1Q2019 Financial Results

8 May 2019

islandsbanki.is

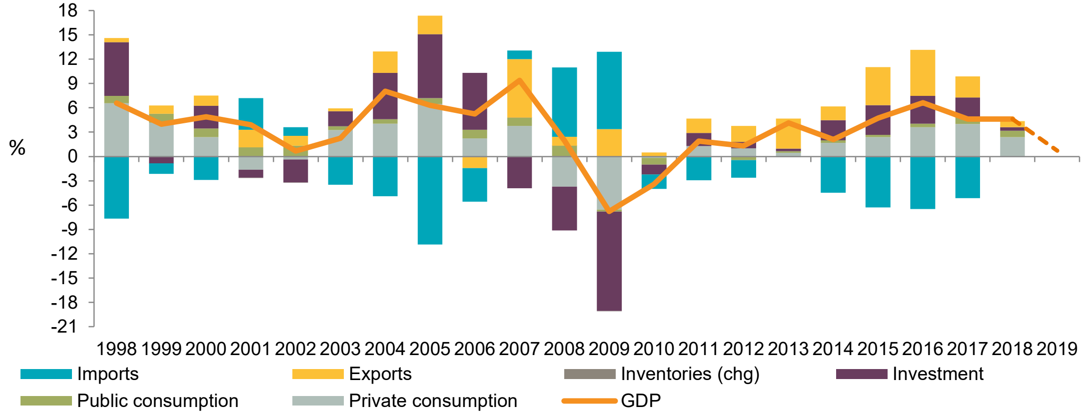
Table of Contents

1. 1Q2019 highlights

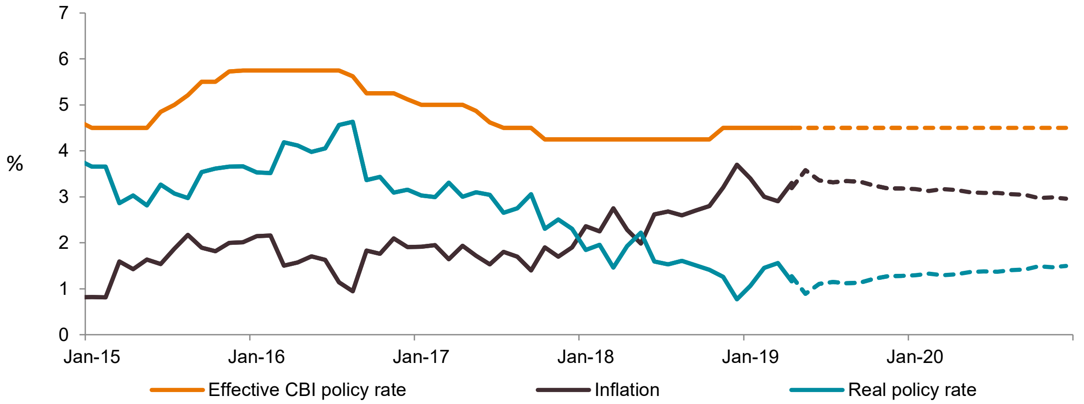
Economic highlights

A year of consolidation after a long and prosperous upswing

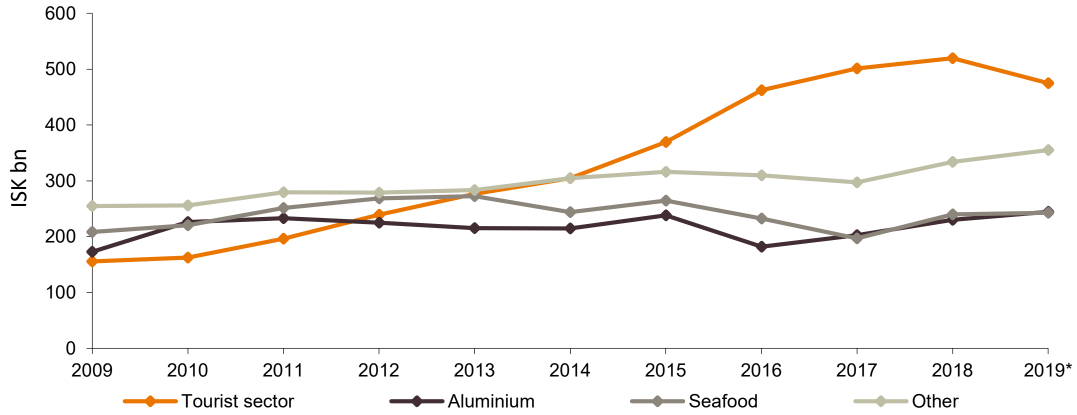
Slow or no GDP growth in 2019 as export sector faces setbacks...



…a cooling economy will lead to decreasing inflationary pressures…



…and revenues from tourism likely to fall to 2016 -2017 levels…



…and economy-wide deleveraging in 2010-2017 has increased economic resilience

Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

8 May 2019

Financial highlights

Key figures & ratios

		1Q19	4Q18	3Q18	2Q18	1Q18
PROFITABILITY	ROE 16% CET1 (regular operations)[1]	**6.7%**	5.3%	8.1%	11.1%	8.0%
	ROE (after tax)	**5.9%**	3.2%	4.7%	11.6%	4.8%
	Net interest margin (of total assets)	**2.8%**	3.0%	3.0%	2.8%	2.9%
	Cost to income ratio[2]	**62.6%**	68.5%	62.1%	65.0%	69.8%
	After tax profit, ISK m	**2,589**	1,404	2,111	5,033	2,097
	Earnings from regular operations, ISK m[3]	**2,653**	2,144	2,928	3,881	2,881

		31.3.2019	31.12.2018	30.9.2018	30.6.2018	31.3.2018
CAPITAL	Total equity, ISK m	**173,621**	176,313	174,630	172,182	166,337
	Tier 1 capital ratio	**19.1%**	20.3%	19.9%	20.5%	20.3%
	Total capital ratio	**20.9%**	22.2%	21.7%	21.6%	21.4%
	Leverage ratio	**13.5%**	14.6%	14.0%	14.5%	14.3%
BALANCE SHEET	Total assets, ISK m	**1,205,228**	1,130,403	1,162,639	1,111,742	1,088,308
	Loans to customers, ISK m	**873,530**	846,599	835,582	799,938	776,149
	Deposits from customers, ISK m	**611,303**	578,959	608,646	578,414	575,196
	Customer deposit / customer loan ratio	**70.0%**	68.4%	72.8%	72.3%	74.1%

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.
2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items).
3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs and income . As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations.

This is Íslandsbanki

A leader in financial services in Iceland, with a clear vision to be #1 for service

Moving Iceland forward by empowering our customers to succeed articulates the Bank's role in shaping and progressing society. Driven by the **vision to be #1 for service,** the Bank provides services to its customer through three business divisions that manage and build relationships with customers

Universal banking

ergo

ÍSLANDSSJÓÐIR

Awards

ÍSLENSKA ÁNÆGJUVOGIN 2013-2018

Leading the Icelandic Customer Satisfaction Index for **six consecutive years**

EUROMONEY AWARDS FOR EXCELLENCE 2013-2018

Credit rating

S&P Global Ratings

BBB+/A-2

Stable outlook

1Q19 Key figures for the Group

ROE (Regular operations)	6.7%
Cost to income ratio	62.6%
Total Capital Ratio	20.9%
Total Assets	ISK 1,205bn

Employees of the Bank

834 Number of **FTE's** for parent company at end of 1Q2019

91% **Job satisfaction** among Íslandsbanki's employees

5 training courses a year per employee

Market share [1]

32% Individuals

37% SMEs

33% Large companies and investors

Ways to bank

54 ATMs

14 branches

86,000 APP users

113,000 online banking users

1. *Based on Gallup survey regarding primary bank.*

A new strategy formed in 2019

In 1Q19 the Bank engaged with BCG to advise on the formulation of a new strategy

The outcome was an articulation of the Bank's purpose, values and vision along with strategic initiatives to be implemented in five years

The purpose: "Moving Iceland forward through empowering customers to succeed," was defined through input from workshops with all employees. It articulates a more active role of the Bank in shaping and progressing society

The purpose is further supported by three values that will serve as guiding principles for employees in all their efforts: "Passion, Professionalism, and Collaboration"

To live the purpose and values, Íslandsbanki continues to be guided by the vision to be "#1 for service", placing the customer at the center for value creation

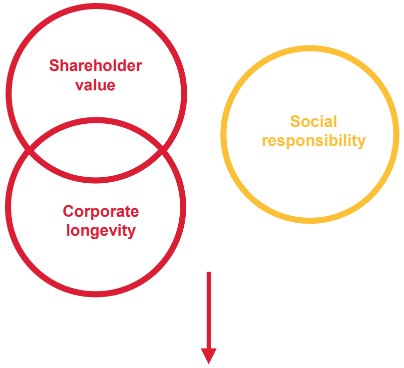
The Bank will put a strong emphasis on data and technology to facilitate innovation and development of simple, efficient solutions for its customers

Positive impact on society

Under the new strategy, the Bank's societal impact work will be centered around 4 of the United Nations' SDGs with a clear link to the Bank's strengths and core business activities

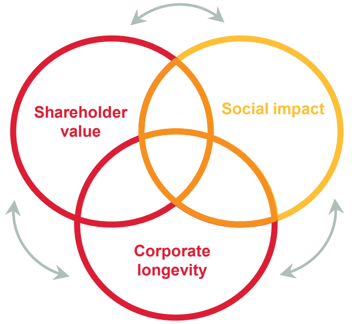
From Corporate Social Responsibility

Run the business first, "do good" in parallel



To Total Societal Impact

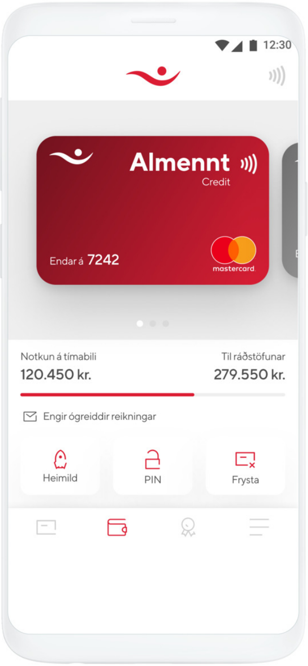
Integrate social and environmental impact as a driver of strategy and value creation



