance (ISK)

**204 bn (186 bn)**

## Contents

- 5.1 Governance and policy
- 5.2 Market risk management
- 5.3 Market risk measurement
- 5.4 Capital requirements
- 5.5 Foreign exchange risk
- 5.6 Indexation risk
- 5.7 IRRBB
- 5.8 Trading book

# 5 Market Risk

## 5.1 Governance and policy

The Bank's market risk policy and market risk appetite are established by the Board of Directors and reviewed on an annual basis.

In accordance with the market risk policy, the Bank's CEO has set up a market risk framework, which outlines responsibilities, rules, and limit framework. On the management level, ALCO is the principal authority for management and monitoring of market risk.

According to the policy, the Bank invests its own capital on a limited and carefully selected basis in transactions, underwritings, and other activities that involve market risk. The Bank aims to limit market exposure and imbalances between assets and liabilities in balance with its strategic goals for net profit.

## 5.2 Market risk management

Market risk controls vary between trading and banking (non-trading) books where the trading book holds positions with trading intent, according to the CRR, that are actively managed on a daily basis. The limit framework for the trading book is explicit and subject to daily monitoring, while such a framework does not apply to the banking book due to the nature of the exposure. The banking book market risk exposure is monitored and reported on a monthly basis. The Board of Directors has set limits on various market risk exposures in the Bank's risk appetite statement.

Table 5.1 Sources of market risk

Origin	Source	Risk Management
Trading Book	Positions held for market making and proprietary trading purposes. Trading derivatives and associated hedge positions managed within Treasury and Capital Markets.	Risk appetite portfolio limits and value-at-risk limits. Specific position limits and hedging requirements. Daily monitoring and ALCO oversight.
Banking Book	Balance sheet imbalances, e.g. mismatches between assets and liabilities in terms of currency denomination, indexation, and term fixing of interest rates.	Risk appetite limits. Internal pricing, natural hedging, derivatives hedging. Monthly monitoring and ALCO oversight.

Risk Management is responsible for measuring and monitoring market risk exposure and compliance with the limit framework. The performance, exposure, and relevant risk measures for the trading book are summarized and reported to the relevant employees and managing directors on a daily basis. Exposures and relevant risk measures are reported on a regular basis to ALCO, BRIC, and the Board of Directors.

## 5.3 Market risk measurement

Market risk exposure and price fluctuations in markets are measured on an end-of-day basis. The Bank uses various risk measures to calculate market risk exposure, see Table 5.2.

Table 5.2 Market risk measurement methods

Market risk type	Measurement methods
Equity risk	Exposure to equity is measured with net and gross positions. VaR and stress tests are used to assess risk of loss under current and severe circumstances. Indirect positions are also monitored, e.g. equity collateral.
Interest rate and indexation risk	Interest rate and indexation risk is quantified as the change in fair value and/or variability in net interest income, after simulating changes to yield curves and CPI. This is done for all positions sensitive to interest rates. Prepayment risk and behavioral duration of non-maturing deposits is reflected in the Bank's models.
Foreign exchange risk	Foreign exchange risk is quantified using the net balance of assets and liabilities in each currency. This includes current positions, forward positions, delta positions in FX derivatives, and the market value of derivatives in foreign currency. The VaR method is used to quantify possible losses.

# Market Risk

## 5.4 Capital requirements

The Bank's capital requirements for market risk under Pillar 1 are calculated using the standardized method as defined in CRR. They are summarized in template EU-MR1.

Table 5.3 Market risk minimum capital requirement

31 December 2025 [ISK m]	REA	Capital requirement
Outright products		
Interest rate risk (general and specific)	6,183	495
Equity risk (general and specific)	7,333	587
Foreign exchange risk	2,309	185
Commodity risk		
Options (non-delta)		
Securitization (specific risk)		
<b>Total</b>	<b>15,825</b>	<b>1,266</b>

As part of the ICAAP, the Bank considers various market risk factors where the Pillar 1 capital requirement may not be sufficient. Additional capital may be needed for foreign exchange risk, interest rate risk in the banking book which includes indexation risk, and the risk that a prolonged stressed period leads to losses from trading book activities.

## 5.5 Foreign exchange risk

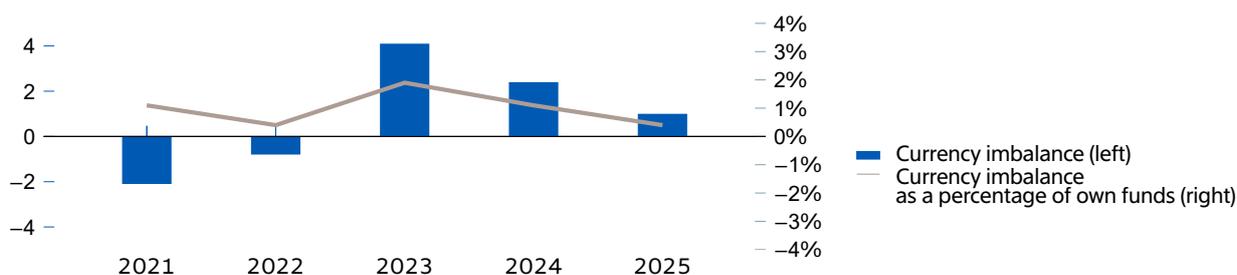
Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to currency risk due to imbalances between assets and liabilities for different currencies.

Table 5.4 Net position of assets and liabilities by currency and Value-at-Risk results

Foreign currency [ISK m]	Net Exposure	10 day 99%VaR
EUR	2,015	39
USD	-148	6
DKK	-558	11
SEK	-551	19
Other	242	9
Diversification	-	-60
<b>Total</b>	<b>1,000</b>	<b>24</b>

At year-end 2025, the Group's currency imbalance was 0.4% of total own funds. According to the Central Bank's rules No. 784/2018, the currency imbalance may not exceed 10% of total own funds or ISK 25bn, whichever is lower.

Figure 5.1 Development of the Bank's Currency imbalance [ISK bn]



## 5.6 Indexation risk

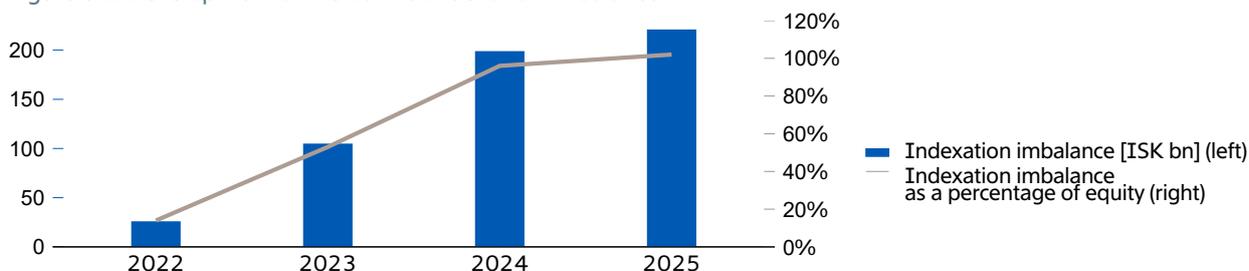
Indexation risk is defined as the risk of loss in earnings due to movements in the Consumer Price

## Market Risk

Index (CPI), i.e. inflation or deflation. A considerable part of the Bank's balance sheet consists of indexed assets and liabilities, whose nominal value is adjusted monthly in proportion to changes in the CPI. This risk factor should not be mistaken for inflation risk which represents the risk of loss in real value due to inflation.

At year-end 2025, the total amount of inflation-linked assets was ISK 540.6 billion and the total amount of inflation-linked liabilities was ISK 319.8 billion. Therefore, the net inflation-linked imbalance was ISK 220.8 billion.

Figure 5.2 Development of the Bank's Indexation imbalance



The indexation imbalance of the Bank's consolidated situation, which excludes insurance operations, and is the scope of prudential requirements for which these disclosures apply, was ISK 204.7 billion at year-end 2025.

It is important to consider the mechanism by which indexation imbalance can lead to losses for the Bank. The difference between the nominal interest rate and real interest rate yield curves represents the market's expectation of future inflation. This risk embedded in a positive indexation imbalance is that if the CPI increases less than the market expects then net interest income will be less than expected. This is because adjustments in the nominal of inflation-linked assets and liabilities are booked as interest income or expense. In the opposite direction, for a negative indexation imbalance, the risk would be that the CPI increases more than expected. This risk is therefore a manifestation of basis risk.

The duration of the assets and liabilities is also a very important factor in assessing the risk. If the duration is short then the risk is limited as short-term forecasts of the CPI are quite accurate. The risk is even fully eliminated for the shortest duration as the CPI value used for the adjustment is published before the start of the month for which it has effect. For longer duration, the imbalance represents an actual risk.

The risk stemming from the indexation imbalance is thus due to the interplay between yield curves and inflation. Because of this coupling, the Bank measures its capital requirements due to indexation risk in conjunction with interest rate risk.

### 5.7 Interest rate risk in the banking book

Interest rate risk is the risk of loss through changes in fair value or net interest income caused by changing interest rates. The Bank's balance sheet is subject to a mismatch between interest-bearing assets and interest-bearing liabilities, characterized by a gap in interest-fixing periods.

The Bank's strategy for managing interest rate risk is to strive for a balance in the interest-fixing profile between assets and liabilities.

The Bank's interest rate risk for foreign currencies is limited as foreign-denominated assets predominantly have short fixing periods and the Bank generally applies cash flow hedging for its foreign-denominated fixed-rate borrowings. For domestic rates, longer fixing periods are more common.

# Market Risk

Figure 5.3 Development of the Central Bank of Iceland benchmark rate and yields of sovereign bonds

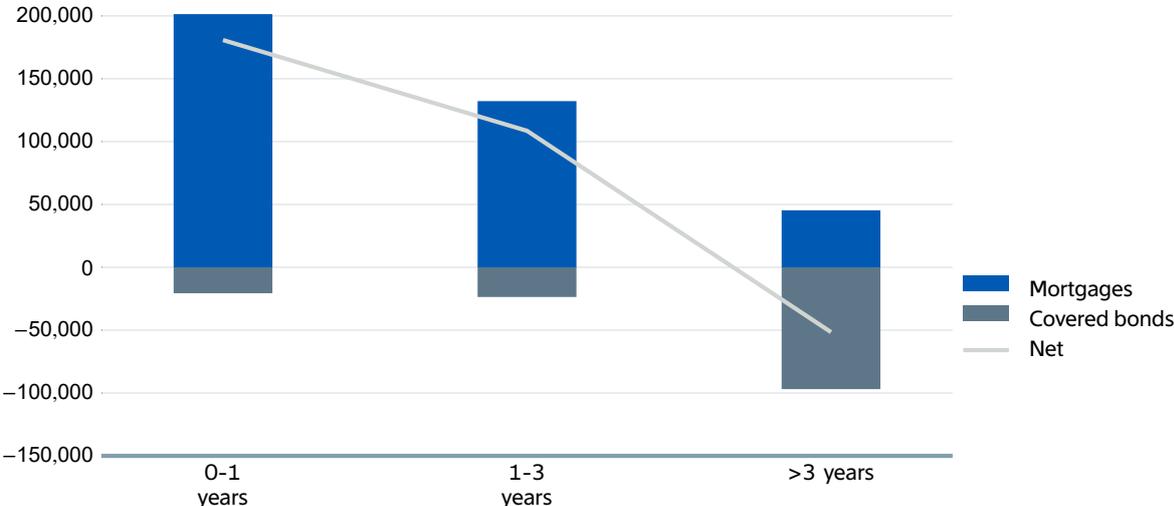


The Central Bank policy rate remains high at 7.25% and inflation concerns have not subsided as quickly as expected. Thus, the payment burden remains heavy for non-indexed floating-rate loans. Consequently, demand for indexed loans remained high in 2025 as these offer lower monthly payments.

In Q4 2025, the Icelandic Supreme Court ruled on several cases concerning variable interest rates on residential mortgage loans to consumers. The Court held that banks could not rely on broadly worded or discretionary clauses to change variable interest rates. However, in the case regarding a mortgage loan with Arion bank, the Court found no issue with the wording of the contract. In response to the broader litigation risk, Arion revised their mortgage contracts and currently offers only fixed-rate mortgages. For non-indexed loans, the mortgage reverts to a floating rate after the fixed period, with a high interest premium which reflects future uncertainty where the possibility of tail events cannot be excluded. Unless these tail events materialize, it is likely that borrowers will be able to refinance the loans at better rates when the fixing period ends. A similar structure applies to indexed loans, which roll into a new fixed-rate period for the remainder of the loan term at comparatively high interest rates. Further rulings in cases covering indexed and non-indexed loans granted under different legal regimes are still pending, and their outcomes are expected to further clarify the legality of interest rate clauses across Iceland’s mortgage market.

For a breakdown of the Bank’s interest-bearing assets and liabilities by interest-fixing periods, see Note 45 of the Consolidated Financial Statements.

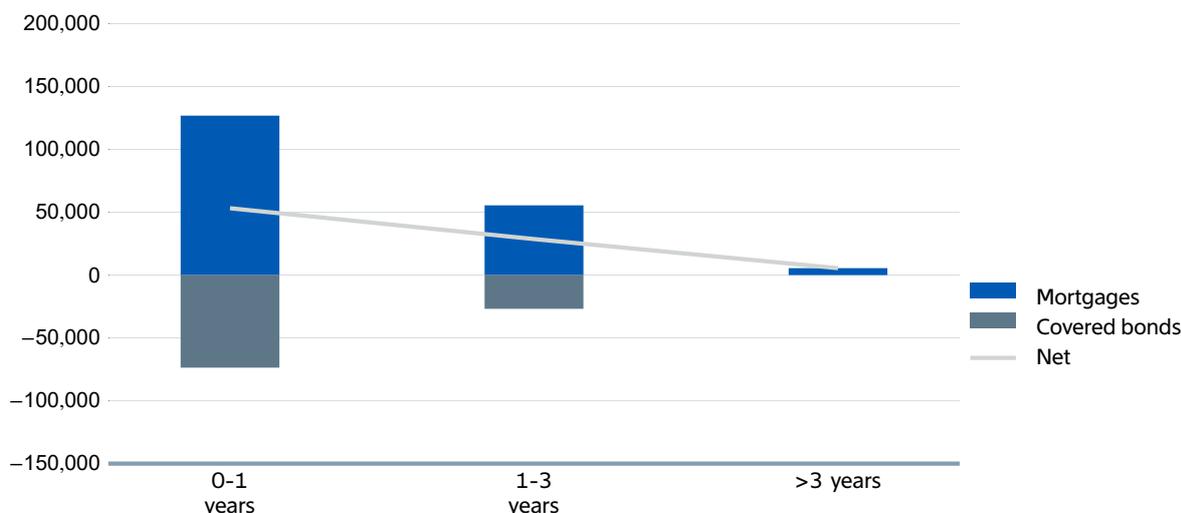
Figure 5.4 Interest fixing profile of the Bank’s indexed mortgages and covered bonds [ISK m]



Figures 5.4 to 5.5 show the Bank’s interest fixing profile for the Bank’s mortgages to individuals and covered bonds, indexed and non-indexed.