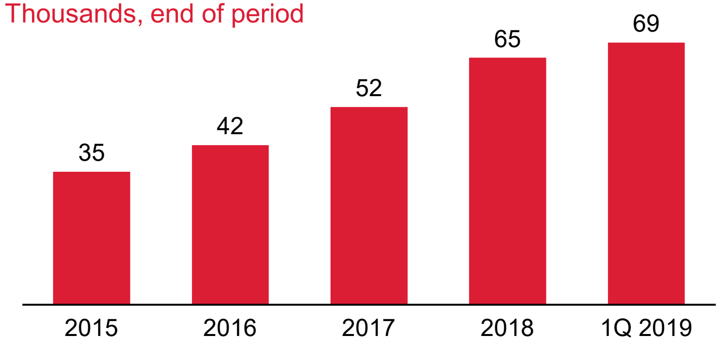
Targeted SDGs	The Bank is already supporting the 4 SDGs through various actions	And will now take its support to the next level
	– The Bank published economic forecasts and four industry sector reports, hosted 96 meetings with 5,300 attending, 70 videos were published on social media with 140k views in 2018. In recent years the Bank has organised around 600 educational talks and welcomed over 40,000 guests – Tapping into Bank employees' knowledge and expertise, the Bank has supported several organisations and charities by donating over 2000 employee working hours through its Helping hand initiative	– Íslandsbanki has a long-standing history of educating its customers to achieve financial security – Ongoing focus on education is clearly linked to the Bank's purpose of empowering its customers to succeed
	– Being at the forefront of equal rights among Icelandic companies, Íslandsbanki has received equal pay certification in recognition of its compliance with the Equal Pay Standard, whose purpose is to combat gender-based pay gaps and promote gender equality in the workplace	– With a legacy of supporting gender equality, Íslandsbanki has a distinctive opportunity to take a leading role in further supporting female entrepreneurs and innovators to be successful
	– The Bank has been actively building up partnerships with innovators, fintechs and start-ups as well as collaborating with the University of Reykjavik and other active organisations – Startup Tourism – an accelerator program for startups in the tourism industry is sponsored by the Bank and employees also providing mentoring services	– Innovation and entrepreneurship are key to creating a knowledge based society in Iceland – Being #1 in financial services, Íslandsbanki is uniquely positioned to advance innovation and entrepreneurship in Iceland
	– Bank participation in a new Nordic CEOs initiative for a sustainable future – Positive environmental impact of move to new HQs in 2017 when the Bank became paperless (50% reduction in printed paper) – Íslandssjóðir launched the first domestic green bond fund in Iceland in 2018 – Íslandsbanki is one of the founding members of the Wetland fund (Votlendissjóður)	– Climate has a clear link to business objectives and is top of mind for customers and investors – The Bank intends to fully endorse climate action and align its business to have a real impact in society

#1 in digital services for individuals

Digital platforms gradually replacing branches as the preferred touchpoint



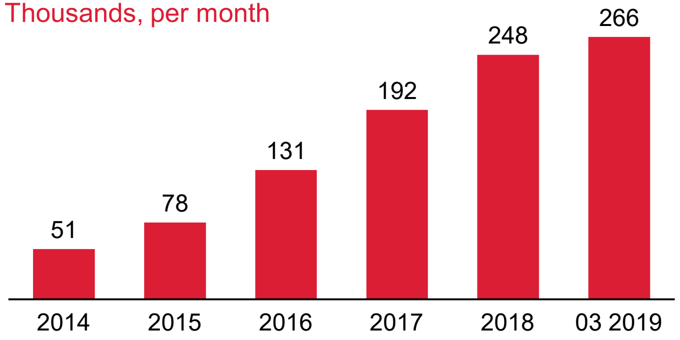
Active Íslandsbanki App users
Thousands, end of period



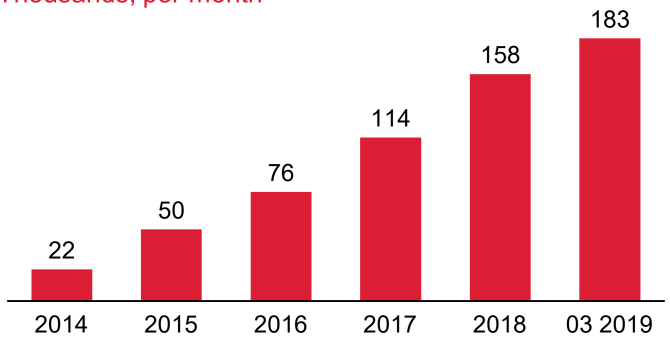
Digital innovation enhancing the customer experience

- 99% of all credit scoring are now made digitally
- 46% of our customers are buying financial products „after hours“ via our new onboarding service
- 67% of our credit card customers are changing their credit limits in our Kort app
- 45% of all split payments are conducted through the Kort app

Bank transfers via App
Thousands, per month



Payment of invoices via App
Thousands, per month



2. Income statement

Income statement

Profits up by 23% compared to 1Q18, due to strong income growth

ISK m	1Q19	1Q18	Δ	4Q18	Δ	2018
Net interest income	8,152	7,740	412	8,294	(142)	31,937
Net fee and commission income	3,217	2,778	439	3,478	(261)	12,227
Net financial income (expense)	448	(283)	731	(637)	1,085	(962)
Net foreign exchange loss	(30)	(10)	(20)	76	(106)	1
Other operating income	1,144	13	1,131	120	1,024	1,784
Total operating income	12,931	10,238	2,693	11,331	1,600	44,987
Salaries and related expenses	(4,051)	(3,926)	(125)	(4,047)	(4)	(15,500)
Other operating expenses	(3,039)	(2,924)	(115)	(3,418)	379	(12,150)
Administrative expenses	(7,090)	(6,850)	(240)	(7,465)	375	(27,650)
Contribution to the Depositor's and Investors' Guarantee Fund	(312)	(292)	(20)	(299)	(13)	(1,173)
Bank tax	(880)	(785)	(95)	(740)	(140)	(3,281)
Total operating expenses	(8,282)	(7,927)	(355)	(8,504)	222	(32,104)
Profit before net impairment on financial assets	4,649	2,311	2,338	2,827	1,822	12,883
Net impairment on financial assets	(919)	88	(1,007)	(297)	(622)	1,584
Profit before tax	3,730	2,399	1,331	2,530	1,200	14,467
Income tax expense	(1,153)	(1,015)	(138)	(1,118)	(35)	(4,734)
Profit for the period from continuing operations	2,577	1,384	1,193	1,412	1,165	9,733
Profit from discontinued operations, net of income tax	12	713	(701)	(8)	20	912
Profit for the period	2,589	2,097	492	1,404	1,185	10,645

Highlights

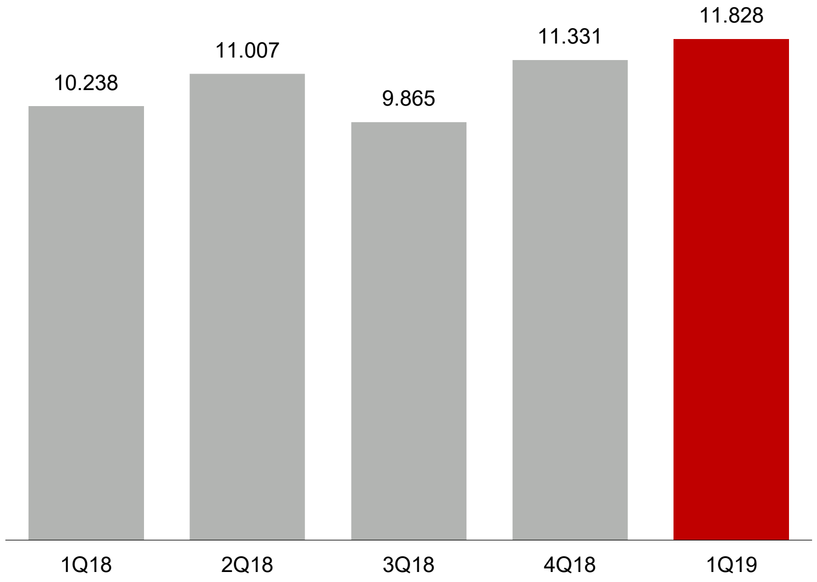
- Total income amounted to ISK 12.9bn in 1Q19, an increase of 26% between years as a result of strong interest and fee income
- Positive changes in the CPI index and continuous loan growth contribute to higher net interest income
- Overall net fee income showed a 16% increase year on year
- Other operating income is ISK 1.1bn, a result from settlement with old Byr bank and the Icelandic Government
- Net impairment is negative by ISK 919m which is largely due to changes in risk model under new IFRS 9
- Profit for the period is ISK 2.6bn which is an increase of 23% from 1Q18

Operating income

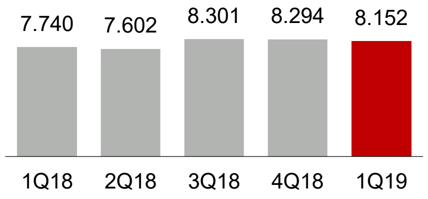
Net fee and commission up by 16% and net interest income up by 5% compared to 1Q18

Income trends

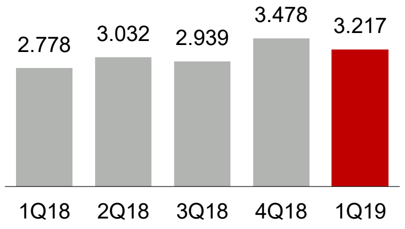
Total operating income[1]
ISKm



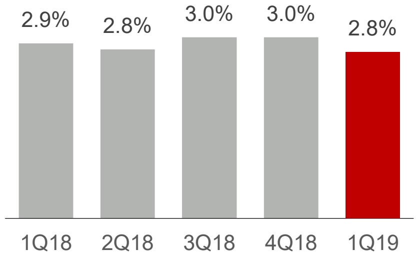
Net interest income (NII)
ISKm



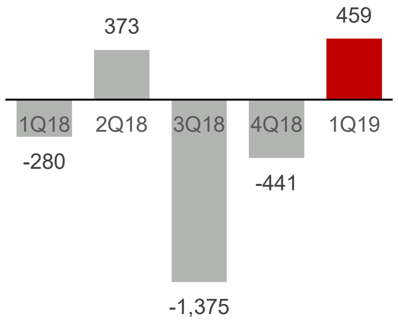
Net fee and commission income
ISKm



Net interest margin (NIM)



Other income (exl. One-off income)
ISKm



1. Excluding one-off income.

Net interest income and net fee and commission income

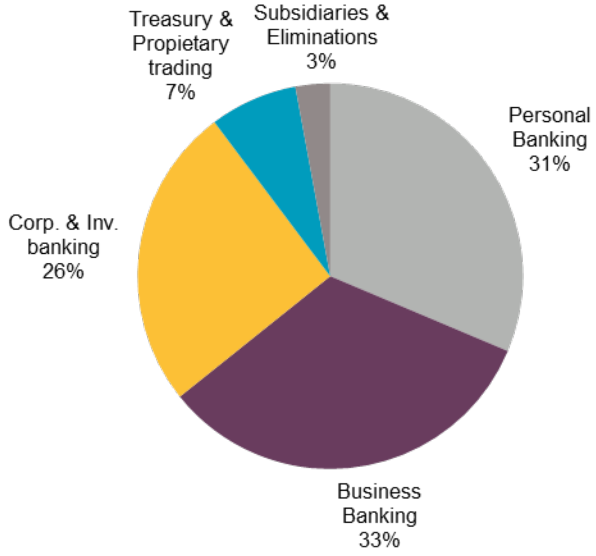
Breakdown by segments

Highlights

- Net interest income was ISK 8.2bn (1Q18: ISK 7.7bn), an increase of 5% between years and the net interest margin was 2.8%, compared to 2.9% in 1Q18
- Net interest income evenly distributed between the three business divisions
- Net fee & commission income was ISK 3.2bn (1Q18: ISK 2.8bn), an increase of 16% between years
- Personal Banking division was the main contributor to net fee and commission income

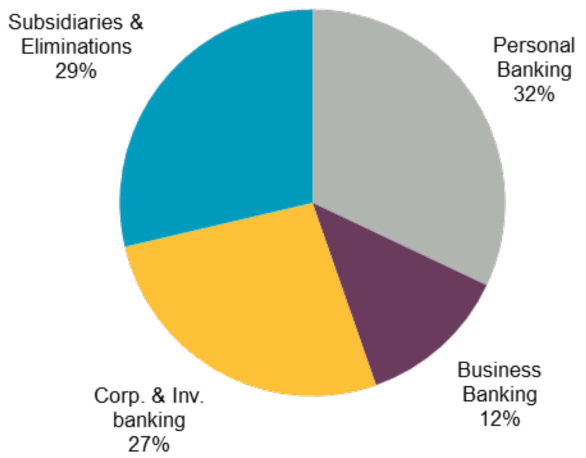
Net interest income

%



Net fee and commission income

%



Earnings from regular operations

Excludes one-off items and ROE calculation is adjusted to normalised CET1 of 16%

Resilient ROE from regular operations

ISKm	1Q19	1Q18	Δ
Reported after tax profit	**2,589**	2,097	492
One-off revenue	**(1,103)**	0	(1,103)
One-off costs	**0**	0	0
Bank tax	**880**	785	95
Tax impact of adjustments	**287**	0	287
Earnings from regular operations[1]	**2,653**	2,881	(229)
ROE 16% CET1 (regular operations)[2]	**6.7%**	8.0%	
ROA from regular operations (after tax)	**1.0%**	1.1%	
Net interest margin adj. 16% CET1	**2.8%**	2.7%	
Cost / income ratio adj. 16% CET1	**58.8%**	72.9%	

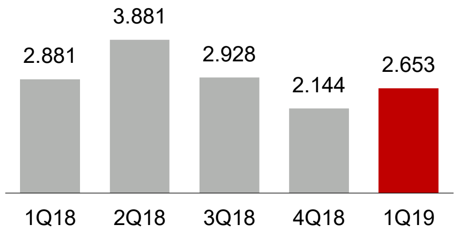
Earnings from regular operations

- The Bank has introduced a new long term minimum capital target of 16% (CET1 16%).
- Lower earnings from regular operations largely explained by negative changes in net impairments.

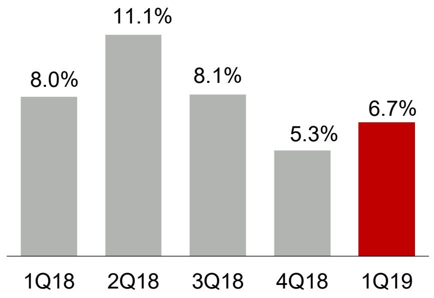
One off items 2019

- ISK 1.1bn from an agreement with Old Byr on the settlement of the dispute deriving from the acquisition with Byr savings bank in 2011.

Earnings from regular operations
(ISK m)



ROE reg. operations CET1 16%
(%)



1. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax.
2. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.

Administrative expenses

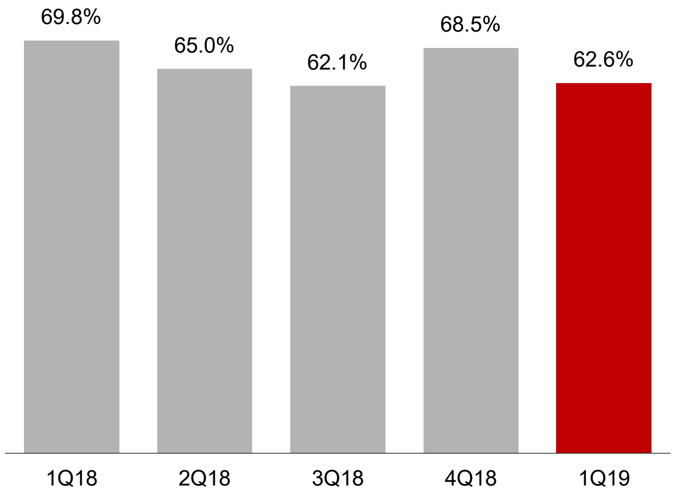
Cost to income ratio on the decline with parent company approaching 55% target

Highlights

- C/I ratio for the parent company in 1Q19 was 58.1%
- The Bank is determined to lower its administrative costs and is determined to reach its C/I ratio target of 55%

Efficiency – Cost to income ratio[1]

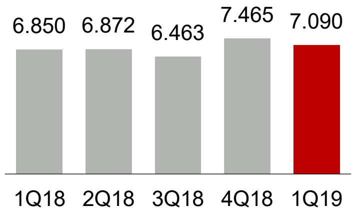
The Group
%



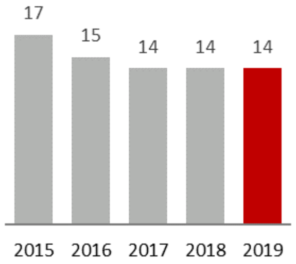
1. The cost-to-income ratio excludes Bank tax and one-off cost and revenue items

Cost structure improving overall

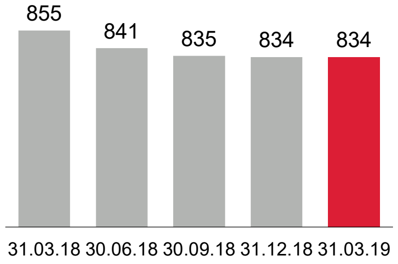
Administrative expenses
ISK m



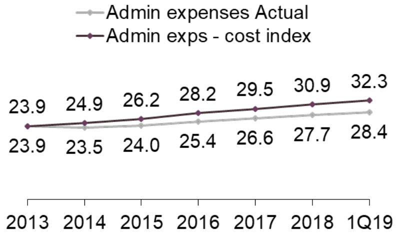
Branch network



Period end FTE numbers[2]
Parent company



Annualised admin. expenses vs cost index[3]
ISK bn, excl. one-off cost, parent company



2. FTE numbers exclude seasonal employees
3. Administrative expense - cost index is calculated as 40% inflation and 60% salary index excluding one-off items

3. Balance sheet

Assets

Total assets are 6.6% up from year-end 2018

Highlights

Liquid assets

- The Bank lowered its cash level with the Central Bank by ISK 6bn from year-end 2018, largely due to the March 2019 ISK 5.3bn dividend pay-out
- Three line items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 275bn

Loans to customers

- Net increase in loan portfolio since year-end 2018 amounted to ISK 26.9bn or 3.2%

Asset encumbrance

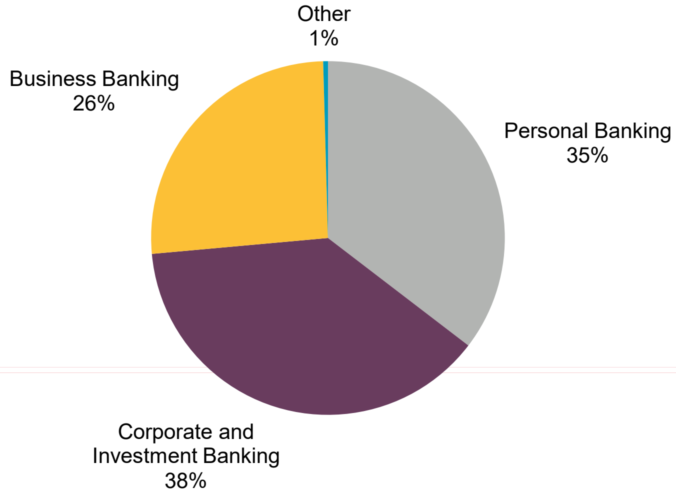
- The Bank's asset encumbrance ratio was 17.1% at end of Q1, compared to 18.0% at 4Q18

Assets, ISK m	31.3.2019	31.12.2018	Δ
Cash and balances with Central Bank	**129,039**	135,056	(6,017)
Bonds and debt instruments	**80,809**	69,415	11,394
Shares and equity instruments	**15,268**	13,074	2,194
Derivatives	**4,837**	4,550	287
Loans to credit institutions	**65,145**	41,577	23,568
Loans to customers	**873,530**	846,599	26,931
Investment in associates	**682**	682	-
Property and equipment	**9,642**	5,271	4,371
Intangible assets	**4,868**	5,002	(134)
Other assets	**21,408**	9,177	12,231
Total assets	**1,205,228**	1,130,403	74,825

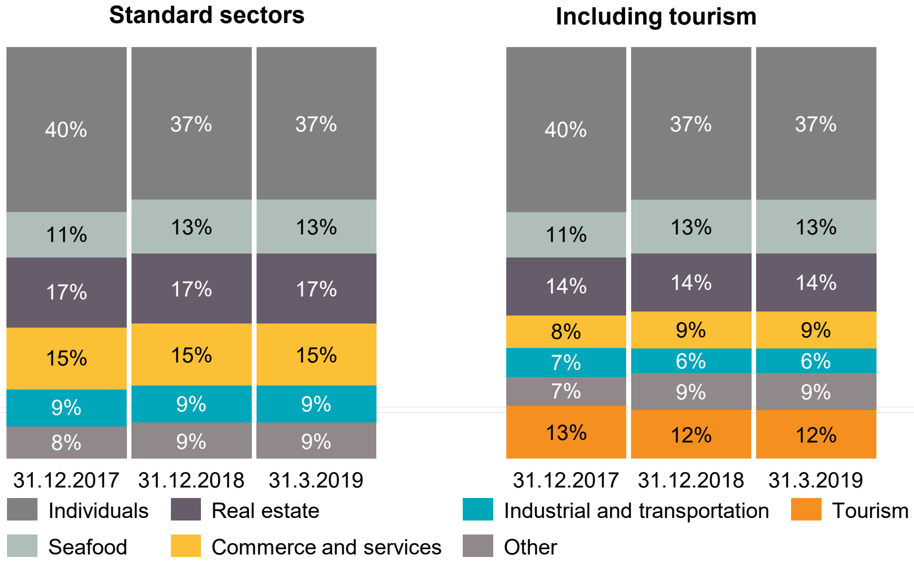
Diversified loan portfolio

Loans to customers grew by 3.2% in Q1 2019

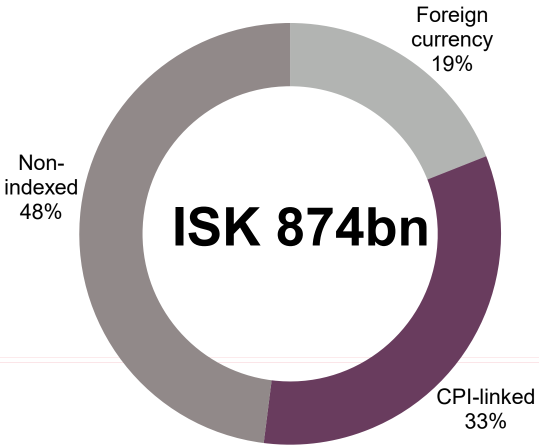
Loan portfolio broken down by business divisions
Consolidated



Loans to customers
By sector, consolidated



Loans to customers
By currency type, consolidated



Highlights

- Strong demand for loans across all sectors in Q1 2019
- The mortgage portfolio increased by 2.5% since year-end 2018
- Exposure to tourism is 12% of loans to customers the same as it was at year-end 2018
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism
- Loan portfolio evenly spread out by the three business divisions although CIB is the largest
- The ratio of FX denominated loans has increased in 1Q19 due to ISK depreciation (trade weighted index)