## Market Risk

Figure 5.5 Interest fixing profile of the Bank's non-indexed mortgages and covered bonds [ISK m]



The fair value sensitivity of interest-bearing assets and liabilities in the banking book for different yield curve shifts is shown in Table 5.5. The risk is asymmetric as the Bank applies its prepayment models in the fair value calculations, taking into account the prepayment likelihood of loans and matched liabilities and the expected behavior of non-maturing deposits. For non-maturing deposits, the longest repricing maturity is 3 years and the average repricing maturity of core non-maturing deposits is 1.5 years. Note that the Bank's book value is not affected in the same way as the fair value. Fixed-rate loans rose in response to the low interest rates observed in 2020 and 2021. However, with the sharp increase in interest rates in 2022 and 2023, the Bank has become increasingly mindful of the sensitivity to fair value changes.

Table 5.5 Sensitivity of the fair value of interest bearing assets and liabilities in the banking book by interest rate base

31 December [ISK m]	2025		2024	
	-100bps	+100bps	-100bps	+100bps
ISK, CPI index-linked	-1,781	1,728	-1,724	1,652
ISK, Non index-linked	638	-610	-2,191	2,156
Foreign currencies	45	-35	-230	197

In Regulation (EU) 2024/856, six supervisory shock scenarios are defined for changes in interest rates. These are called parallel up, parallel down, flattener, steepener, short rates up, and short rates down. Template EU-IRRBB1 shows the effect these shocks would have on the net fair value of the Bank's assets and liabilities and the Bank's net interest income should they occur. The abovementioned regulation, together with Regulation (EU) 2024/857 on the IRRBB standardized approach, will form the basis for the SREP assessment for IRRBB.

The capital assessment for interest rate risk in the banking book for domestic rates is calculated through simulations of nominal and real yield curve movements and the value of the CPI. The dynamics between interest rates and the CPI are calibrated to historical data and economic fundamentals. Significant diversification is observed due to the relationship between inflation and nominal rates. Prepayment rates are dynamic in the model as changing interest rates affect customers' repayment spreads. Economic capital is the 1% worst loss due to fair value losses or loss to net interest income. For foreign currencies, the Bank applies a 200bps interest rate shock.

### 5.8 Trading book

The trading book is defined as the Bank's positions held with trading intent, which includes market making and proprietary trading positions as well as non-strategic derivatives positions and associated hedge positions. The purpose of strategic derivatives is to reduce imbalances on the balance sheet and hedge against market risk. Non-strategic derivatives are offered to the Bank's customers to meet their investment and risk management needs. Financial instruments in the trading book are exposed to price risk, i.e. the risk of possible losses from adverse movement in

## Market Risk

the market prices at which securities in the Bank's possession are valued.

### Market Making and Proprietary Trading

Securities positions in relation to the Bank's market making and proprietary trading activities are shown in Table 5.6.

Table 5.6 Positions within the Bank's market making activities and proprietary trading

31 December [ISK m]	2025	2024
Bonds	10,166	9,642
Equity	3,634	3,737
<b>Total</b>	<b>13,800</b>	<b>13,379</b>

Market making and proprietary trading are subject to a limit framework where possible breaches are monitored daily and reported to relevant parties such as the CEO, CRO, relevant MD, and trader. The Bank's trading exposure varies from day to day and the following table shows the end of year exposure along with the 2025 average and maximum exposure in both equity and bonds.

Table 5.7 The Bank's proprietary trading exposure

31 December 2025 [ISK m]	Bonds		
	Long	Short	Net
Year-end	3,634	-	3,634
Average	4,184	-11	4,173
Maximum	5,093	-125	5,044

31 December 2025 [ISK m]	Equity		
	Long	Short	Net
Year-end	10,166	-	10,166
Average	10,925	-40	10,885
Maximum	14,993	-373	14,993

### Trading derivatives

The Bank's derivative operation is twofold: a) a trading operation where the Bank offers a variety of derivatives to customers to meet their investment and risk management needs and b) a strategic operation where the Bank uses derivatives to hedge various imbalances on its own balance sheet in order to reduce risk such as currency risk.

Trading derivatives are subject to a rigid limit framework where exposure limits are set per customer, per security, per interest rate etc. Forward contracts on securities are traded within Capital Markets and bear no direct market risk since they are fully hedged. Commodity swap agreements are also fully hedged. Derivatives for which the Bank takes on market risk are traded within Treasury and are subject to interest rate limits per currency and an open delta position limit for each underlying security.

Table 5.8 Derivatives on the trading book

31 December 2025 [ISK m]	No. of contracts	Assets	Liabilities	Net	Underlying positions	Main risk factor
Forward exchange rate agreements	113	210	-34	175	17,999	Market risk
Interest rate and exchange rate agreements	3	224	-16	208	4,200	Market risk
Bond forward	20	70	-5	66	2,103	Credit risk
Equity forward	527	4,747	-769	3,978	18,035	Credit risk
Commodity swap agreements	-	-	-	-	-	Credit risk
Options	-	-	-	-	-	Market risk
<b>Total</b>	<b>663</b>	<b>5,251</b>	<b>-824</b>	<b>4,427</b>		

## Market Risk

31 December 2024 [ISK m]	No. of contracts	Assets	Liabilities	Net	Underlying positions	Main risk factor
Forward exchange rate agreements	89	130	-482	-352	20,315	Market risk
Interest rate and exchange rate agreements	2	-	-50	-50	160	Market risk
Bond forward	28	87	-2	85	3,523	Credit risk
Equity forward	647	2,596	-2,018	578	20,877	Credit risk
Commodity swap agreements	-	-	-	-	-	Credit risk
Options	-	-	-	-	-	Market risk
<b>Total</b>	<b>766</b>	<b>2,813</b>	<b>-2,551</b>	<b>262</b>		

Counterparty credit risk is the risk of the Bank's counterparty in a derivative contract defaulting before final settlement of the derivative contract's cash flows. This risk is addressed in section 4.7.

### Trading book risk

The trading book's profit or loss is calculated daily. Table 5.9 shows the 10-day 99% Value-at-Risk for the trading book position at the end of 2025, based on historical data collected over the previous 250 business days. The risk of loss is calculated for each instrument and portfolio within the trading book, as well as for the aggregate portfolio. Loss due to currency risk is not taken into account in the loss distribution as it is addressed in the Bank's VaR calculations for currency risk which covers both the banking book and the trading book.

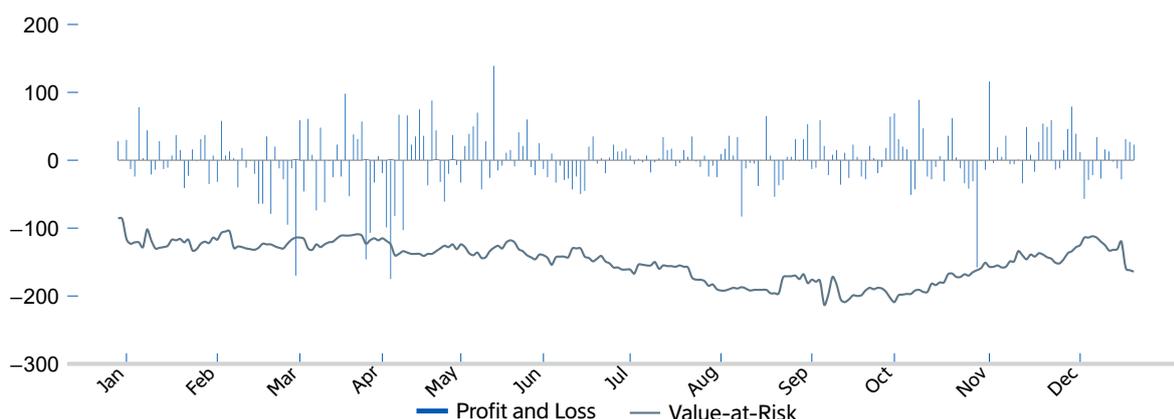
Table 5.9 Value-at-Risk for the trading book with a 99 percent confidence level over a 10-day horizon

31 December 2025 [ISK m]	10 day 99%VaR
Equities	354
Equity options	-
Bonds	236
Bond options	-
Interest rate swaps	182
Diversification effect	-253
<b>Trading book total</b>	<b>519</b>

According to the result, there is 1% likelihood of loss in the trading book that exceeds ISK 519 million over a 10-day period.

Figure 5.6 further shows the daily profit and loss of the Bank's trading book for 2025 along with the evolution of its one-day 1% Value-at-Risk. The trading book's loss exceeded the VaR three times during the 250 business days, but exceeding 2.5 times is to be expected by the risk measure. These three days were during a period of heightened geopolitical uncertainty and market volatility due primarily to US tariff announcements.

Figure 5.6 Backtesting of the Bank's one-day 99 percent Value-at-Risk for 2025 [ISK m]



# Liquidity Risk

Liquidity risk is the current or prospective risk that the Bank, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can only secure them at excessive cost.

Liquidity risk arises from the inability to manage unplanned changes or loss of funding sources. An important source of funding for the Bank is deposits from individuals, corporations, and institutional investors. As the maturity of loans generally exceeds the maturity of deposits, the Bank is exposed to liquidity risk.

Liquidity Coverage Ratio

**199% (181%)**

Net Stable Funding Ratio

**118% (118%)**

Asset Encumbrance Ratio

**17% (20%)**

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6.1 Governance and policy

6.2 Liquidity risk management

6.3 Liquidity and funding risk measurement

6.4 Liquidity position

6.5 Funding

# 6 Liquidity Risk

## 6.1 Governance and policy

The Bank's liquidity and funding policy and related risk appetite statements are established by the Board of Directors and reviewed annually.

In accordance with the liquidity and funding policy, the Bank's CEO has set up a liquidity and funding framework, which outlines responsibilities, strategy, and methods in relation to the Bank's management of liquidity and funding risk. On the management level, ALCO is the principal authority for management and monitoring of liquidity and funding.

According to the liquidity and funding policy, the Bank follows a conservative approach to liquidity exposure, liquidity pricing, and funding requirements. The Bank maintains a sufficient level of liquid assets to meet expected and unexpected cash flows and collateral needs without adverse financial impact on the Bank. The Bank shall have a funding profile that supports its liquidity profile and allows the Bank to withstand extended periods of stress without reliance on volatile funding or external support. The Bank manages its asset and liability mismatches, seeks a balanced maturity profile, and diversifies its funding between deposits and wholesale funding.

## 6.2 Liquidity risk management

Liquidity risk is a key risk factor for the Bank and is managed accordingly. The Bank's liquidity risk is managed by Treasury on a day-to-day basis and monitored by Risk Management. Treasury provides all divisions with funds for their activities in exchange for an internal interest charge. A small part of the Group's total liquidity risk is due to subsidiaries.

The ALCO is responsible for liquidity management conforming to the policies and risk appetite set by the Board. The committee meets at least monthly to review liquidity reports and make strategic decisions on liquidity and funding matters.

Liquidity risk is controlled by limit management and monitoring. Active management of liquidity is only possible with proper monitoring capabilities. An internal liquidity report is issued daily for Treasury and Risk Management staff and at ALCO meetings monthly, liquidity and funding ratios are reported as well as information on deposit development and withdrawals, secured liquidity, stress tests, recovery indicators, and any relevant information or risk management concern regarding liquidity and funding risk.

Legal requirements on liquidity risk management are laid out in Article 78h of Act No. 161/2002 on Financial Undertakings. For best practice liquidity risk management, the Bank additionally looks to the Principles for Sound Liquidity Risk Management and Supervision, issued by the Basel Committee in 2008. Complementing these principles are the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) measures as defined in CRR and Regulation (EU) 2015/61 which are key inputs into the Bank's approach to liquidity and funding risk management and discussed in more detail below.

### Internal Liquidity Adequacy Assessment Process

In conjunction with the ICAAP, see Section 3.3, the Bank runs the Internal Liquidity Adequacy Assessment Process (ILAAP) with the purpose of assessing the Bank's liquidity position. The ILAAP is carried out in accordance with the Act on Financial Undertakings with the aim to ensure that the Bank has in place sufficient risk management processes and systems to identify, measure, and manage the Bank's liquidity risk.

The Bank's ILAAP report is approved annually by the Board of Directors, the CEO, and CRO, and submitted to the FSA. The FSA reviews the Bank's ILAAP report as part of the SREP.

### Contingency plan for liquidity shortage

The Bank monitors its liquidity position and funding strategies on an on-going basis, but recognizes that unexpected events, economic or market conditions, earning problems, or situations beyond its control could cause either a short or long-term liquidity crisis.

The Bank's Contingency Plan for Liquidity Shortage is continuously active and the contingency level is reviewed at ALCO meetings monthly, based on various analyses and stress tests. ALCO re-

## Liquidity Risk

views a liquidity risk report from Risk Management and receives projections on sources of funding and the use of funds from Treasury.

The contingency plan is linked to the Bank's Recovery Plan which is triggered if recovery indicators indicate a possible recovery situation. In adverse circumstances, the Bank's emergency team takes over control from ALCO.

### 6.3 Liquidity and funding risk measurement

In December 2010, the Basel Committee on Banking Supervision issued Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring. The framework introduced two new liquidity measures, the LCR and the NSFR, designed to coordinate and standardize liquidity risk measurements between banks.