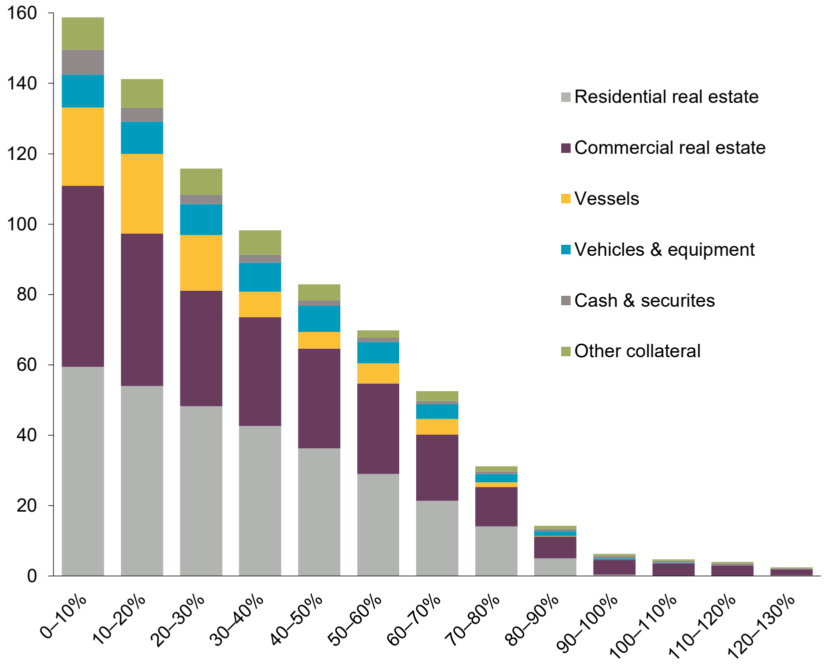
LTV distribution of loan portfolio

Loans generally well covered by stable collateral, majority in residential and commercial real estate

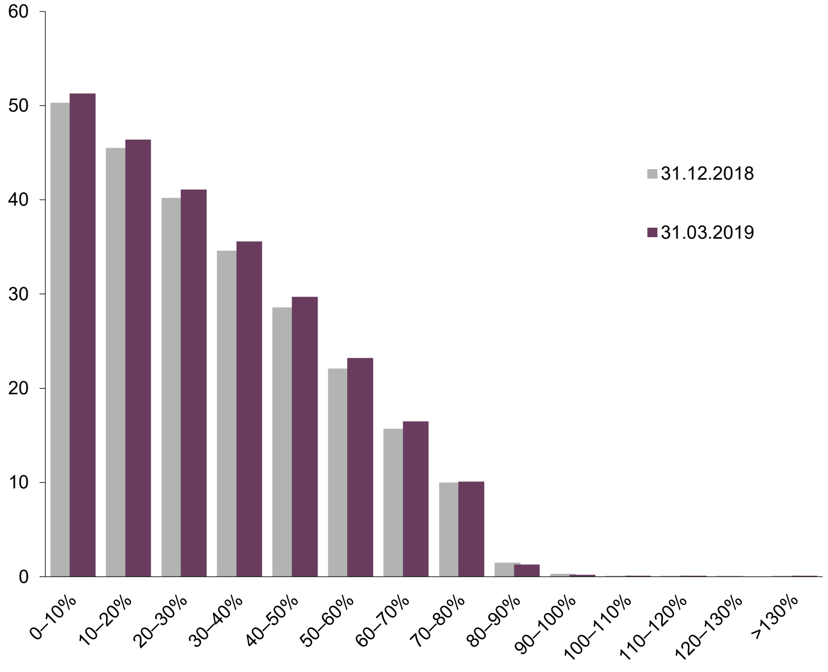
Highlights

- Most of the Bank's collateral is in the form of residential and commercial real estate
- The second most important collateral type is vessels, mostly fishing vessels
- For seasoned mortgages, the LTV distribution is calculated from tax value of properties, which is published annually in June, but for newly granted mortgages the purchase price of the property is used as a valuation while it is considered more accurate

LTV distribution by underlying asset class
ISK bn, by type of underlying asset, as of 31.03.2019



LTV distribution of mortgages to individuals
ISK bn – avg LTV 61% as of 31.03.2019 (61% as of 31.12.2018)[1]



1. The average LTV can be calculated in many different ways and therefore the definition is important for comparison to other banks. The weight is Íslandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Íslandsbanki's loans of the property.

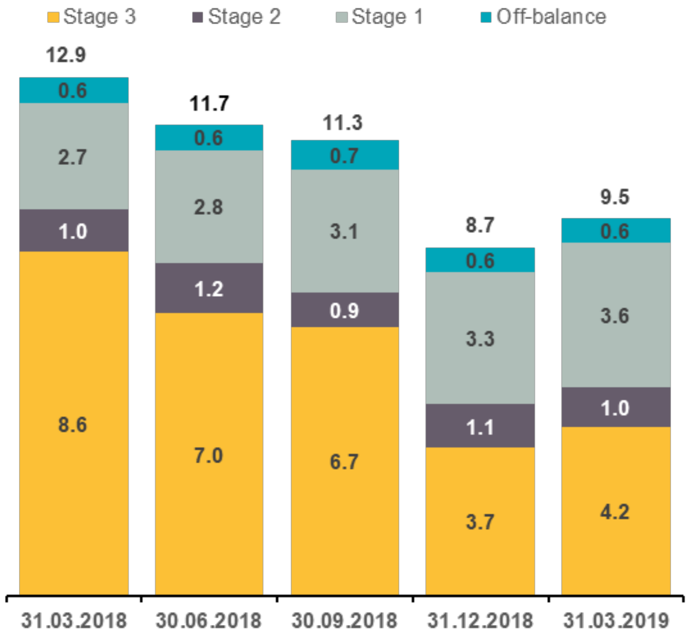
Asset quality

Asset quality improving with NPL ratios continuing downward trend

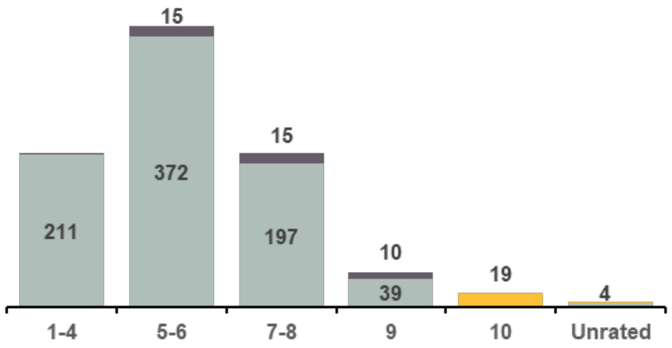
Highlights

- In 1Q2019, the impairment allowance increased due to less favourable economic environment. According to the forward-looking impairment model of IFRS 9 which is based on a probability-weighted average over several scenarios, it can be expected that such uncertainty will lead to an increase in the impairment allowance
- Using the European Banking Authority's definition of NPL, which does not only include loans to customers but also loans and advances to central banks and credit institutions, the Bank's NPL ratio was 1.8% at the end of Q1 2019, compared to 3.2% average for European banks[1]

Loans to customers & off-balance sheet items: impairment allowance account
Development of allowance account, ISK bn



Loans to customers: gross carrying amount
Risk class and impairment stage, ISK bn



Loans to customers: credit quality
Break-down of loans to customers

	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISK bn)	(%)	(ISK bn)	%	(ISK bn)	%
Stage 1	823	93.3%	3.6	0.4%	820	93.9%
Stage 2	40	4.5%	1.0	2.4%	39	4.4%
Stage 3	19	2.2%	4.2	22.1%	15	1.7%
Total	882	100.0%	8.8	1.0%	874	100.0%

1. Source European Banking Authority, data as of Q4 2018

Liabilities

Diversified funding strategy

Highlights

Deposits

- Customer deposits are up by 5.9% to ISK 611bn from year-end 2018
  - The increase was mainly due to a rise from institutional clients and pension funds
  - The customer deposit to customer loan ratio was 70% at end of 1Q19

Debt issued and other borrowings

- Includes covered bonds, commercial papers and bonds in foreign currency
- Market access for covered bonds remains solid, with issuance of ISK 12bn in 1Q19, reinforcing the Bank's position as leading domestic covered bond issuer

Equity

- At the March 2019 AGM, it was approved that ISK 5.3.bn was to be paid in dividends to shareholders for the 2018 financial year. The dividend corresponded to about 50% of after tax profits for 2018, and was consistent with the Bank's dividend pay out ratio target of 40-50%

Liabilities & equity, ISK m	31.3.2019	31.12.2018	Δ
Deposits from Central Bank and credit institutions	**16,404**	15,619	785
Deposits from customers	**611,303**	578,959	32,344
Derivatives and short positions	**7,325**	5,521	1,804
Debt issued and other borrowed funds	**325,035**	300,976	24,059
Subordinated loans	**16,468**	16,216	252
Tax liabilities	**8,303**	7,150	1,153
Other liabilities	**46,769**	29,649	17,120
Total liabilities	**1,031,607**	954,090	77,517
Total equity	**173,621**	176,313	(2,692)
Total liabilities and equity	**1,205,228**	1,130,403	74,825

Deposits remain the main source of funding

Core deposits continue to be stable

Highlights

Stable core deposit base

- Deposits remain the main funding source for the Bank and the deposit to loan ratio remains high
- At the end of the period, 70% of the deposits were in non-indexed ISK, 16% CPI linked and 14% in foreign currencies

Deposits concentration remains stable

- At the end of March 2019,15% of the Bank's deposits belonged to the 10 largest depositors and 37% belonged to the 100 largest depositors. Compared to 14% and 35% respectively for year-end 2018

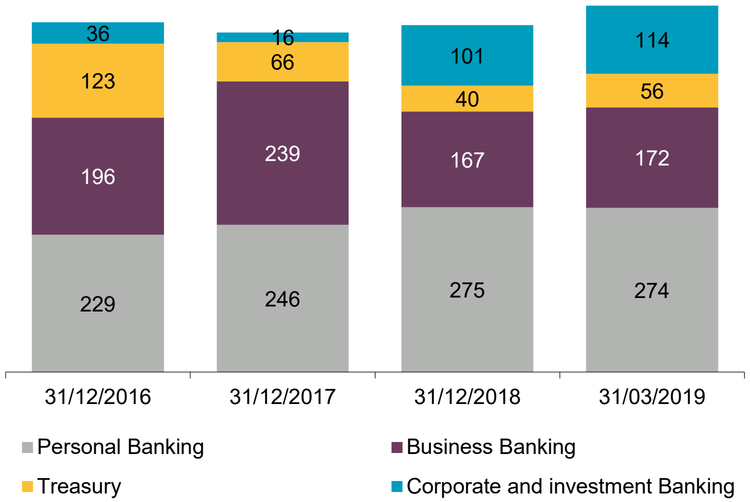
Customer and credit institutions deposits by LCR category

31.03.2019 compared with year end-2018, ISK bn, consolidated

ISK bn	Less stable	Δ	Stable	Δ	Term deposits	Δ	Total deposits	Δ
Retail	**217**	0	**80**	(0)	**80**	2	**377**	1
Operational relationship	**3**	0	**-**	-	**-**	-	**3**	0
Corporations	**68**	5	**0**	0	**22**	(1)	**91**	4
Sovereigns, central-banks and public sector entities	**7**	(0)	**0**	0	**1**	0	**9**	0
Pension funds	**43**	12	**-**	-	**26**	(1)	**69**	12
Domestic financial entities	**27**	(0)	**-**	-	**38**	14	**65**	13
Foreign financial entities	**6**	2	**-**	-	**8**	0	**14**	3
Total deposits	**371**	19	**81**	(0)	**175**	14	**628**	33

Breakdown of deposits from customers by business divisions and Treasury

ISK bn, consolidated



Borrowings

Successful international and domestic market transactions

Highlights

Íslandsbanki is one of the largest issuers of covered bonds in the domestic market