LCR matches high quality liquid assets against estimated net outflow under stressed conditions over a period of 30 days. Different outflow weights are applied to each deposit category and the measure is thus dependent on the stickiness of each bank's deposit base. The ratio is therefore comparable throughout the banking sector. The LCR is the Bank's key risk indicator for short-term liquidity.

While the focus of LCR is on short term liquidity, the NSFR is aimed at requiring banks to maintain an overall stable funding profile. In the context of NSFR, funding with maturity greater than one year is considered stable. Different weights are applied to funding with shorter maturities depending on the type of funding. The aggregated weighted amounts are defined as the Available Stable Funding (ASF). Similarly, on-balance and off-balance sheet items on the asset side are weighted differently, depending on their liquidity and maturity, to form a bank's Required Stable Funding (RSF) under NSFR. The ratio of the two gives the NSFR.

According to the Central Bank's Liquidity Coverage Requirements for Financial Institutions, effective 1 January 2023, the Bank must maintain a minimum Liquidity Coverage Ratio (LCR) Total of 100% and a minimum LCR in ISK of 50%. Additionally, there are specific requirements regarding the LCR in EUR whereby the Bank must maintain a minimum LCR EUR of 80% if its liabilities in EUR constitute 10% or more of its overall liabilities.

The Bank is required to maintain a minimum of 100% for NSFR in total and to monitor the NSFR in significant currencies, i.e currencies having at least 5% share of the their total liabilities.

In addition to these regulatory requirements, the Bank monitors and reports its LCR for currencies for which aggregate liabilities exceed 5% of its total liabilities. The Bank reports the LCR on a monthly basis and the NSFR on a quarterly basis to the Central Bank of Iceland.

In addition to using LCR and NSFR for liquidity and funding measurement, the Bank performs various analyses, including liquidity survival horizons and stress tests in relation to the concentration of deposits.

### 6.4 Liquidity position

At year-end 2025, the Bank's liquidity buffer amounted to ISK 302,657 million, or 17% of total assets and 33% of total deposits. Composition of the Bank's liquidity buffer is shown in Note 46 of the Bank's Consolidated Financial Statements.

The Bank's strong liquidity position was reflected in high Liquidity Coverage Ratio (LCR) values, 199%, 288%, and 166% for total, EUR, and ISK, respectively.

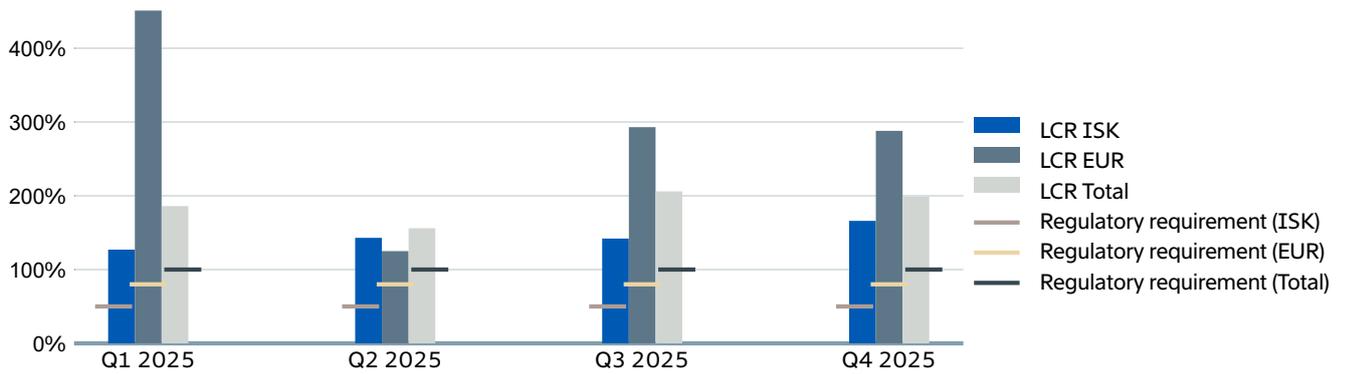
Table 6.1 Liquidity Coverage Ratio

31 December 2025	ISK	EUR	Total
Liquidity Coverage Ratio	166%	288%	199%
LCR Central Bank requirements	50%	80%	100%

The Bank maintained a strong liquidity position throughout 2025, in ISK, EUR, and in total, with an LCR well above the regulatory minimums. The development of LCR ISK, LCR EUR, and LCR Total is shown in Figure 6.1. Standardized disclosure on the calculation of the LCR are provided in template EU LIQ1.

# Liquidity Risk

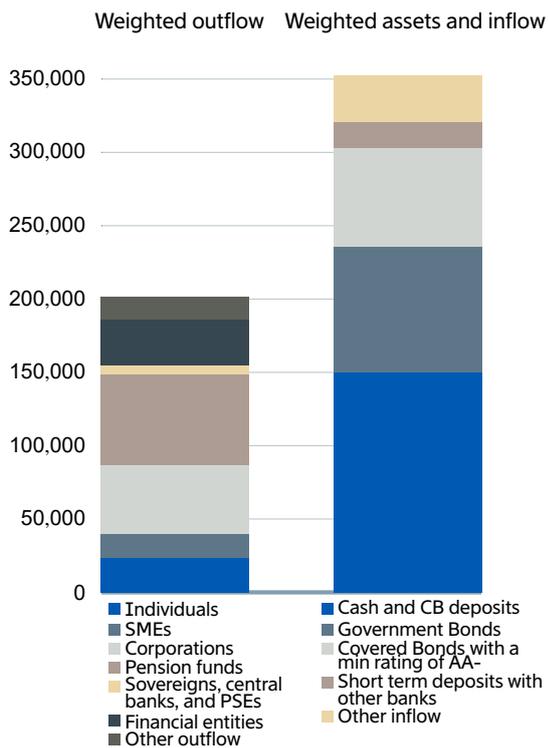
Figure 6.1 Development of the Bank's LCR



## Breakdown of LCR

At 31 December 2025, under the LCR stressed scenario, the Bank's weighted assets and inflows amount to ISK 352.6 billion, substantially exceeding the weighted outflow of ISK 201.9 billion. Of the total stressed outflow, ISK 185.9 billion are due to deposits which are further analyzed in the following section. Figure 6.2 further shows the contribution of the Bank's main components to the LCR's weighted outflows, inflows, and assets.

Figure 6.2 Weighted outflow, inflow, and assets under LCR's stressed scenario as of 31 December 2025 [ISK m]



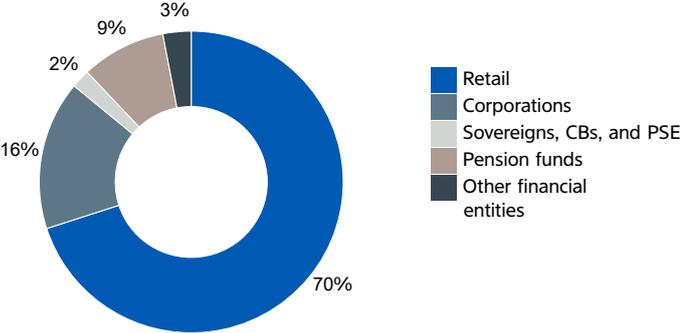
## Deposit categories

As per the LCR methodology, the Bank's deposit base is categorized based on the type of deposit holders. Deposits are also classified as stable or less stable based on business relations and insurance scheme coverage. Each category is given an expected outflow weight based on stickiness, i.e. the likelihood of withdrawal under stressed conditions.

At year-end 2025, 70% of the Bank's deposit base is due to retail clients. Figure 6.3 shows the distribution of the Bank's deposit base.

# Liquidity Risk

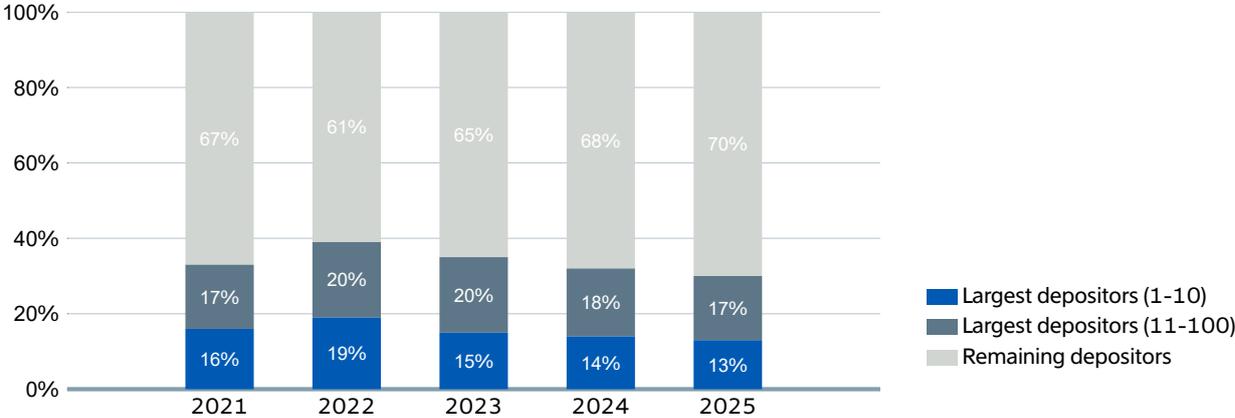
Figure 6.3 Distribution of deposits by LCR category at year-end 2025



## Concentration of deposits

At year-end 2025, 70% of the Bank’s deposits mature within 30 days. Of those, 13% belonged to the 10 largest depositors as shown in Figure 6.4.

Figure 6.4 Concentration of deposits on demand within 30 days



## 6.5 Funding

Over the past few years, the Bank has taken significant steps to diversify its funding options, issuing green bonds in EUR and ISK, covered bonds in euros, as well as unsecured and subordinated bonds in the domestic market. The Bank pursues prudent funding and liquidity management strategies which is reflected in the Bank’s strong liquidity ratios and steady maturities of long-term debt over the next few years.

In January 2025, the Bank issued floating rate bonds in the amount of NOK 350 million and SEK 250 million with a 3-year maturity. The bonds were priced at a spread of 111 bps over 3-month NIBOR and 113bp over 3-month STIBOR. At the end of January, the Bank issued senior preferred bonds in the amount of USD 27.5 million. The bonds were sold at a yield of 5.547% with a final maturity on 25 July 2028.

In February, the Bank issued EUR 300 million senior preferred notes with a 5-year maturity. The notes pay a coupon of 3.625% which corresponded to a spread of 130 bps over mid-swaps in EUR. The deal was more than 4 times oversubscribed with orders received from more than 140 investors. The final order book stood at around EUR 1.3 billion.

In June, the Bank issued senior preferred bonds amounting to NOK 600 million and SEK 900 million. The bonds have a maturity of 2.5 years and were priced at a spread of 117 bps over 3-month NIBOR and 120 bps over 3-month STIBOR. The issue was launched off Arion’s Sustainable Financing Framework.

In August, the Bank issued EUR 300 million senior preferred notes with a 6-year maturity. The notes pay a coupon of 3.50% which corresponded to a spread of 120 bps over mid-swaps in EUR. The deal was close to five times oversubscribed, with orders received from 105 investors spanning more than 20 countries across EMEA and APAC. The final order book stood at more than EUR 1.45 billion.

# Liquidity Risk

In the domestic market, the Bank continued to issue senior preferred bonds in the series ARION 28 1215, issuing ISK 4.86 billion at the beginning of January. The total size of the series is currently ISK 16.9 billion. The series is inflation-linked and has semi-annual interest payments, maturing on 15 December 2028.

In June, the Bank issued a new series of Tier 2 subordinated bonds. The total issue amounted to ISK 10 billion at yields of 5.09%. The series is inflation-linked and pays interest twice a year. The series matures in December 2036 and can be called by the issuer in December 2031 and on every subsequent interest due date.

The Bank continued to issue covered bonds secured in accordance with the Covered Bond Act No. 11/2008. In 2025, the Bank issued bonds amounting to ISK 18.5 billion (of which ISK 960 million were for own use).

Arion Bank renewed its agreement with Kvika, Íslandsbanki, and Landsbankinn on market making for covered bonds issued by Arion Bank on Nasdaq Iceland. The purpose of the agreement is to stimulate trading of benchmark covered bonds issued by the Bank.

Moody's Investors Service (Moody's) affirmed the Bank's A3 rating for senior unsecured debt and its rating for covered bonds Aa1 during the year.

Despite progress in diversifying the Bank's funding sources and extending the maturity profile, the deposit base continues to be an important funding source and the focal point of liquidity risk management. The ratio of loans to deposits was 144% as at year-end 2025. The ratio of wholesale funding over tangible assets was 25% as refinanced borrowings had not yet been repurchased, leading to an element of double counting in the calculation of the metric.