— ISK 12bn issued in covered bonds in 1Q19

Successful private placement issuance in Q119

— NOK 1,400m in January

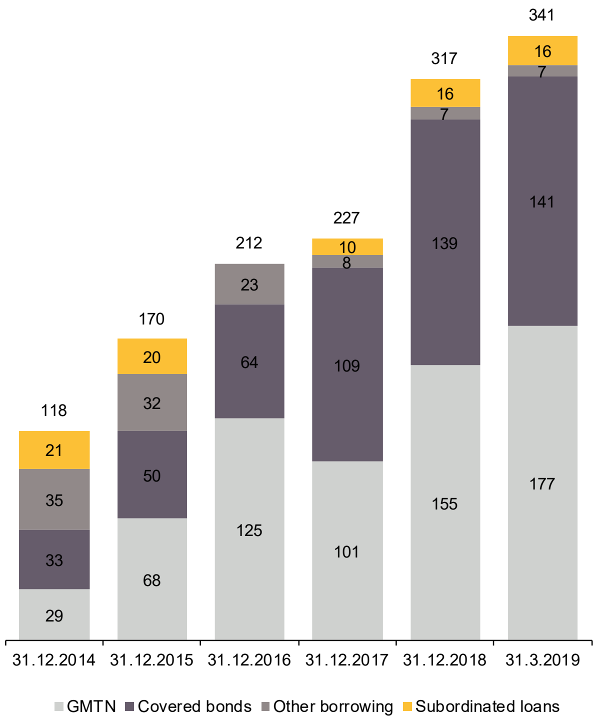
— SEK 650m in January-February

— EUR 11.5m issued in March

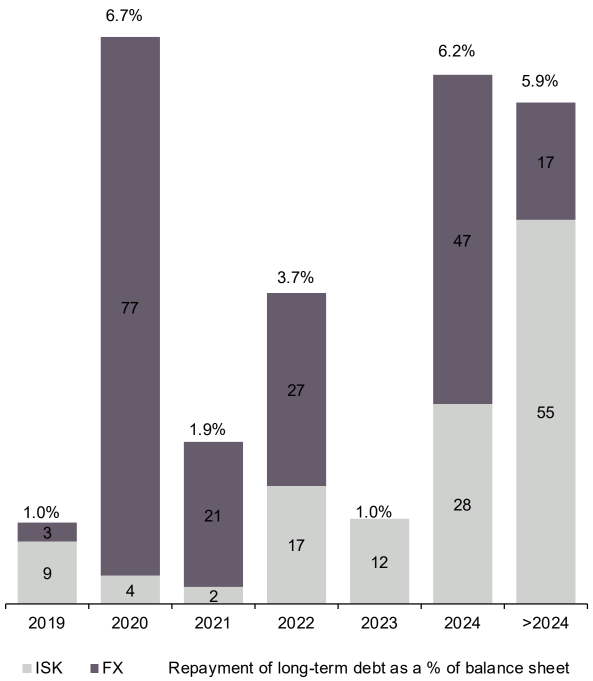
In April, the Bank issued a new public 3yr EUR 300m bond and bought back EUR 300m of the EUR 500m bond maturing in 2020 through a public tender

— Thus reducing the 2020 maturity by approximately ISK 41bn

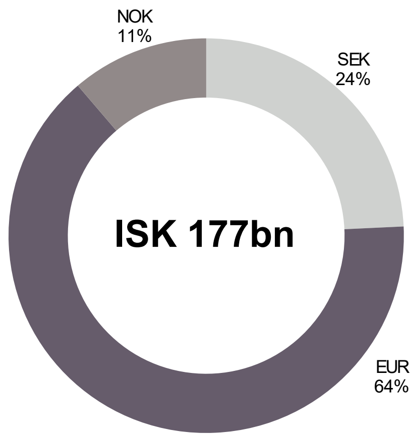
Borrowing sources
Book value, ISK bn



Maturity profile of long-term debt and repayment of long term debt as percentage of balance sheet[1]
31.03.2019, Nominal value, ISK bn



Currency split of GMTN borrowing sources
31.03.2019, Nominal value, ISK bn

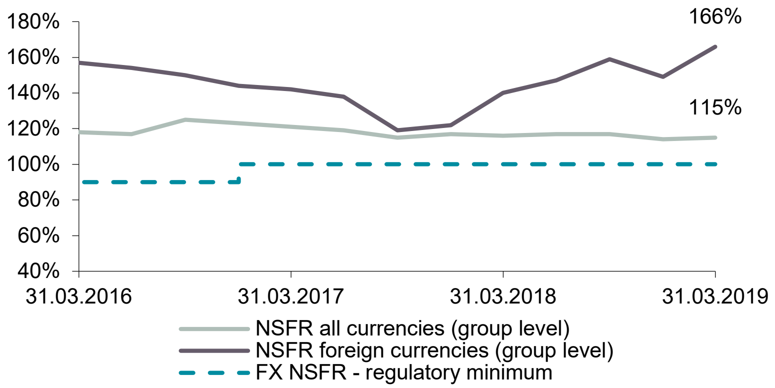


1. Final maturity assumed for callable bonds

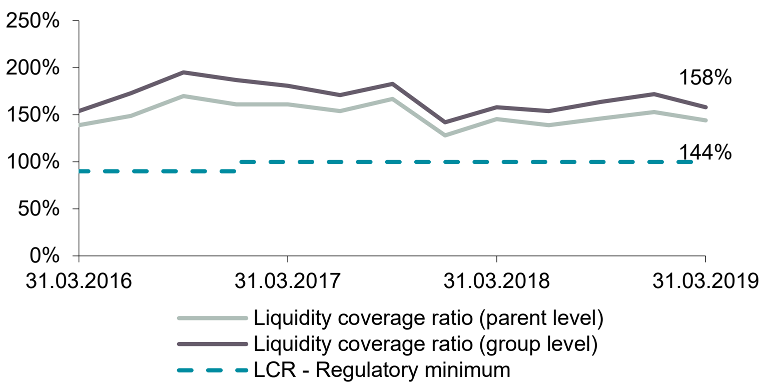
Sound management of liquidity

Liquid assets of ISK 235bn are prudently managed

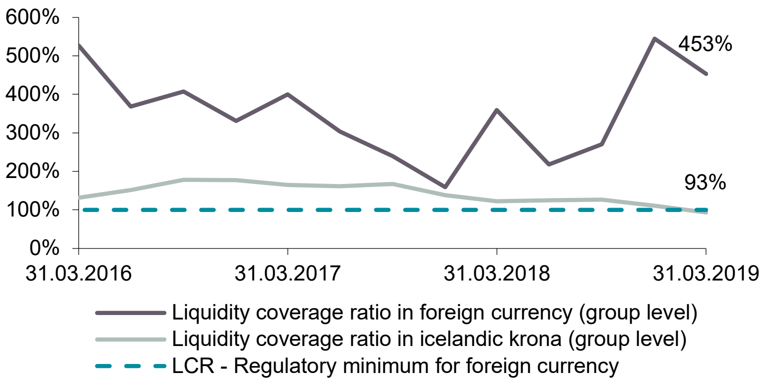
Net stable funding ratio (NSFR)



Liquidity coverage ratio – all currencies



Liquidity coverage ratio – foreign currencies and Icelandic krona



Highlights

- All liquidity measures well above regulatory and internal requirements
- FX liquid assets are composed of government bonds that have a minimum requirement of AA rating and cash placed with highly rated correspondent banks
- Stress testing of liquidity position is an integrated part of the annual ICAAP/ILAAP process as well the annual regulatory stress test
- Liquidity Contingency Plan is in place which shall be tested regularly

Sound capital position

The capital ratio in line with target

Highlights

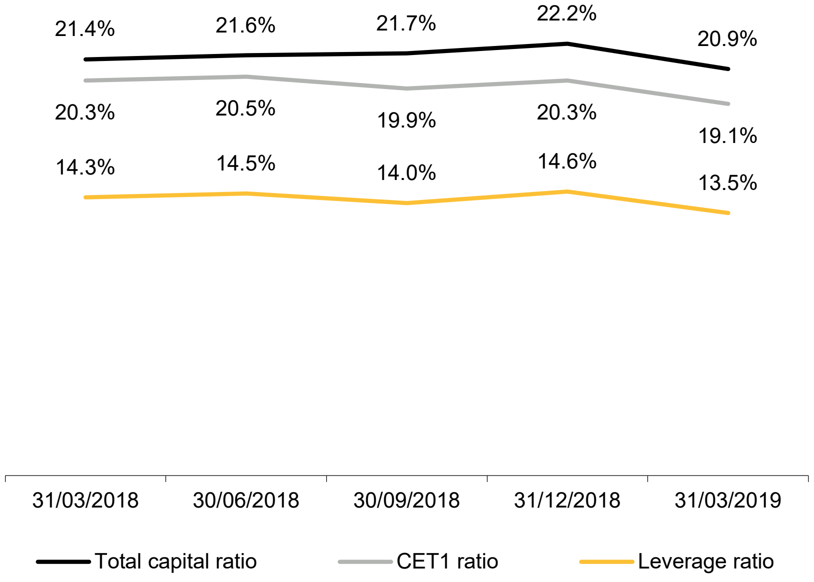
Capital ratios

- The capital base was ISK 186bn and the CET1 capital was ISK 169bn at end 1Q19, compared to ISK 188bn and ISK 172bn respectively at year-end 2018
- The decrease in the capital base CET1 capital is mainly due to the ISK 5.3bn dividend payment in March 2019, offset by retained earnings for the period

Risk exposure amount (REA)

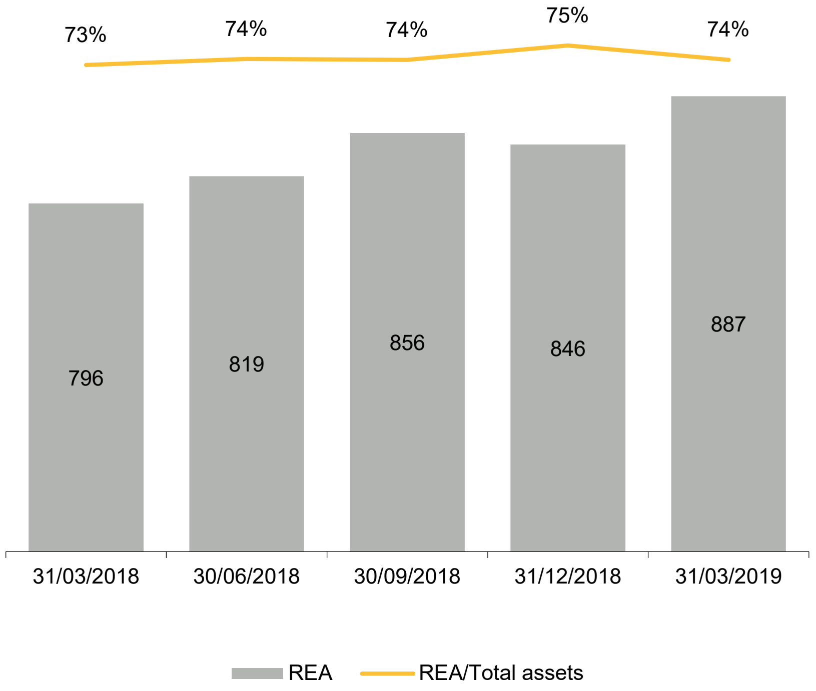
- The REA growth is mainly due to increase in loans to customers during the period
- The implementation of IFRS 16 where the right to use assets is capitalized contributes to a ISK 4.3bn increase of REA
- The ratio of REA of total assets remains fairly stable at 74%