Figure 6.5 Development of wholesale funding over tangible assets

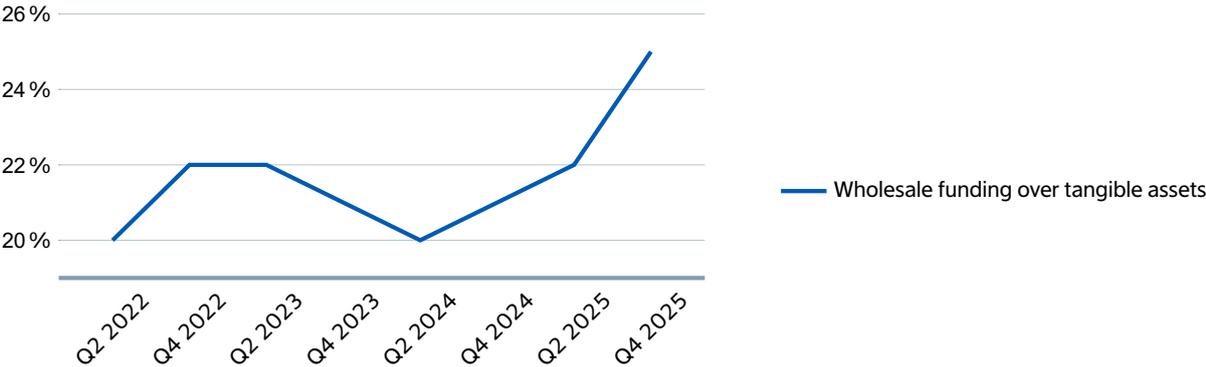
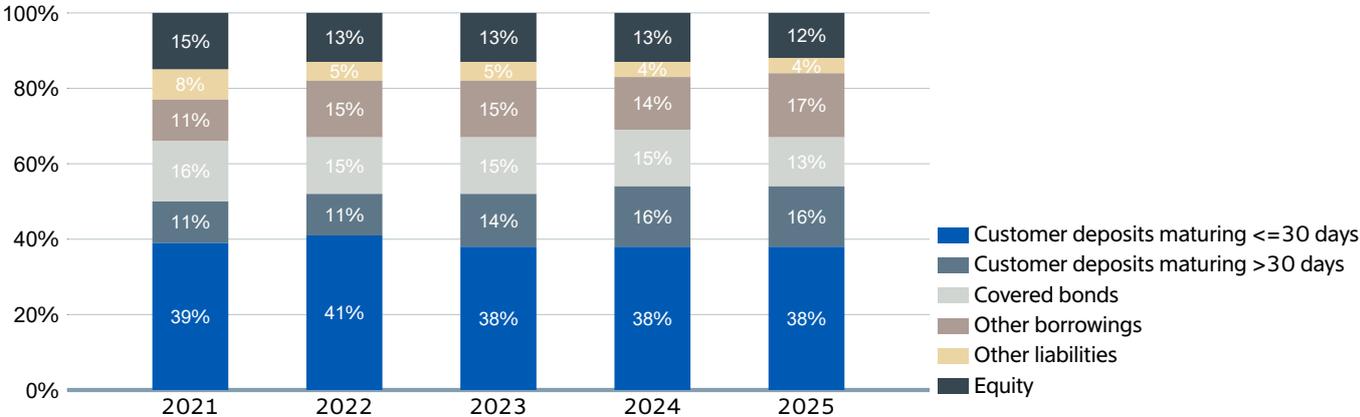


Figure 6.6 shows the development of the Bank's funding profile.

Figure 6.6 Development of funding by type

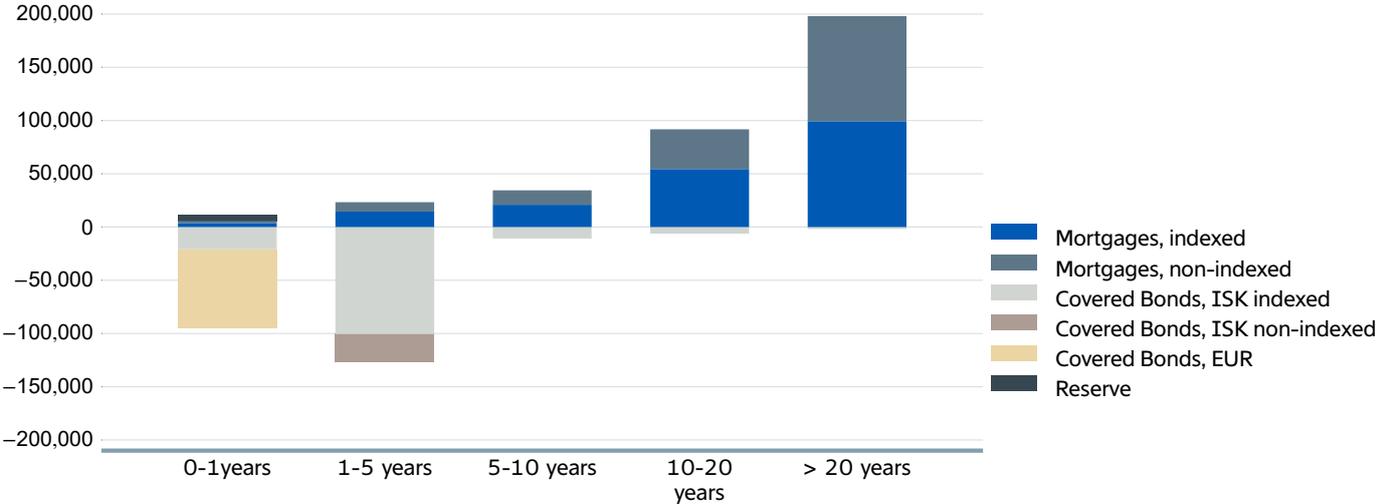


## Secured borrowings

At year-end 2025, the Bank had an outstanding amount of covered bonds totalling ISK 238 billion. Figure 6.7 shows the contractual payment profile of the Bank's covered bonds and corresponding pledged mortgages. Note that the behavioral maturity of mortgages is generally much shorter than the contractual maturity.

# Liquidity Risk

Figure 6.7 Contractual cashflow profile of covered bonds and corresponding pledged mortgages [ISK m]



The Bank’s asset encumbrance ratio, the ratio of pledged assets to total assets, was 17% at year-end 2025. The development of the asset encumbrance ratio is shown in Table 6.2.

Table 6.2 Development of the Bank’s asset encumbrance ratio

31 December	2025	2024	2023
Asset encumbrance ratio	17%	20%	21%

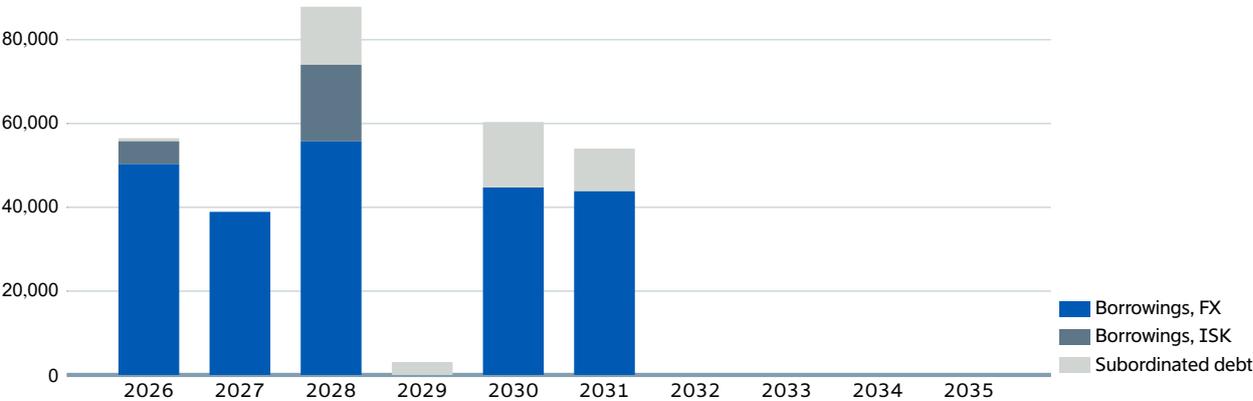
Templates EU AE1, EU AE2, and EU AE3 provide details on encumbered and unencumbered assets and collateral received.

## Unsecured borrowings

Unsecured borrowings are mostly foreign currency-denominated. Figure 6.8 shows the Bank’s maturity profile of borrowings other than covered bonds, and includes AT1 instruments. AT1 and Tier 2 capital instruments are shown at the earliest callable date.

As the Bank’s foreign currency deposits are effectively entirely covered by liquid assets, these other FX liabilities are a source of funding for loans to customers in foreign currency. The maturity of those liabilities is greater than that of the loans, so there is low maturity gap risk for the Bank’s foreign currency position.

Figure 6.8 Maturity profile of borrowings, other than covered bonds [ISK m]



# Liquidity Risk

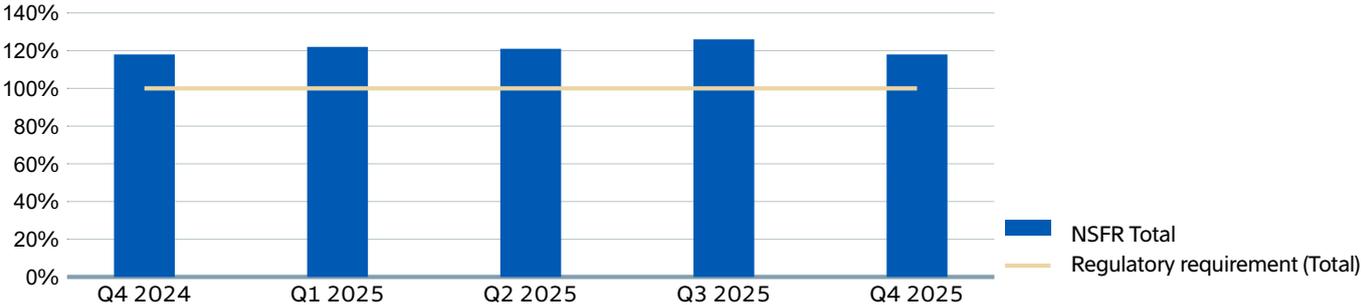
## NSFR

The Bank's Net Stable Funding Ratio in all currencies (NSFR-Total) was 118% at year-end 2025, well above the regulatory minimum of 100%. The development of the NSFR over 2025 can be seen in Figure 6.9. Template EU LIQ2 provides details on ASF items and RSF items which are the basis for the calculation of the NSFR.

Table 6.3 Net Stable Funding Ratio

31 December 2025		Total
Net Stable Funding Ratio		118%
NSFR Central Bank requirements		100%

Figure 6.9 Development of the Bank's NSFR



# Operational Risk

Operational risk is defined as the risk of direct or indirect financial loss or damage to the Bank's reputation resulting from inadequate or failed internal processes or systems, from human error, or external events that affect the Bank's image and operational earnings. This includes a range of non-financial risks such as technology and information security risks, third-party and resilience-related risks, model risk, and business and strategic risk.

Operational risk is managed through a system of risk assessments, controls, loss event analyses, audits and corrective actions, with emphasis on key risk areas.

Risk exposure amount (ISK)

**84.6 bn (106 bn)**

Operational events

**522 (455)**

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7.1 Governance and policy

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7.3 Conduct and regulatory compliance

# 7 Operational Risk

The Bank continues to strengthen its operational risk framework, which is now embedded in day-to-day activities and supported by ongoing improvements in governance, operational resilience, and information and communication technology (ICT) risk management. Over the year, the Bank made further progress in meeting evolving regulatory expectations, including DORA-related upgrades, launching a new third-party risk management framework, and deepening collaboration across Operational Risk, Security Risk, and IT.

Risk identification and assessment became more consistent in 2025, control monitoring and testing were expanded, and greater use of deviation analysis sharpened insight into emerging themes. Technology and information security risks remained prominent, driven by growing digital complexity and increased use of AI. Regulatory pressures, process and execution risks, third-party dependencies, and a shifting legal and geopolitical environment also contributed to the Bank's operational risk profile and informed governance and oversight.

## 7.1 Governance and policy

The Bank's Operational Risk Policy and operational risk appetite are set by the Board of Directors and reviewed at least annually. In accordance with this policy, the Bank's CEO has established an operational risk governance structure that defines responsibilities, decision-making authority, rules, and oversight arrangements across the three lines. At the management level, the Operational Risk Committee (ORCO) is the principal authority for the management and monitoring of operational risk, serving as the Bank's primary forum for operational risk oversight. It is supported by specialist sub-committees and cross-functional cooperation across the first and second lines. Together, these elements form the Bank's Operational Risk Management Framework.

The Operational Risk Policy aims to reduce the frequency and impact of operational risk events while ensuring an efficient and proportionate control environment. The Bank follows the Basel Committee's Principles for the Sound Management of Operational Risk and applies a structured approach to risk identification, assessment, control management, loss event analysis, audits, and corrective actions, with a focus on key risk areas. These processes are supported by documented controls, quality management practices, and ongoing training to promote a sound risk culture and strengthen operational resilience.

Risk Management produces a monthly operational risk report for ORCO, providing an overview of key indicators, major deviations, significant ICT and security incidents, loss data trends, and compliance-related observations, measured against the risk appetite approved by the Board of Directors. Operational risk information is also incorporated into the monthly Risk Report presented to the Board Risk Committee (BRIC) and the Board of Directors, ensuring consistent and transparent oversight at the highest level.

In line with CRR3, the Bank calculates capital requirements for operational risk using the business indicator component. In the previous year, the Bank applied the former standardized approach for operational risk. Further quantitative information is available in Template OR1 in the Additional Pillar 3 disclosures.

## 7.2 Operational risk management

Operational risk is inherent to all aspects of the Bank's activities, and its effective management relies on clear responsibilities across the three lines:

- ◆ Business units are responsible for identifying, assessing, and managing the operational risks arising from their activities
- ◆ Risk Management and Compliance develop, maintain, and oversee the frameworks, methodologies, and tools that support consistent and structured operational risk management across the Bank
- ◆ Internal audit independently evaluates the design and effectiveness of operational risk management and controls, providing objective assurance to senior management and the Board of Directors.

Internal control functions provide independent monitoring and reporting of operational and compliance risks, helping identify risk concentrations and promoting a strong and forward-looking risk culture.

# Operational Risk

The Bank’s operational risk management framework aims to embed risk awareness in day-to-day operations, ensuring a holistic view of the Bank’s risk profile, the effectiveness of mitigating actions, and the interdependencies between processes, systems, people, data, and third-parties. As second line functions, Risk Management and Compliance support senior management in maintaining alignment between the Bank’s operations, risk appetite, and strategic objectives. In addition to these processes, the Bank maintains insurance coverages to limit the financial impact of severe and unexpected operational events that may occur despite the existing control environment.

Figure 7.1 Operational risk lifecycle



## Risk identification and assessment

The Bank applies a structured and forward looking approach to identifying and assessing operational risks across its activities. Risk identification is carried out through both top down and bottom up processes, ensuring that risks are captured at the strategic, functional, and operational levels. The annual top-down assessment, performed by management, holistically identifies key risk themes that may affect the Bank’s strategic objectives, business environment, or resilience posture. These themes guide the bottom-up assessments performed within each division, where business units evaluate risks related to their products, services, processes, systems, data, models, and material changes.