Capital and leverage ratios



Risk exposure amount (REA)

ISK bn



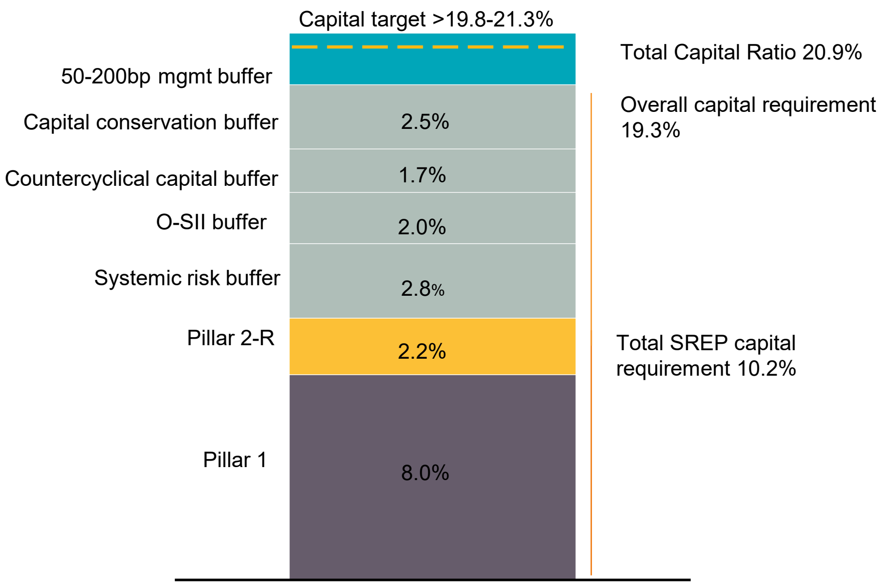
Íslandsbanki’s capital target

Based on the regulatory SREP requirement in addition to 50 – 200bp management buffer

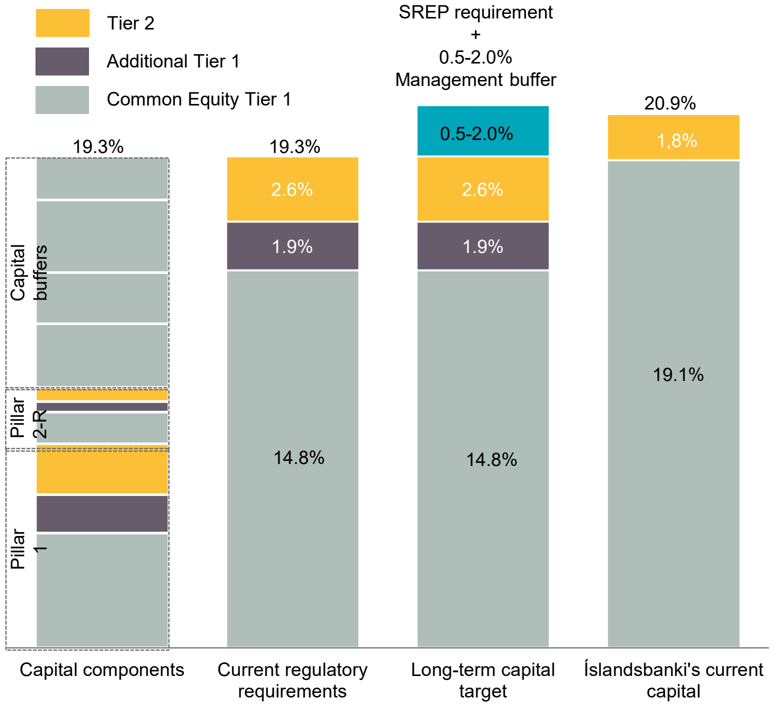
Íslandsbanki’s capital target

- The sum of Pillar 1, Pillar 2-R and the combined capital buffers form the overall regulatory capital requirement
- Based on the SREP 2018 results, published in October 2018, the overall capital requirement for Íslandsbanki is 18.8% of risk exposure amount (REA)
- The countercyclical capital buffer increases from 1.25% to 1.75%, effective from May 2019
- Íslandsbanki's total capital target ratio is based on the regulatory SREP requirement in addition to a 50-200bp management buffer
- The size of the management buffer is based on factors such as volatility in the capital ratios for example due to currency fluctuations, volatility in earnings and REA and uncertainties in the regulatory or operating environment

Íslandsbanki’s capital target



Capital requirement composition



Íslandsbanki credit ratings

Ratings affirmed from S&P in 2018

Íslandsbanki

	S&P
Long-term	BBB+
Short-term	A-2
Outlook	Stable
Rating action	Jul 18

Icelandic sovereign

	S&P	FITCH	MOODY'S
Long-term	A	A	A3
Short-term	A-1	F1	-
Outlook	Stable	Stable	Positive
Rating action	Jun 18	Jun 18	Jul 18

S&P
BBB+/A-2 Stable Outlook

Press Release 17 July 2018

In July, S&P Global Ratings **affirmed** Íslandsbanki's ratings of **BBB+/A-2** with a **stable outlook** along with three other Icelandic financial institutions. S&P had in October 2017 upgraded the Bank to this rating

In its press release, S&P notes that the rating actions take into account their view that **economic growth in Iceland continues to support the banking sector, resulting in business growth and low default rates**. This is balanced by their expectation of more challenging competitive and funding dynamics

S&P also comments that the stable outlook on Íslandsbanki reflects our expectation that the **Bank's RAC ratio will remain sustainably above 15%**, even while the bank prepares for an eventual sale or IPO over the next two years, and it optimises its capital base by paying extraordinary dividends and issuing capital instruments

4. Financial targets and next steps

Financial targets

Medium and long term strategies structured around achieving key financial targets

	Target	1Q19	2018	2017	Guidance
ROE regular operations[1]	8-10%	6.7%	✔ 8.0%	✔ 9.9%	— Based on risk free rate + 4-6% which is considered to be CBI current account rate, currently at 4.25% (average in 2018 = 4%) — As the Bank retains substantive liquid assets, interest rate levels in Iceland can have a substantial impact on ROE — The bank tax, excluded from target returns, will have an impact on profitability if kept at current high levels — ROE target will be challenging to reach in the near term in a slowing economy and before a full realisation of the Bank's planned efficiency gains
Cost/ Income ratio[2]	<55%	62.6%	66.3%	62.5%	— This is a medium to long term target, C/I ratio can be expected to be higher than target in the near term — Headcount and non-headcount related cost control programmes in place — Lower C/I on parent company basis than on a consolidated basis
CET1	>16% LT	✔ 19.1%	✔ 20.3%	✔ 22.6%	— Current SREP requirement of 18.8% (will increase in May to 19.3%) plus management buffer means currently a target 14.8-16.3% CET1 ratio
Total capital ratio	> 19.3 – 20.8%	✔ 20.9%	✔ 22.2%	✔ 24.1%	— Based on the regulatory SREP requirement with a 50 – 200 bp management buffer — Current SREP requirement is 18.8% — Short term target removed in Q317 due to less uncertainty regarding lifting of capital controls and IFRS9 implementation
Dividend payout ratio	40-50%	✔ 50%	✔ 50%	✔ 100%	— Dividend pay-out ability will be impacted if the bank tax will be kept at current high levels — The BoD agreed to pay out ISK 5.3 billion in dividend for the 2018 financial year which is in line with the Bank's dividend pay out target

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.
2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one-off items)

Next steps for Íslandsbanki

Digital advances at the forefront for Íslandsbanki, anchored by a new strategy and enhanced societal impact, preparing the Bank for future challenges and opportunities

Established business position with a new forward looking strategy, preparing the Bank for future challenges

- Íslandsbanki has maintained a stable market share for all business segments while continuing to be ranked at the top in terms of customer satisfaction while Net promoter scores continue be high for all business segments
- The Bank has made substantive investments in IT infrastructure, including a new core payment and deposit system
- The roll out of impressive new digital customer solutions backed up by a new ambitious Bank strategy and enhanced commitment to societal impact developed with international consultancy firm Boston Consulting Group, will enable the Bank to tackle future challenges and exploit new opportunities

Successful funding operations, which along with growing and stable deposits, contribute to high liquidity levels

- Continued successful debt transactions with the issue of domestic bills and covered bonds, as well as foreign currency denominated bonds
- Íslandsbanki remains the largest issuer of covered bonds in Iceland and despite credit markets being in bearish mode for most of 2018, the Bank enjoyed good success with its funding programme in foreign currencies
- Deposits continue to grow with the Bank maintaining its market share with a special focus on securing stable long term deposits
- As a result, the Bank’s liquidity position is strong

Capital position at its long term target while earnings continue to be in line with expectations and C/I ratio on the decline

- Capital ratio at 20.9% in line with long term target
- The regulator (FME) recently lowered the Bank’s total SREP capital requirements from 11.2% to 10.2%, in recognition of the Bank's reduced market risk whereas the countercyclical capital buffer increased from 1.25% to 1.75% in May 2019, changing the Bank's overall capital requirement from 19.8% to 19.3%.
- The Bank has seen a steady rise in interest and fee and commission income while ROE for regular operations has been in line with goals
- C/I ratio on the decline with the Bank expecting to reach its 55% C/I ratio target in the near future as lowering costs is a top priority

Managing the loan portfolio in a lower growth economy

- Robust risk management and conservative lending policies are attributed to the Bank’s credit quality remaining strong
- The Bank has been carefully watching and managing loans that are in certain specific segments of the Icelandic economy, such as the tourism sector, with overall exposure to the sector lowering between years