This assessment process ensures broad organisational involvement and supports consistency across the Bank’s operational risk taxonomy. Risks are evaluated using a common methodology that considers likelihood, impact, and the effectiveness of existing controls, reflecting both inherent and residual risk levels. The evaluation results are then used to determine whether a given risk is acceptable or whether additional mitigating actions must be implemented. Bottom-up assessments are also used to identify risks within specific domains, such as third-party arrangements or significant projects or engagements, allowing for timely recognition of emerging or temporary risks. Assessment results are reviewed annually and incorporated into the Bank’s central risk registry, ensuring a current and comprehensive overview of its operational risk profile.

## Control management

Controls are core to the Bank’s operational risk management framework and are designed to ensure that identified risks are maintained within acceptable levels. Controls are documented and maintained using a standardized methodology that supports consistency, clarity of ownership, and alignment with regulatory expectations. Control effectiveness is evaluated through ongoing monitoring and risk-based testing, ensuring that they operate as intended. Controls are adapted when processes, systems, or requirements change.

A positive risk culture, rooted in employee awareness and capability, is integral to the risk management environment. Regular training on operational, compliance, and security related matters helps employees understand their responsibilities and maintain a strong risk culture. Together, the Bank’s control activities and training practices support a robust and responsive control environment across its operations.

# Operational Risk

## Incident and loss-event analysis

The Bank maintains a centralized platform for reported operational deviations and loss events, supporting a consistent approach to capturing incidents across the organization. Events are recorded regardless of whether they result in financial loss, and may include impacts in the form of reputational or regulatory damages. The Bank applies a no-blame policy to encourage transparency and timely escalation of issues.

All reported events are classified according to the Bank's operational risk taxonomy, which is aligned with ORX's standard risk taxonomy, enabling structured analysis of trends across business areas, processes, systems, and third-party arrangements. Event level of impact is assessed, and severe events undergo formal root cause analysis to identify underlying drivers and determine appropriate corrective measures, allowing lessons learned to be applied across the organization. The analysis of incident data supports continuous improvement of controls and provides management with a current view of the Bank's operational risk exposure.

In 2025, the risk categories Transaction processing and execution, Technology, and Information Security accounted for 75% of the total number of reported deviations. However, Transaction processing and execution accounted for 80% of the total loss amount attributed to operational risk events.

## Corrective actions

Issues identified through risk assessments, incident analysis, control testing, audit findings, or supervisory observations are managed through a structured remediation process. Once an issue is recorded, the responsible business unit develops and implements corrective actions to address the root cause and prevent recurrence. The internal control functions provide oversight and guidance throughout the process to ensure that actions are proportionate, timely, and aligned with the Bank's operational risk framework and regulatory expectations.

## Monitoring and reporting

Monitoring and reporting are core components of the Bank's operational risk management lifecycle. Risk Management conducts ongoing monitoring of key indicators, incidents, and control performance to identify emerging trends and areas requiring attention. This information is consolidated into regular management reporting, including the monthly operational risk report and contributions to the Bank's monthly Risk Report. Ad-hoc updates are provided when significant events or changes in the operating environment occur.

In addition to regular monitoring and reporting, the Risk Management function contributes to the design and execution of the Bank's Combined Assurance Plan and performs operational risk audits in accordance with this plan, complemented by ad-hoc audits when emerging risks or significant events warrant deeper review. These audits assess how operational risk topics are managed across the Bank and identify opportunities to strengthen processes, governance, and overall operational risk maturity, alongside the function's other ongoing monitoring activities.

## Operational resilience and business continuity management

Operational resilience objectives and business continuity arrangements are aligned with the Bank's operational risk appetite and governance framework. The Bank's operational resilience framework is designed to ensure the continued delivery of its most critical activities during severe disruptions. This includes identifying the Bank's critical or important functions, mapping key processes, systems, and third-party dependencies, and assessing the Bank's ability to remain within defined impact tolerances. These activities are coordinated across Risk Management, IT, the Chief Security and Resilience Officers, and business units through the Bank's newly established Operational Resilience Committee, ensuring a consistent approach that reflects evolving regulatory expectations, including those introduced under DORA.

Business continuity management supports these resilience objectives by maintaining documented response and recovery plans that guide the Bank's actions during major operational interruptions and threats. An annual business impact analysis (BIA) is performed to assess the consequences of severe disruptions and to ensure that continuity plans remain accurate and effective. Plans are reviewed and tested periodically to validate recovery capabilities and confirm that the Bank can respond effectively to disruptive events.

## Third-party risk management

The Bank strengthened its third-party risk management framework during the year, introducing a more clearly defined and risk-based approach to assessing and managing third-party relationships. Governance roles were clarified across the three lines, lifecycle processes were standard-

# Operational Risk

ized, and risk assessment criteria were enhanced to better capture ICT dependencies and concentration risk. The revised framework also introduced enhanced due diligence requirements, strengthened contractual and monitoring expectations, and closer integration with operational resilience and ICT risk management.

By embedding a structured, risk-based methodology into third-party oversight, these updates ensure consistent evaluation and monitoring of third-party exposures and strengthen alignment with the Bank’s operational risk taxonomy and reporting, improve transparency, strengthen resilience planning, and support the Bank’s alignment with DORA implementation.

## New Product Approval Process

The Bank’s New Product Approval (NPA) process ensures that new products, services, and material changes are comprehensively assessed before implementation. The process requires business units to evaluate operational, regulatory, technological, and third-party risks, and to demonstrate alignment with internal policies, the Bank’s risk appetite, and applicable legal requirements. The NPA committee reviews and challenges proposals to confirm that risks are understood and appropriately mitigated and that adequate controls are in place. This structured approach ensures that new initiatives are introduced in a safe, sustainable, and well-governed manner.

## Model risk management

Model risk is managed through established controls that include ongoing model performance monitoring and periodic independent validation. Validation is carried out at predetermined intervals, with timing and scope determined in a risk-based manner that considers each model’s complexity, usage, and materiality.

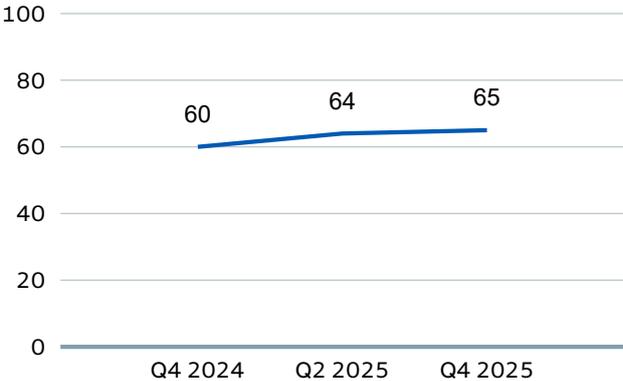
Several key enhancements were made to the model risk management framework in 2025. A new model materiality classification was introduced with risk-based requirements, including differentiated validation frequencies. Roles and responsibilities were clarified, including a more detailed specification of model owner duties. Guidance on the treatment of third-party models was also added, aligned with the improvements made to the third-party risk management framework.

## Reputational risk

Managing reputational risk focuses on understanding how operational failures, misconduct, or external events may affect trust in the Bank. The Bank’s reputational risk management framework emphasises strong internal controls, monitoring of key indicators, and transparent engagement with stakeholders. This framework was strengthened in 2025 through the introduction of a reputational risk score methodology. Based on this methodology, a score is measured twice annually, providing a structured and risk-based view of the Bank’s reputational risk profile. This view complements perception-driven measures such as net promoter score.

The assessment is conducted by Gallup through independent market analysis and results in a score on a 0-100 scale. Since the first measurement in late 2024, the Bank has seen a steady upwards trend in results, and the score of 65 at year-end 2025 indicates a solid and improving reputation. This enhanced approach supports earlier identification of emerging concerns and reinforces the Bank’s ability to maintain stakeholder trust through sound decision-making and continued adherence to ethical and regulatory expectations.

Figure 7.2 Development of reputational risk score



# Operational Risk

## Information and communication technology (ICT) risk

In preparation for the implementation of DORA in Iceland on 1 January 2026, following its earlier application in the European Union, the Bank significantly enhanced its ICT risk management framework during the year.

The Chief Security Officer continues to oversee day to day IT and security risk management, while ORCO remains responsible for the oversight of ICT security risk at the management level. To provide more specialised focus, the Bank established a dedicated ICT Risk Committee as a sub-committee of ORCO, strengthening cross-functional governance and improving oversight of technology-related risks, cyber security developments, and DORA-related compliance activities. These updates ensures comprehensive ICT risk management that is aligned with evolving regulatory expectations.

The use of artificial intelligence (AI) is governed to ensure safe and responsible adoption. During the year, formal Rules on the Use of Generative AI were introduced, supported by security monitoring to prevent the exposure of sensitive data. AI-related activities are managed within the ICT risk framework through defined controls and oversight to ensure new technologies are integrated securely and in line with the Bank's risk appetite.

Key components of the ICT risk management framework have been revised to align with DORA requirements, including the introduction of new DORA-aligned policies and rules, strengthened governance through clearer definitions of ICT roles and responsibilities, enhanced ICT risk assessment and monitoring practices, and a more integrated approach to ICT resilience and critical dependency management. The Group also maintained its ISO 27001 compliance as a foundational element of its information security management system. Together, these developments improve visibility for senior management and the Board, and position the Bank to meet the full set of regulatory obligations under DORA.

## 7.3 Conduct and regulatory compliance

The Bank is committed to maintaining high ethical standards and is fully aware that its operations affect a wide range of stakeholders and society at large. The Bank is required to conduct its business in accordance with sound business practices and all applicable regulatory requirements and recognizes that conduct and compliance risk is an inherent part of the Bank's business.

Conduct and compliance risk are managed by the first line. The Compliance function provides independent oversight, advice, and monitoring of these risks. The Conduct and Compliance Policy sets out principles and standards for conduct, compliance, and the management of associated risks at the Bank.

The Bank has no tolerance for the breach of compliance which is systemic, severe, repeated, intentional, or the result of gross negligence, nor misconduct that results in unfair outcomes for its customers or is likely to have material negative impact on market integrity or the Bank's reputation.

The Bank uses a risk-based approach to manage conduct and compliance risks. The Compliance function develops an annual Compliance Plan based on risk assessment results to prioritize the Bank's mitigating measures, which is then approved by the Board of Directors.

The Compliance function provides quarterly compliance briefs to the BRIC on the execution of the Conduct and Compliance Policy, and an annual report to the Board of Directors. Additionally, conduct and compliance risk metrics are included in the Operational Risk Report and the Bank's Risk Report.

Information on legal cases relating to the Bank can be found in Note 39 of the Annual Financial Statements for 2025.

### Conduct risk

The Bank defines conduct risk as the risk of any action of the Bank, or its representatives, leading to customer detriment or having an adverse effect on market integrity.

The Bank's actions to manage conduct risk include maintaining processes and procedures designed to control, limit, or monitor identified risks and addressing any deviations that may occur. Key components include, but are not limited to:

- ◆ Tone from the top, promoting responsible governance throughout the organization
- ◆ Internal policies, rules, and procedures that set clear principles and standards

## Operational Risk

- ◆ Processes to minimize conduct risk, including robust procedures for handling customer complaints, as well as procedures for managing conflicts of interest
- ◆ Internal and external reporting frameworks, including whistleblowing mechanisms
- ◆ Ongoing monitoring, including automated controls to ensure compliance with internal and external requirements
- ◆ Robust training programs for employees and support for employees on conduct-related matters

The Bank's employees are expected to treat customers fairly, to conduct themselves with integrity, and to perform their duties with due skill, care, and diligence. They are also expected to promptly report any suspicion or knowledge of misconduct.

### Compliance risk

The Bank defines Compliance risk as the risk of failing to comply with rules and guidelines applicable to the firm as a licensed financial institution, a listed company, and a company engaged in large-scale processing of personal data. The risk is managed through a comprehensive process of identification, advisory support, monitoring, and reporting.

The Bank has implemented measures to minimize and monitor compliance risk. Each division is responsible for adhering to relevant laws and regulations, while the Compliance function is responsible for monitoring the Bank's overall compliance risk. These measures include:

- ◆ A framework for implementing new regulations or changes to existing regulatory requirements
- ◆ A structured process for product development (New Product Approval)
- ◆ Clear allocation of responsibility within each division for compliance with laws and regulations
- ◆ Monitoring and oversight of compliance risk by the Compliance function

Each business unit is primarily responsible for managing the conduct and compliance risk inherent in its operations. The Compliance function is responsible for providing expertise and advice, and coordinating, monitoring, and assessing the adequacy and effectiveness of controls.

### Financial crime

The Policy on Combating Financial Crime sets out the approach the Bank takes to preventing money laundering and terrorist financing, and to the execution of internal sanctions and freezing of funds. The Bank implements and upholds both domestic and internationally recognized standards in this regard.

The Bank manages financial crime risk through a governance framework according to the three lines model and has appointed a first line Managing Director responsible for anti-money laundering (AML) measures and combating the financing of terrorism (CFT), and a second line independent AML/CFT Compliance officer.

The Bank uses a risk-based approach for managing financial crime risk based on its enterprise-wide financial crime risk assessment, and has in place a framework of measures including:

- ◆ Procedures for Customer due diligence and Customer risk assessment including enhanced measures regarding higher-risk relationships
- ◆ Procedures for ongoing monitoring, including sophisticated solutions for transaction monitoring, customer screening, and sanctions screening
- ◆ A framework for internal and external reporting of suspicious transactions and activities, and
- ◆ An adequate training program for employees.

Each business unit within the Bank is primarily responsible for managing the financial crime risk inherent in its operation. The Compliance function is responsible for providing expertise and advice, and coordinating, monitoring and assessing the Bank's measures combating financial crime.

The Managing Director responsible for AML/CFT and the independent AML/CFT Compliance function provide quarterly compliance briefs to the Board Risk Committee on the status of the execution of the Policy on Combating Financial Crime, and an annual report to the Board of Directors.

The Bank maintains a zero-tolerance approach to bribery and corruption, as set out in its Anti-Bribery and Corruption Policy. The Bank has in place a policy on internal alerts which applies to any suspected irregularity involving employees, directors, shareholders, vendors, contractors, or any party who performs duties on behalf of the bank.