5. Annex – Icelandic economy update

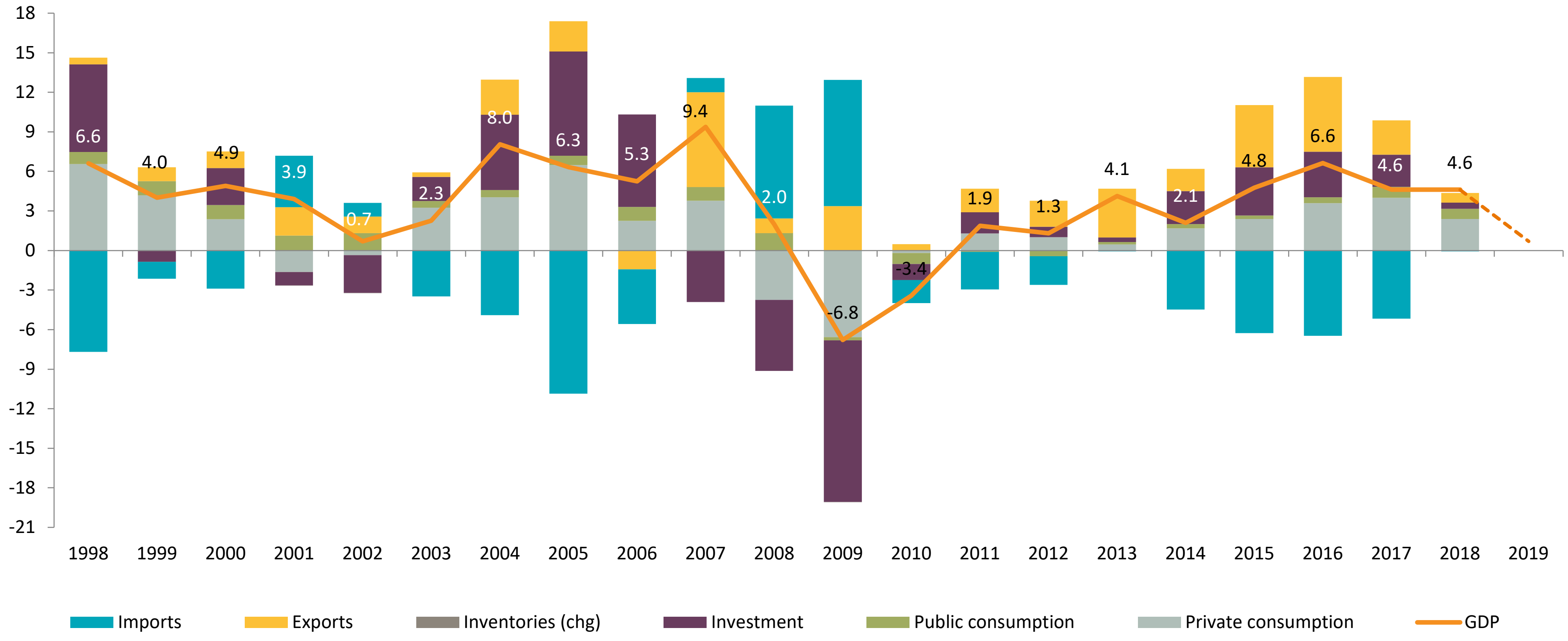
Small to no GDP growth likely in 2019

Investment and exports will contract this year

- A long period of continuous upswing in the Icelandic economy appears to be at an end
- Output growth measured 4.6% in 2018. The exact same growth rate as in 2017
- An identical growth rate masks significantly different growth drivers between 2017 and 2018
- In 2018, growth in exports and investment was much slower than in the previous year. However, stagnant imports offset the aforementioned slowdown
- ISB Research's January forecast assumed 1.1% growth for 2019 as a contraction in service exports and business investment was seen to be offset by increasing private consumption, other investment and goods exports
- In the wake of setbacks in the tourism and seafood sectors, small-to-no GDP growth appears the more likely scenario for this year
- The outlook is for growth to pick up again in 2020, buoyed up by livelier private consumption growth, a resumption of growth in business investment, and continued growth in other investment and in goods and services exports

GDP and the contribution of major subitems [1]

YoY change (%)



1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

8 May 2019

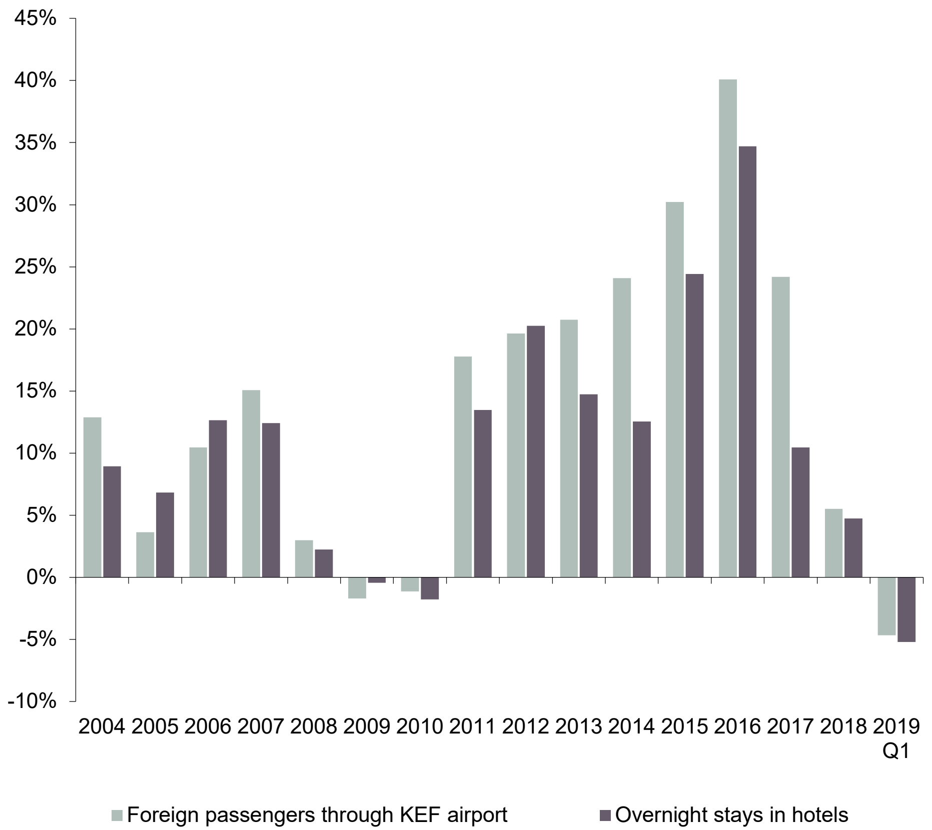
Tourism sector faces headwinds after rapid growth

Largest export sector likely to contract significantly in 2019

- Following rapid expansion throughout most of the decade, the tourism sector is now entering a phase of consolidation
- In 2018, the number of foreign tourists increased by 5.5% YoY and overnight hotel stays went up by 2.3%
- In Q1 2019, the number of foreign tourists declined by 4.7% and overnight stays decreased by 5.2% YoY
- The tourism sector shows various signs of maturing, with increased emphasis on streamlining and mergers taking over from rapid growth and supply-side increases among many providers
- The demise of Wow air and problems with Icelandair's Boeing 737 MAX aircraft means that a larger YoY contraction is likely in Q2-Q3
- Tourism is likely to return to moderate growth in the coming term as airlines gradually fill the supply gap left by Wow air and Icelandair's fleet becomes fully operational once more

Foreign visitors and overnight hotel stays

YoY change



Services exports and foreign card turnover

YoY change

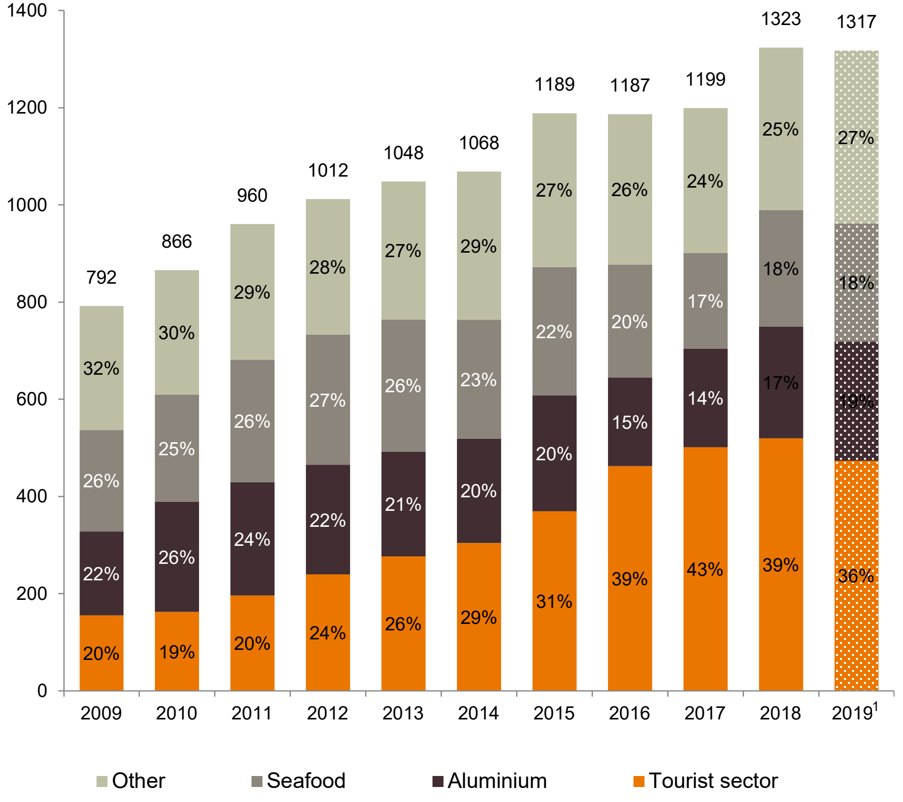
Source: Statistics Iceland, Centre for Retail Studies and Icelandic Tourist Board

Current account outlook reasonably benign

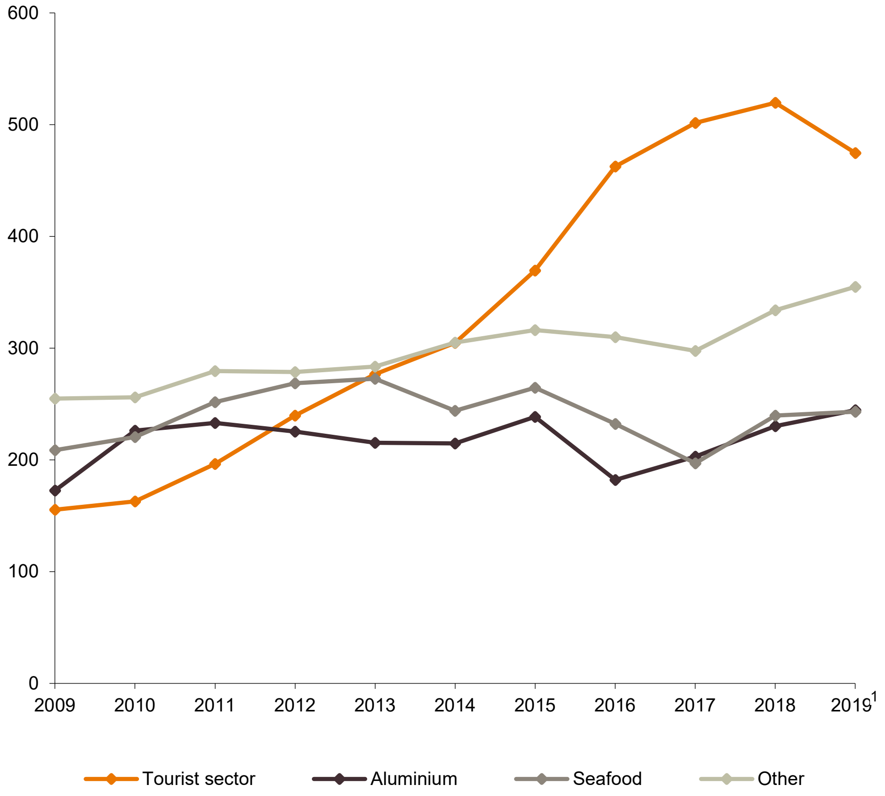
Strong net external position increases resilience

- Exports are likely to contract in 2019 for the first time since 2006
- The number of tourists visiting Iceland expected to contract significantly, from 2.3m in 2018 to ca. 2.0m in 2019
- Seafood exports declining moderately due to negative developments in the capelin stock
- The effect of declining exports partially offset by less tourism-related imports, slower growth in consumer imports and a contraction in business investment imports
- A small C/A surplus or a broadly balanced current account the most likely outcome for 2019
- Exports expected to pick up again in 2020 as the tourist sector returns to moderate growth and seafood exports increase once more.
- Iceland's net external position positive by just under 10% of GDP at end-Q1 2019. Strong external position increases the economy's resilience to temporary swings in the current account