# Operational Risk

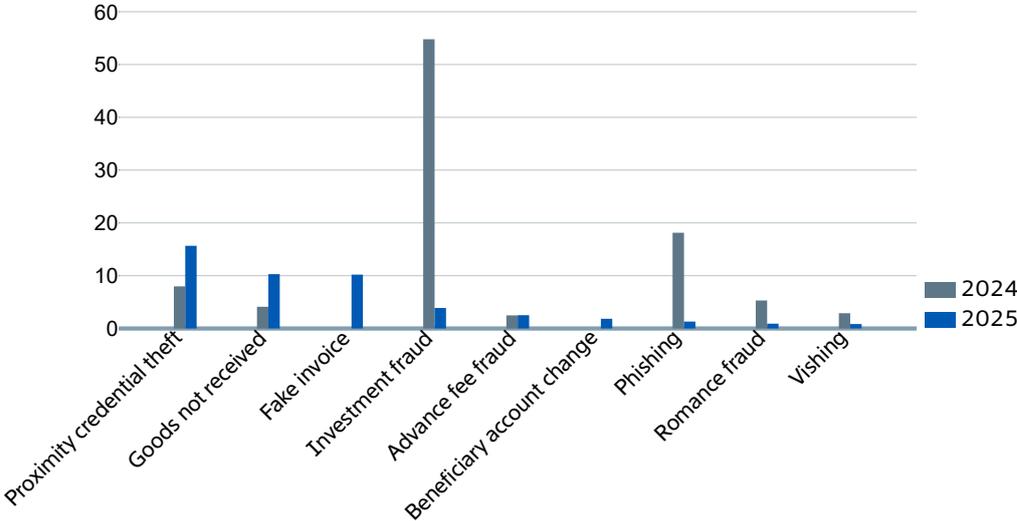
Training on the Bank’s measures against financial crime is available for all staff and annual participation is mandatory for certain groups of employees whose tasks are considered to pose higher risks in this regard.

## Financial fraud

Financial fraud and scam risks represent a significant component of the Bank’s operational risk profile and are closely interconnected with technology, information security, conduct, and third-party risks. These risks are managed in accordance with the Bank’s Operational Risk Management Framework and embedded in the Bank’s governance, control, and reporting structures across the three lines.

During 2025, the number of online fraud cases reported to the Bank nearly doubled compared with 2024, while aggregate customer losses decreased materially. This trend reflects both the growing sophistication and diversification of fraud typologies and the increased maturity of the Bank’s preventive and detective measures. Whereas cryptocurrency investment fraud accounted for the majority of losses in 2024, the 2025 fraud landscape was more dispersed, with proximity fraud, non-delivered goods, and fake invoice scams representing the most significant loss drivers. Losses from account-takeover fraud declined sharply, and cryptocurrency-related fraud fell by 92% year-on-year.

Figure 7.3 Customer loss amount by fraud type [ISK million]



The Bank manages fraud and scam risks through a combination of preventive and detective controls, transaction and behavioural monitoring, customer due diligence, awareness initiatives, and structured incident reporting and escalation processes. These activities are integrated into the Bank’s three-lines governance model, with clear accountability for business units, second-line risk and compliance oversight, and independent assurance through the third line.

# Sustainability Risk

Sustainability risk is defined in the Bank's Enterprise Risk Management framework as the risk associated with environmental, social, or governance (ESG) related events or conditions that can result in a negative financial and/or non-financial impact on the Bank or its clients.

Sustainability risk is a driver of other risk types. It can materialize in the short term, the medium term, and the long term. The Bank assesses both inside-out risks (negative impact from the Bank's operations on people or the environment) and outside-in risks (negative materialization of environmental, social, or governance (ESG) factors on the Bank through its counterparties or invested assets).

Sustainable lending (% of total lending)

**12.9% (15.5%)**

Total financed emissions

**292 ktCO<sub>2</sub>e (286)**

Emission intensity of corporate loans

**0.27 tCO<sub>2</sub>e/ISKm (0.29)**

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8.1 Governance and policy

8.2 Business strategy

8.3 Risk management

# 8 Sustainability Risk

## 8.1 Governance and policy

Sustainability risk is not a fully stand-alone risk type and may increase the severity or likelihood of other financial and non-financial risks faced by financial institutions, such as compliance risk, market risk, and credit risk. For this reason, sustainability risk is embedded in the Bank's risk management framework and its processes, rather than being considered in isolation.

Arion Bank seeks to ensure that its activities and the financial services it provides do not result in an unacceptable impact on people or the environment. The Bank is committed to supporting the global effort to transition to a net zero carbon economy. The Bank engages with its customers, where appropriate, and supports them in adopting more sustainable practices.

In January 2025, the European Banking Authority (EBA) published its final Guidelines on the management of ESG risks. These Guidelines set out detailed expectations for how institutions should identify, measure, manage, and monitor ESG risks as part of their overall risk management framework. A core element of the Guidelines is the requirement for institutions to carry out regular and comprehensive materiality assessments of ESG risks. Further details on the Bank's ESG materiality assessment process, in line with these Guidelines, are provided in a dedicated subsection later in this chapter.

Although the EBA Guidelines have not yet been formally implemented in Iceland, the Bank initiated preparations in 2025 to align its practices with the supervisory expectations set out therein. As part of this ongoing process, the Bank aims to strengthen its framework for climate risk and further integrate it into its core risk management processes. This includes further deepening the materiality assessments for different sectors and risk drivers, with the aim of gaining a comprehensive overview of the risks the Bank faces.

The Bank's risk policy on sustainability is approved by the Board of Directors and reviewed annually. The policy stipulates that the Bank should ensure that its operations and services do not negatively impact people or the environment. Key performance and risk indicators relating to ESG factors are now part of the monthly risk report to the Board, and the Bank's risk appetite statement includes a subset of these indicators. Broadly, outside-in risk is managed by Risk Management, while inside-out risk is managed by the Bank's sustainability team.

Arion Bank has a Sustainability Committee (SUCO) and the management of risk in connection with ESG factors is defined as part of the Bank's risk management system. The CEO is the chairman of the committee, the role of which is to monitor the Bank's performance in connection with its policy and commitment on sustainability and to ensure that ESG factors are considered in decisions and plans made by the Bank. The Sustainable Financing Committee and Equality Committee are sub-committees of the SUCO.

In addition to the CEO, the SUCO comprises the managing directors of Retail Banking, Corporate & Investment Banking, Markets, Operations & Culture, and Finance. The Chief Risk Officer, the Head of Corporate Communications, the Head of Operational & Sustainability Risk, and the Bank's Head of Sustainability attend meetings but do not have voting rights. Meetings are also attended by representatives of Stefniir and Vörður if required.

The Sustainability Committee's primary responsibility is to:

- ◆ decide on the Bank's commitments related to sustainability and review the Bank's performance in relation to those commitments,
- ◆ align the Bank's strategy and risk appetite considering the ESG commitments and sustainability risk management,
- ◆ review risk assessment of ESG factors and other assessments of climate risk impact and oversee ESG disclosures in line with best practices,
- ◆ oversee the Bank's Sustainable Financing Framework,
- ◆ monitor the implementation of relevant rules and regulations on sustainability and sustainable finance, and
- ◆ ensure the Bank's employees are adequately educated and aware of ESG factors and sustainable finance.

Sustainability risk reporting is provided to SUCO quarterly. The reporting includes selected sustainability risk metrics and risk appetite measures, KPIs, updates on the development of sus-

## Sustainability Risk

tainable products and finance, and gender equality. Sustainability risk is also part of the ICAAP process, which is subject to robust governance culminating in approval by the Board of Directors.

More information on the Bank's governance framework and lines of reporting can be found in Chapter 2 of this report.

### Suppliers' code of conduct

The Bank has a Code of Conduct for suppliers designed to set expectations with respect to environmental, social, and governance issues. For 2025, the Bank set the target that at least 90% of new suppliers who have a contract with the Bank must have undergone a supplier assessment where environmental, social, and governance performance is assessed and that the same proportion of suppliers has accepted the Bank's Code of Conduct. During the year, 93% of Arion Bank's new suppliers, who fall under that definition and have a contract with the Bank, underwent the assessment.

## 8.2 Business strategy

Arion Bank places great importance on environmental and social issues and good corporate governance in its operations. It seeks to act as a role model in responsible and profitable business practices, considering the environment, the economy, and society. Social responsibility and sustainability are part of the Bank's day-to-day activities. The Bank's code of ethics informs responsible decision-making at the Bank.

Sustainability KPIs are a part of the Bank's remuneration policy, and the Bank has had equal pay certification since 2019. Chapter 9 contains detailed information about the Bank's remuneration policy.

### Climate targets

In 2025 the Bank published a new report "The Road to Net Zero" which includes its updated climate targets up to 2030, including the following:

- ◆ sustainable lending to be at least 20% of the total loan portfolio by 2030,
- ◆ targets on financed emissions validated by the Science-Based Targets initiative (SBTi) according to the new Financial Institutions Net-Zero standard by mid-2027,
- ◆ aim for reductions in financed emissions in highest-impact sectors in line with the net zero target by 2040,
- ◆ monitoring of suppliers' environmental and climate impact, and
- ◆ carbon-reduction target set and met by 2030.

Since 2023, Arion bank has endeavoured to align with the Science-Based Targets Initiative (SBTi) methodology in formulating science-based targets for reducing greenhouse gas emissions by 2030. In this work, the corporate net zero standard issued by SBTi was used, but with a new SBTi standard published in July 2025, aimed specifically at financial institution target-setting, the Bank decided to delay validation of its targets by 2 years to develop targets and meet the requirements of this new standard by 2027.

Target-setting is based on calculations of the Bank's financed carbon emissions and is done in accordance with the Icelandic government's goal to achieve net zero by 2040 and the Paris Agreement's objective to keep global warming below 1.5°C. The calculations follow the methodology of the Partnership for Carbon Accounting Financials (PCAF), which is recognized by the SBTi. Targets related to lending are set for residential mortgages and for business loans in connection with aluminium production, fisheries, agriculture, energy production, real estate, transportation, coal, oil, and gas.

The way banks manage and allocate funds can greatly influence sustainable development both locally and globally. Arion Bank's sustainability policy is designed to support Iceland's climate action plan, aiming to fulfil the Paris Climate Agreement obligations and achieve carbon neutrality in Iceland by 2040.

The Bank published sustainability policies for seafood and industry, energy, manufacturing, and agriculture in 2023. Reflecting its growing focus on the Arctic region as part of its business strategy, a sustainability policy specifically for the Arctic was also published. These policies outline the Bank's criteria and approach to promoting sustainability in the economy through its lending operations and business relationships, in line with the Bank's commitments and within its risk appetite. In developing these policies, the Bank draws on the government's climate plans, as well as the plans and actions of its customers with respect to ESG factors.

# Sustainability Risk

In 2024, the Bank published an exclusion list of business activities including lending and corporate advisory services.

The Bank's Annual and Sustainability Report includes a range of non-financial information on ESG factors.

## Sustainable financing framework

The Bank's Sustainable Financing Framework was published in August 2024 and applies to the Bank's financing, deposits, and loans which are classed as environmentally and/or socially sustainable. This new framework replaces the Bank's Green Financing Framework, published in 2021, which was integral to the Bank's green lending programme and green bond issuances. Prior to the introduction of the Green Financing Framework, the Bank had a framework for green deposits. These frameworks were merged.

The framework consists of eleven categories that align with the objectives to reduce or prevent climate change or to have a positive social impact. By issuing sustainable financing instruments based on the framework, the Bank restricts the use of proceeds from said instruments to financing green loans or projects that promote increased education, equality, and access to services to vulnerable groups. At present, the Bank has not issued bonds that include social categories but has been active in green bond issuance in recent years.

Of the eleven categories defined in the framework, seven are considered green and the remaining four are social.

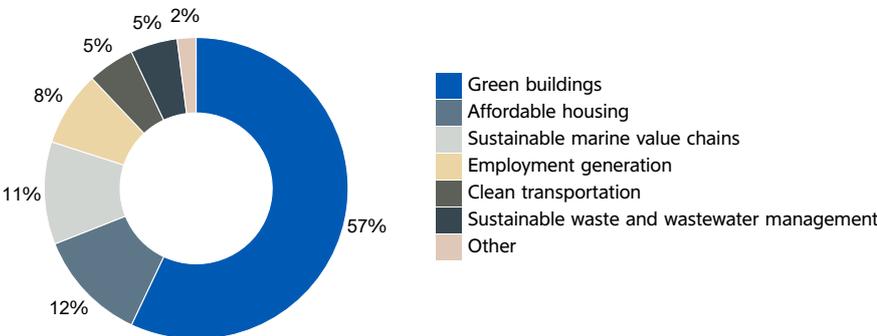
Green:

- ◆ sustainable marine value chains and marine ecosystem management
- ◆ sustainable forestry and agriculture
- ◆ renewable energy
- ◆ clean transportation
- ◆ green buildings
- ◆ energy efficiency
- ◆ sustainable waste and wastewater management.

Social:

- ◆ affordable housing
- ◆ education
- ◆ healthcare
- ◆ employment creation and the alleviation of unemployment.

Figure 8.1 Sustainable loans under the Bank's Sustainable Financing Framework by category at year-end 2025



At the end of 2025, sustainable lending was 12.9% of the Bank's total loan portfolio. The Bank's target is to increase the percentage of sustainable loans under the framework to at least 20% by 2030. For more information see: Sustainable Financing Framework.

## European Investment Fund

The European Investment Fund (EIF) and Arion Bank entered into an agreement to facilitate new loans for small and medium-sized enterprises (SMEs) in Iceland in late 2024. This framework allows Arion Bank to lend up to ISK 15 billion to Icelandic businesses, with partial guarantee from

# Sustainability Risk

the EIF. This framework is financed by the EU's InvestEU programme, which focuses on sustainability, innovation, digital transformation, and the cultural and creative sectors. Loans provided under this framework will offer more favourable terms, aiming to support the aforementioned initiatives.

## Sustainability-related regulatory developments

Information in accordance with the EU Taxonomy has been published in an annex to the Consolidated Financial Statements since 2023, with accompanying text to discuss the challenges inherent in meeting disclosure requirements. The EU Omnibus Package significantly simplifies the EU Taxonomy disclosure requirements moving forwards, allowing delayed reporting for 2025, while also narrowing the scope of companies required to disclose information according to the taxonomy (limiting the scope to companies with over 1,000 employees and EUR 450 million net annual turnover) in the EU. This simplification has not been implemented in Iceland, further enhancing the transposition deficit already in place due to Iceland forgoing implementing the EPC score. Assuming the simplifications will be implemented in Iceland eventually, it would mean a drastic reduction in available data for the Bank as even fewer companies would disclose information on aligned activities.

## Green Asset Ratio

The Green Asset Ratio (GAR) is a key performance indicator for credit institutions. The indicator shows the ratio of a financial institution's assets which finance economic activities aligned to the EU Taxonomy. While the GAR has its merits, it falls short in giving insights into the state of sustainable financial services in Iceland. The indicator is mostly affected by the distribution of the loan portfolio, with loans to households the largest class of assets included in the denominator. Due to lack of data availability, these assets cannot be assessed against the Taxonomy technical screening criteria, and therefore approximately 45% of total covered assets cannot be considered environmentally sustainable until such data becomes available. While this might be seen to indicate that none of the Bank's mortgages are financing environmentally sustainable assets, this fails to acknowledge that a majority of Icelandic households are heated with renewable energy.

Further, only about 300 corporates fall within the scope for disclosure obligation, and a majority of these are unable to meet the technical screening criteria required. Taken together, this results in a GAR of 0.0003% in 2024 and 0.00003% in 2025. Further information can be found in an annex to the 2025 Consolidated Financial Statements.

## 8.3 Sustainability risk management

The Risk Management Division plays an active role in the management of ESG risk. To reflect the increasing importance of this risk factor, Operational & Sustainability Risk is explicitly responsible for supporting ESG risk management across the Bank. Integrating ESG risk in such a way into the existing structure of Risk Management serves the goal of recognizing ESG risk as potentially amplifying other risks and ensures that it is given appropriate consideration and in the appropriate context.

Credit risk is the Bank's primary risk. The Bank's credit policy emphasises sustainability, and credit rules stipulate that ESG factors are assessed as part of the credit rating process.

The Bank is actively working to strengthen its capacity to identify and manage ESG risk. A key prerequisite for this is data used to assess risk, which forms the foundation for sustainability-related monitoring and reporting. Arion bank measures financed emissions from its loan portfolio and proprietary investments annually, and uses the results for further analysis, reporting, and target setting.

The data underpinning climate risk analysis is continuously evolving, becoming increasingly accurate and accessible. Despite this progress, it remains common to have to rely on estimates and data that are not fully precise. There is growing pressure on companies to improve data disclosure, which is essential for the Bank to conduct robust and reliable analyses. In Iceland, many smaller companies fall outside formal disclosure requirements, resulting in continued reliance on estimates and assumptions in climate risk assessments. The current EU Omnibus Package has yet to take into effect in Iceland. While it remains unclear whether the proposals will be implemented unchanged, it is likely that the amount and granularity of corporate data will decrease, negatively impacting the Bank's ability to assess the underlying risk. Nevertheless, the Bank is actively developing methodologies to identify risk factors and establish strong indicators and thresholds in line with the Board's risk appetite.

The first line is responsible for evaluating its own ESG risks as part of the annual risk assessment

## Sustainability Risk

process. This involves identifying potential ESG risks, assessing their likelihood and impact, and documenting all relevant risks and mitigations in the Bank's risk registry. The inherent risk related to human resources and social factors is generally assessed as low. In terms of environmental issues, the risk of greenwashing and the environmental and climate impacts on lending and investments were assessed as the main risks. The results also show that the Bank's main governance-related risks are linked to anti-money laundering measures, breaches related to KYC requirements, and data protection issues. The controls for these risks within the Bank were assessed as generally satisfactory or strong.

### Materiality assessment of ESG risks

The Bank performs its ESG materiality assessment in line with the EBA Guidelines. This assessment is separate from the double materiality assessment under the Corporate Sustainability Reporting Directive (CSRD), which follows a separate regulatory framework and serves different objectives.

The materiality assessment is a cornerstone for the Bank in identifying and managing ESG risks. Its purpose is to identify which environmental, social, and governance factors are most relevant to the Bank's risk profile and financial stability. This process ensures that ESG considerations are integrated across all traditional risk categories, including credit, market, operational, liquidity, reputational, and business model risks.

The Bank applies a combination of methodologies in its materiality assessment, in line with the EBA Guidelines. The EBA outlines several methodological approaches for assessing ESG risks, which the Bank is in the process of introducing and further developing for its own risk assessment framework:

- ◆ Exposure-based analysis entails the assessment of ESG risks at the level of individual counterparties or assets, providing granular view of vulnerabilities
- ◆ Sector-based analysis evaluates concentration of ESG risks arising from exposures to sectors that are particularly sensitive to environmental, social, or governance factors
- ◆ Portfolio-based analysis ESG risks assessed across the Bank's entire portfolio
- ◆ Scenario-based analysis comprises forward-looking analysis to assess how ESG risk factors may evolve under plausible future scenarios, including both transition and physical risk pathways.

Together, these methodologies support a comprehensive assessment of ESG risks across relevant time horizons, as required by the EBA Guidelines.

The Bank applies a risk-based approach to identifying ESG risks, using methodologies that address both transition and physical climate risks. As part of this work, the Bank has conducted a qualitative sector-based assessment to evaluate how both transition risks and physical risks may affect sectors with heightened ESG sensitivity. Furthermore, the Bank has initiated a portfolio-level physical risk assessment, beginning with an analysis of coastal flood risk within the Bank's mortgage portfolio. These assessments represent initial steps in the broader implementation of the methodological approaches outlined by the EBA.

### Sector-based analysis

The Bank has conducted a sector-based analysis to assess climate-related financial risks. The outcome is a heatmap based on a qualitative assessment of the potential impact of various risk drivers across different sectors. The heat map was developed to assess how ESG risk drivers affect the Bank's customers, the channels through which the risk materialises and the financial impact on the Bank through those channels.

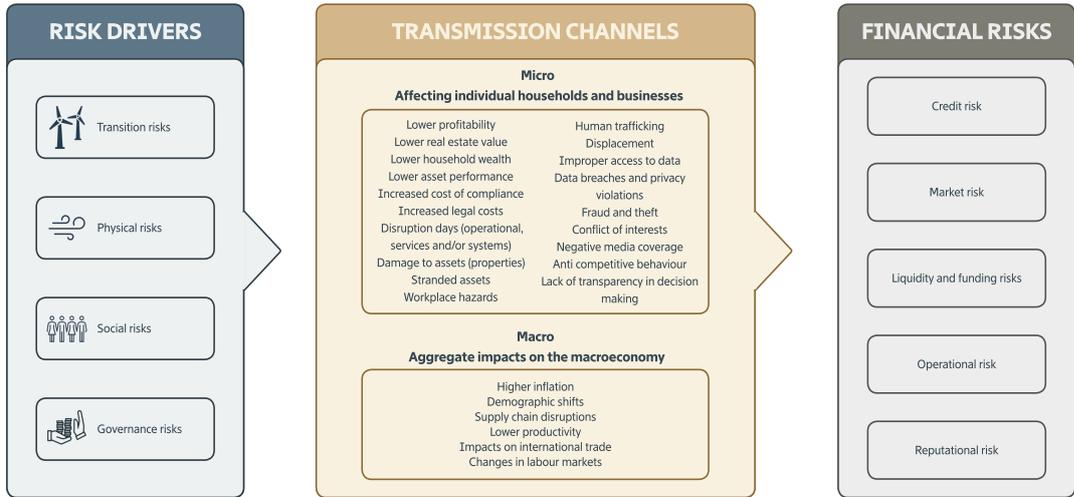
A risk driver is the underlying factor or event that creates or amplifies a risk. Risk drivers are the initial pressure points that originate from climate change or climate policy.

A transmission channel is the causal pathway and/or mechanism, through which a risk driver affects an entity's financial position. A transmission channel translates the climate hazard into a tangible effect.

The analysis is based on possible developments over the short, medium, and long term. The assessment has been incorporated into the overall credit risk assessment system as a benchmark, which loan and fund managers use to evaluate how their project compares to industry benchmarks. This ensures an efficient and uniform methodology for assessing sustainability risks for the Bank's loan portfolio.

# Sustainability Risk

Figure 8.2 Transmission channels of ESG risks



Environmental risk was estimated to have the highest possible impact on the Bank’s portfolio. Environmental risk entails both transition risk, the potential cost of moving towards a low-carbon economy, and physical risk (acute and chronic), which captures the possible impacts from climate change. Transition risk is identified as the most significant factor, driven by potential regulatory changes and technological advancements. In the table below the highest rated environmental risk drivers are presented for the three categories in which the highest environmental risk was assessed.

The sectors that were assessed to have the highest possible impact were Fisheries, Construction, and Transportation and storage. Concerning physical risk, the greatest potential impact was assessed to be on the seafood sector through ocean acidification and long-term changes in ocean currents.

Table 8.1 Highest rated environmental risk drivers

Sector	Highest-rated environmental risk drivers
Fisheries	<ul style="list-style-type: none"> <li>• Technological changes in production technology relating to fishing and processing.</li> <li>• Increased costs arising from energy transition of vessels and ports</li> <li>• Regulatory changes in relation to GHG emissions incl. increased taxation</li> </ul>
Construction	<ul style="list-style-type: none"> <li>• Regulatory changes in building regulations and standards in relation to e.g. materials and energy efficiency</li> <li>• Market changes especially for residential real estate due to increased demand</li> </ul>
Transportation and storage	<ul style="list-style-type: none"> <li>• Technological changes in the entire value chain, increased automation needs, and energy transition of vessels</li> <li>• Regulatory changes in relation to GHG emissions, increased taxation, and trade-routes</li> </ul>

Social risk comprises such factors as employee rights, human rights, diversity, and equality. The risk driver identified as having the highest potential impact involves labour rights and human rights within the supply chain.

Governance risk refers to the dangers of poor governance practices, corruption, bribery, and legal compliance violations, as well as the security of sensitive information. Information and cyber security risk, specifically whether an industry handles significant amounts of sensitive personal data and/or how cyber security is managed, is highlighted as a primary concern.

**Location-based physical risk analysis**

The Bank has begun analysing coastal flood risk within its mortgage portfolio to better understand the potential impact of physical environmental factors on credit risk and asset quality.

To evaluate the exposure of real estate in Iceland to coastal flooding, the Bank relies on projections from the Climate Atlas of Iceland (Iceland Meteorological Office), which are based on the Intergovernmental Panel on Climate Change’s (IPCC) climate scenarios but recalculated specifically

## Sustainability Risk

for Iceland and the surrounding ocean. In this analysis, the Bank uses the SSP5-8.5LC scenario, a high emissions pathway that also considers the possibility of faster than expected melting of the major ice sheets. This scenario represents upper-range outcomes that, while uncertain, cannot be ruled out.

As part of this work, the Bank assesses coastal flood risk using projected 200-year return period coastal flood events, which represent severe but plausible flooding (a 1-in-200, or 0.5% chance of occurring every year) occurring under extreme conditions. The analysis now incorporates two-time horizons:

- ◆ Present-day conditions, which serves as the Bank's baseline for understanding the level of risk that already exists today
- ◆ Long-term projections for the year 2100 under the SSP5-8.5LC scenario, which provides insights into how coastal flood risk may evolve under a high emissions climate pathway with elevated sea level rise assumptions.

By combining both present-day and future projections with the geographic locations of properties in the Bank's mortgage portfolio, the Bank evaluates which assets are currently exposed to coastal flooding and which may become exposed over the long term. This approach enables a comprehensive understanding of both current vulnerabilities and potential future risks within the portfolio.

The results of the analysis indicate that a small proportion, or 2.7%, of the Bank's mortgage portfolio is projected to be exposed to coastal flood risk by the year 2100 under the SSP5-8.5LC scenario. This overall pattern of exposure broadly aligns with the findings presented in the Climate Atlas of Iceland, with higher risk concentrated in low lying coastal areas.

Iceland's insurance framework provides an important layer of protection against coastal flood risk. By law, all properties in Iceland must carry mandatory fire insurance based on the property's official fire insurance valuation. This mandatory fire insurance automatically includes coverage from the Natural Catastrophe Insurance of Iceland (NTÍ). Premiums for NTÍ are collected alongside fire insurance, meaning that all buildings are insured against major natural hazards, including floods. Through this system, losses from sudden coastal flooding are compensated as part of NTÍ's statutory coverage of direct damage from natural catastrophes. While insurance does not eliminate the physical risks themselves, it helps mitigate the financial impact on property owners and supports the overall resilience of the Bank's mortgage portfolio.

### Financed emissions

Arion Bank is a signatory to the Partnership for Carbon Accounting Financials (PCAF), a global partnership of financial institutions that work together to develop and implement a harmonized approach to assessing and disclosing the greenhouse gas (GHG) emissions associated with their loans and investments. Assessing and disclosing the financed emissions is a prerequisite for the Bank's ability to set climate targets and manage climate related financial risks. The PCAF disclosures are now incorporated into the Bank's 2025 Annual and Sustainability Report.

To measure financed emissions for business loans and investments, financial data from the Bank's counterparties is required. As most counterparties have not yet published data for the 2025 financial year, the financed emissions in this report are based on data for 2024, combined with modelled or estimated emissions factors in line with PCAF methodology.

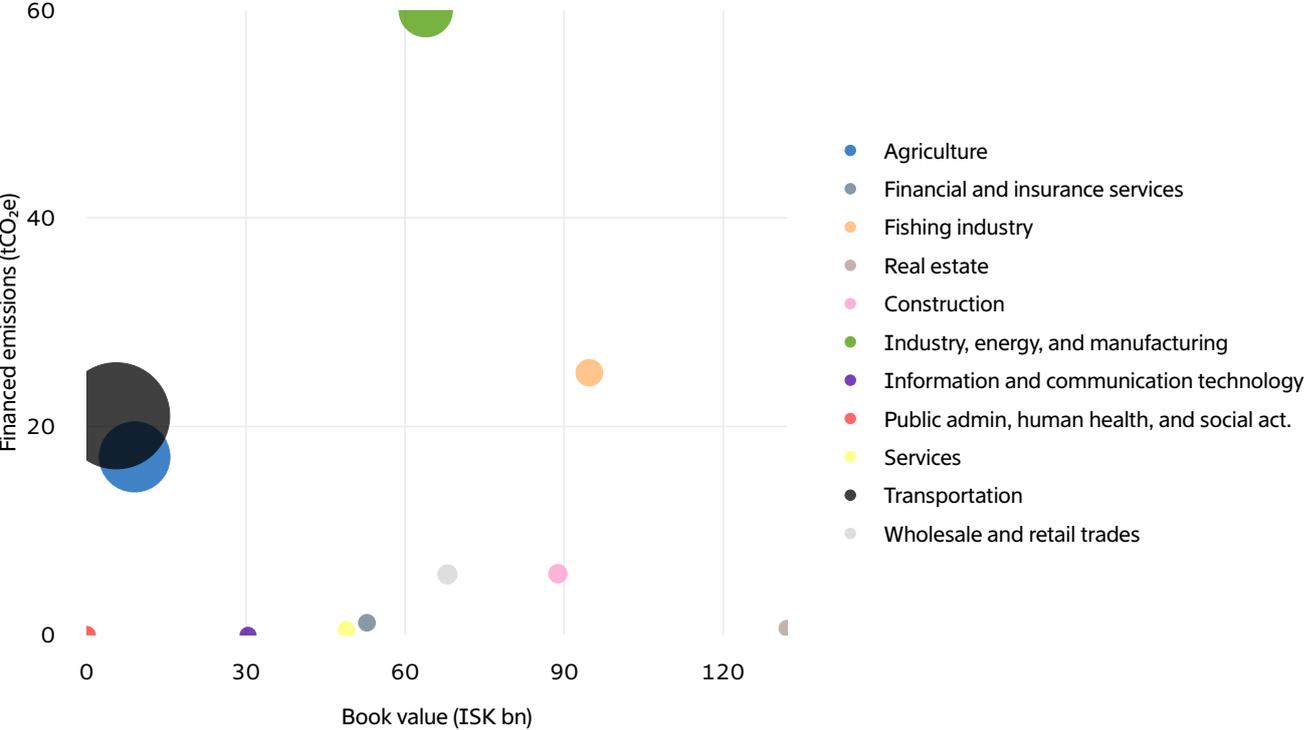
In 2025, the Bank adopted a policy on recalculating financed emissions. Restatements are required when significant methodological or data changes occur and must be applied when results change by 5% or more. Consequently, financed emissions for the 2023 base year have been restated, and all year-on-year comparisons in this section reflect this updated dataset.

Total financed emissions in 2024, including emissions associated with sovereign bonds and excluding LULUCF, amounted to 292 ktCO<sub>2</sub>e, representing a 2% increase year-on-year. If financed emissions from sovereign bonds are excluded, total emissions drop to 167 ktCO<sub>2</sub>e, a 5% increase year-on-year. The rise in total financed emissions is mainly attributable to loan portfolio growth and increased own investments. At the same time, the emission intensity of the corporate loan portfolio declined, from 0.29 to 0.27 tCO<sub>2</sub>e/ISKm, indicating that the Bank is financing proportionally lower emissions per ISK million lent.

Corporate lending remains the dominant driver of financed emissions, accounting for 92% of total emissions from the Bank's lending portfolio. These emissions increased from 145 to 153 ktCO<sub>2</sub>e, or 6% year-on-year, but emission intensity decreased, reflecting a gradual improvement.

# Sustainability Risk

Figure 8.3 Financed emissions



A comparison of sector exposures and associated emissions shows that the Bank's financed emissions are concentrated in a relatively small share of the loan book. Corporate sectors with high emission intensities, such as Transportation, Industry, energy, and manufacturing and Agriculture, represent a modest proportion of total lending yet generate a disproportionately large share of the Bank's financed emissions. In contrast, low intensity sectors such as Real estate activities, Construction, and Residential mortgages account for a significant share of the loan book but contribute minimally to total emissions and therefore offer limited decarbonisation potential. This highlights that the Bank's primary opportunities to reduce financed emissions and address transition risk lie within selected carbon intensive corporate sectors and, to a lesser extent, sovereign exposures, rather than in broad reductions across the portfolio.

# Remuneration

Arion Bank's remuneration policy is an integral part of the Bank's strategy to protect the long-term interests of the Bank's owners, employees, customers, and other stakeholders in an organized and transparent manner.

The Bank's main objective concerning employee remuneration is to attract and retain outstanding individuals, while ensuring that the remuneration policy does not encourage excessive risk-taking.

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# 9 Remuneration

## 9.1 Arion Bank's remuneration policy

Arion Bank's remuneration policy is framed in accordance with regulatory requirements, such as those established in Article 57a of Act No. 161/2002 on Financial Undertakings and the EBA Guidelines on sound remuneration policies. The Bank's remuneration policy is reviewed annually by the Board and submitted and approved at the Bank's AGM. Arion Bank's remuneration policy is published on the Bank's website and information on compensation to the Board of Directors and Bank's management is disclosed in the Consolidated Financial Statements for 2025, see Note 12. Arion Bank's remuneration policy is, furthermore, consistent with the integration of sustainability risks for the purposes of Article 5 of Regulation (EU) 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector (SFDR).

The Bank's main objective concerning employee remuneration is to offer competitive salaries in order to attract and retain outstanding and qualified individuals. The Bank, furthermore, aims to ensure that the policy does not encourage excessive risk taking, but rather supports the Bank's long-term goals and sound operation. The policy is an integral part of the Bank's strategy to protect the long-term interests of the Bank's owners, employees, customers, and other stakeholders in an organized and transparent manner. In accordance with Article 79a of Act No. 2/1995 on Public Limited Companies, Article 57a of Act No. 161/2002 on Financial Undertakings, and rules on good corporate governance, the Board of Directors of Arion Bank approves the Bank's remuneration policy with respect to salaries and other payments to the Board Directors, Chief Executive Officer, Managing Directors, Compliance Officer, and Internal Auditor.

## 9.2 Remuneration components and parameters

According to Article 57b of Act No. 161/2002 on Financial Undertakings, the combined amount of variable remuneration, including deferred payments, may not exceed 25% of annual salary of the recipient employee excluding the bonus. The rules require a deferral of at least 40% of the variable remuneration for a period of no less than four years and in the case of the CEO and employees reporting directly to the CEO, this shall be five years unless the total aggregate is less than 10% of the fixed salary of the employee, in which case the variable remuneration does not require deferral and may be paid in full.

In accordance with the rules, Risk Management and Compliance perform a risk assessment of the incentive scheme and Internal Audit regularly reviews its structure, execution, and impact on the Bank's operations. The current performance-based system was originally approved in December 2020. The current scheme, to be applied in 2026 based on 2025 performance, was approved by the Board of Directors in November 2024. Under the scheme, all employees of the Bank, excluding internal controls units, are included and can receive up to 10% of their fixed annual salary for 2025 in the form of variable remuneration once the annual financial statement for 2025 has been published, on condition that the targets set out in the scheme have been reached. Managers and those employees who have the greatest influence on the Bank's value creation are eligible to receive an incentive payment of up to 25% of their fixed annual salary. Part of the payment (5%) is in cash but the remaining 20% is either in the form of shares in the Bank or share options or a mix thereof, but subject to deferral of 40% and a sale restriction for a period of three years for delivered shares.

The criterion used for the Bank's remuneration system to determine whether incentive payments will be paid in 2026 (for the reference year 2025), in part or in full, is whether the Bank's return on equity (ROE) in 2025 is higher than the weighted average ROE of the Bank's main competitors: Íslandsbanki, Landsbankinn, and Kvika. Failure to reach this target means that no variable remuneration will be paid. The total amount paid out in incentive payments, furthermore, may not be higher than the amount by which the Bank's ROE exceeds the weighted ROE of competitors.

When estimating the variable remuneration to be paid in respect of 2025 performance, a range of factors will be taken into consideration, such as ROE of the Bank, cost-to-income ratio, bancassurance ratio, compliance with the law and code of ethics, knowledge of the customer (KYC/AML), the Bank's Sustainability rating, customer satisfaction score, mandatory education health, and various other metrics.

The objective of the scheme is to reflect the Bank's objectives for good corporate governance as well as sustained and long-term value creation for all stakeholders, including customers, creditors, shareholders, and employees. The Board of Directors re-evaluates on an annual basis the incentive scheme and its key targets in accordance with the Bank's remuneration policy, taking

## Remuneration

into consideration the current status of the Bank, market conditions, and that variable remuneration is awarded in a manner which promotes sound risk management in line with the Bank's risk policy and does not induce excessive risk-taking.

Pursuant to the remuneration policy, the Bank is allowed to pay Annual Fixed Supplemental Remuneration for Employees in Internal Control Units. The payments shall not exceed 10% of the employee's annual salary and be designed to comply with applicable laws and regulations,

### 9.3 Corporate governance arrangements

The Board Remuneration Committee (BRC) and the Board Risk Committee (BRIC), which are established by the Board of Directors of Arion Bank, provide guidance to the Board on the Bank's remuneration policy. The BRC advises the Board on the remuneration of the CEO, Managing Directors, the Compliance Officer, and Chief Internal Auditor, as well as the Bank's remuneration scheme and other work-related payments. The BRC convened five times in the year 2025. BRC consists of at least three members, the majority of whom must be independent of the Bank and the Bank's day-to-day management. The CEO, Managing Directors, and other employees of the Bank cannot be members of BRC.

The main responsibilities of the BRC are to review and propose changes to the Bank's remuneration policy to the Board of Directors, which proposes the changes to a shareholders' meeting. In addition, the BRC is tasked with ensuring that wages and other employment terms are in accordance with laws, regulations, and best practices as applicable from time to time. BRC decides on a salary framework for Managing Directors and the Compliance Officer, taking into consideration the size of the relevant division and level of responsibility.

A performance-based variable remuneration system has been in place since 2013 and both BRC and BRIC have a role as regards its design and annual review. BRC reviews and monitors the scheme, before submitting it to the Board of Directors, and BRIC's role is to assess annually whether incentives which may be contained in the Bank's system are consistent with the Bank's risk policy.

### 9.4 Quantitative information on remuneration

According to disclosure requirements set out in Article 450 of the Capital Requirements Regulation (EU) No. 575/2013, financial undertakings are required to provide aggregate quantitative information on total remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the institution. For quantitative information on remuneration, please refer to the Bank's Additional Pillar 3 Risk Disclosures.

# 10 Abbreviations

ACC	Arion Credit Committee
ADC	Arion Composition and Debt Cancellation Committee
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
AML	Anti-Money Laundering
APAC	Asia-Pacific
ASF	Available Stable Funding
AT1	Additional Tier 1
BAC	Board Audit Committee
BCC	Board Credit Committee
BCMS	Business Continuity Management System
BICRA	Banking Industry Country Risk Assessment
BRC	Board Remuneration Committee
BRIC	Board Risk Committee
BRRD	Bank Recovery and Resolution Directive
BTC	Board Tech Committee
CCF	Credit Conversion Factor
CCO	Chief Compliance Officer
CCR	Counterparty Credit Risk
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CFO	Chief Financial Officer
CFT	Combating the Financing of Terrorism
CMS	Collateral Management System
COREP	Common Reporting
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CRD	Capital Requirements Directive
CRM	Credit Risk Mitigation
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSO	Chief Security Officer
CSRD	Corporate Sustainability Reporting Directive
CVA	Credit Valuation Adjustment
D-SII	Domestic Systemically Important Institution
EAD	Exposure at Default
EBA	European Banking Authority
ECAI	External Credit Assessment Institution
EEA	European Economic Area
ECL	Expected Credit Loss
EMEA	Europe, Middle East, and Africa
ERCO	Executive Risk Committee
ERM	Enterprise Risk Management
ESG	Environmental, Social, and Governance
EU	European Union
FATF	Financial Action Task Force
FRTB	Fundamental Review of the Trading Book
FSA	Financial Supervisory Authority of the Central Bank of Iceland
FTE	Full-time equivalent
G-SII	Global Systemically Important Institution
GHG	Greenhouse Gas
ICAAP	Internal Capital Adequacy Assessment Process
ICFR	Internal Controls over Financial Reporting
ICT	Information and Communication Technology
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IPCC	Intergovernmental Panel on Climate Change

## Abbreviations

IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
ISAT08	Icelandic industry classification based on NACE Rev. 2
ISMS	Information Security Management System
ktCO <sub>2</sub> e	Kilotonnes of carbon dioxide equivalent
KYC	Know Your Customer
LAA	Loss Absorption Amount
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LTV	Loan to Value
LULUCF	Land use, land-use change and, forestry
MCC	Market Confidence Charge
MD	Managing Director
MREL	Minimum requirement for own funds and eligible liabilities
NFDR	Non-Financial Disclosure Regulation
NSFR	Net Stable Funding Ratio
NTÍ	Náttúruhamafaratrygging Íslands - Natural Catastrophe Insurance of Iceland
ORCO	Operational Risk Committee
ORSA	Own Risk and Solvency Assessment
ORX	Operational Riskdata eXchange Association
PCAF	Partnership for Carbon Accounting Financials
PD	Probability of Default
PiT	Point-in-Time
PSD	Payment Services Directive
PSE	Public Sector Entities
RB	Reiknistofa bankanna hf.
RCA	Recapitalization Amount
RCSA	Risk Control Self-Assessment
REA	Risk-weighted Exposure Amount, previously referred to as Risk-Weighted Asset (RWA)
ROAC	Return on Allocated Capital
ROE	Return on Equity
RSF	Required Stable Funding
SA-CCR	Standardized Approach for Counterparty Credit Risk
SFDR	Sustainable Finance Disclosure Regulation
SDRs	Swedish Depositary Receipts
SII	Systemically Important Institution
SME	Small and Medium Enterprise
SNP	Senior Non-Preferred
SP	Senior Preferred
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SFT	Securities Financing Transaction
SUCO	Sustainability Committee
T1	Tier 1
T2	Tier 2
TCFD	Task Force on Climate-related Financial Disclosures
tCO <sub>2</sub> e	Tonnes of carbon dioxide equivalent
TtC	Through-the-cycle
UCITS	Undertaking for Collective Investment in Transferable Securities
UN	United Nations
VaR	Value at Risk