Export revenues
ISK bn



Revenues of main export sectors
ISK bn

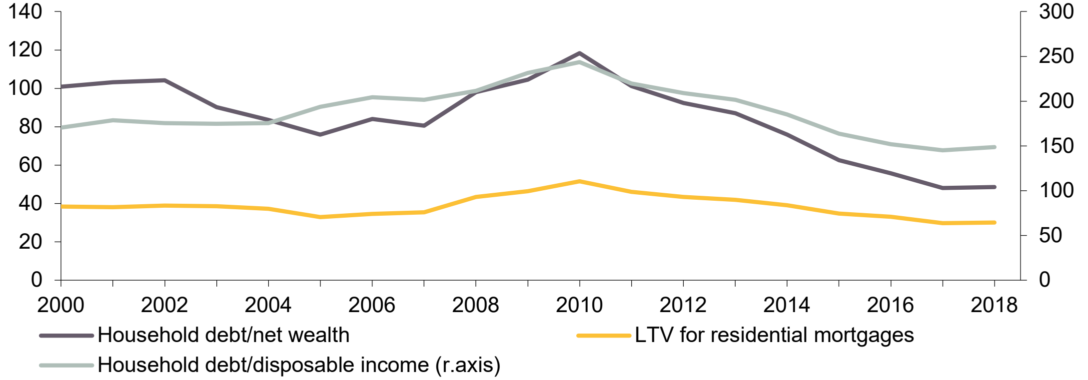


1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Central bank of Iceland, Statistics Iceland and ISB Research

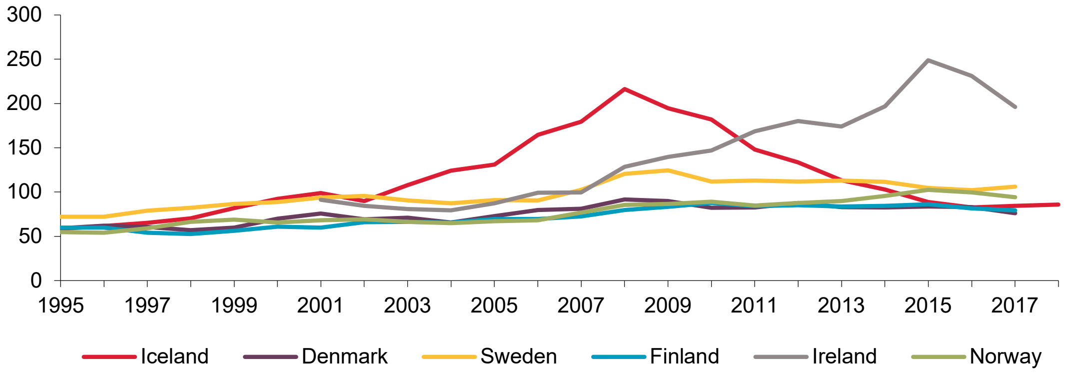
Domestic balance sheets well placed to weather setbacks

Economy-wide leverage moderate in comparison with peers and historical levels

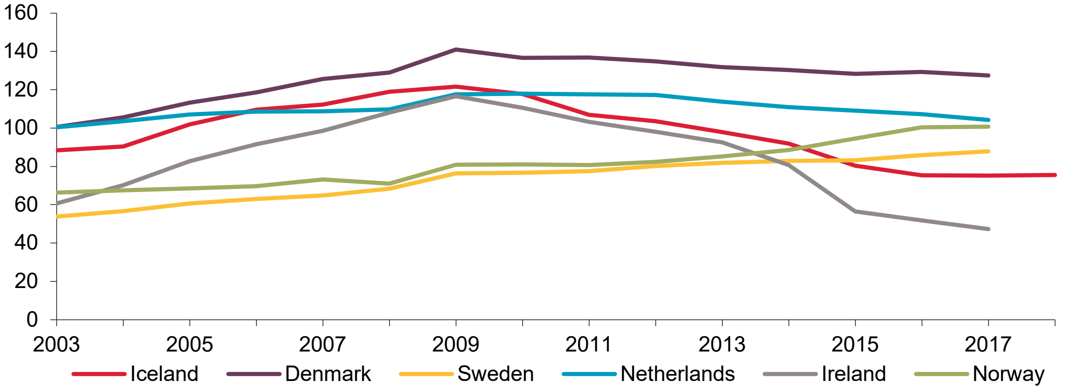
Household debt
%



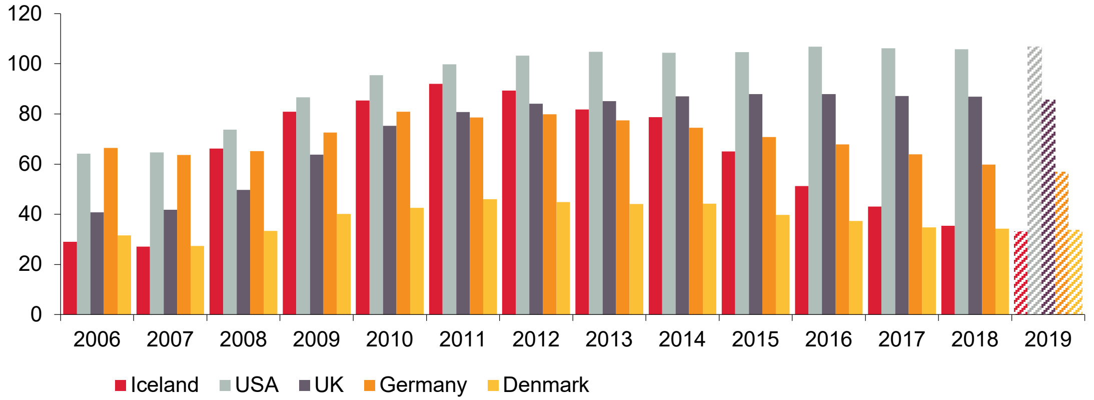
Corporate debt
% of GDP



Household debt
% of GDP



General government gross debt
% of GDP



Source: Central bank of Iceland, Statistics Iceland, IMF

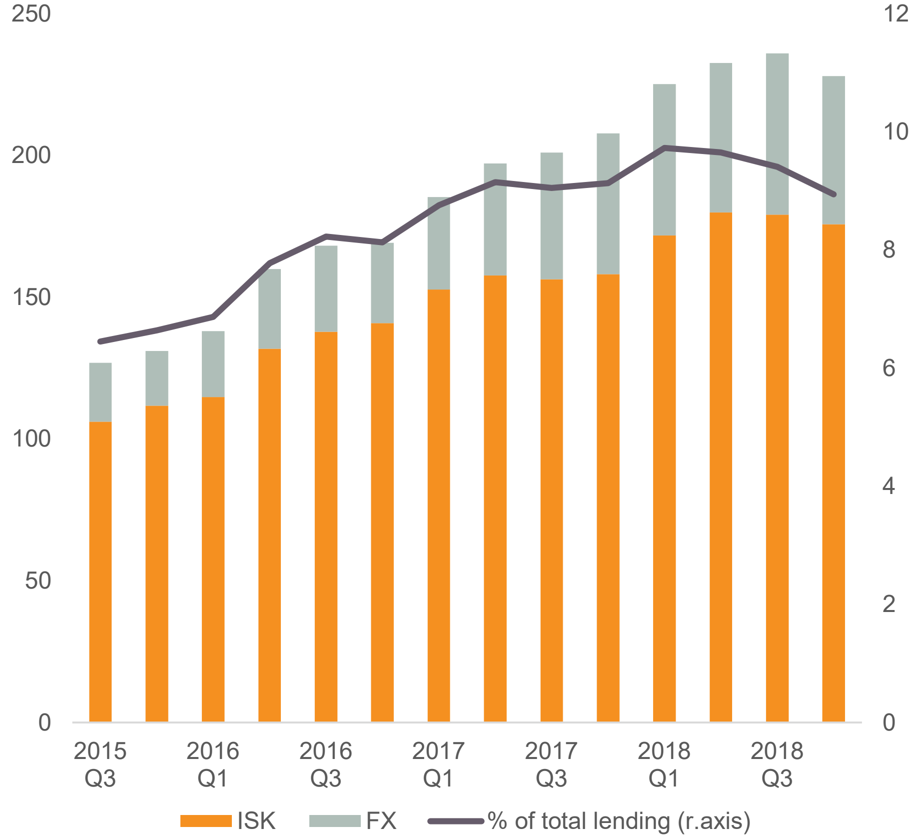
Businesses brace for leaner times

Slowdown in lending growth to tourist sector

- Business investment contracted by 5.4% in 2018 following four years of robust growth
- Contraction in 2018 largely due to significant reduction in transport equipment investment as well as one-off factors
- Further contraction in business investment likely for 2019 as the private sector adjusts to weaker economic outlook
- Business sentiment has dropped considerably in recent quarters as tourist sector growth stalled, Wow-air financial difficulties escalated and the ISK depreciated
- Investment in the tourist sector has slowed and lending into the sector has moderated
- A relatively benign near-term outcome from recent general wage negotiations could improve business sentiment in coming months

Business sentiment, 400 largest companies
Index

Deposit money banks' lending to tourist sector
ISK bn



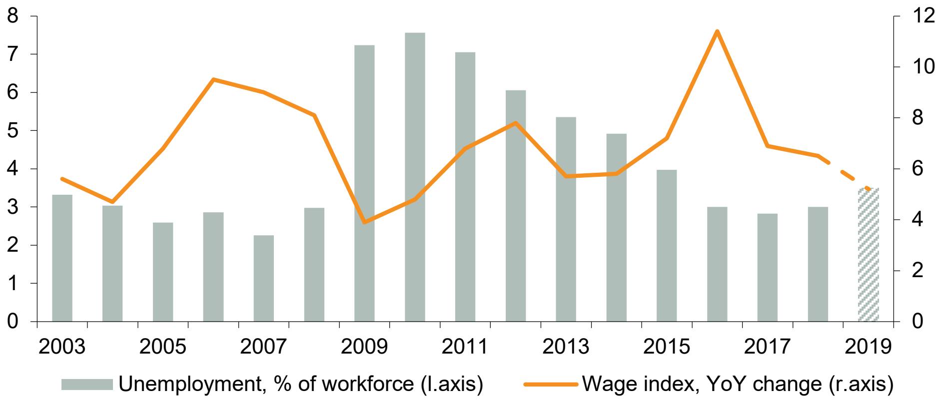
Source: Statistic Iceland, the Central Bank of Iceland and Gallup

Household consumption growth eases

Labour market cooling and population growth slowing

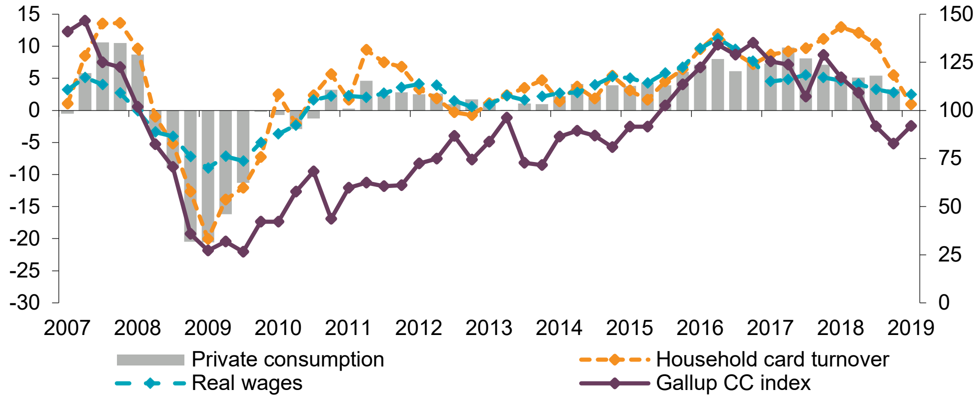
- In recent quarters, private consumption growth has levelled off following rapid growth in 2015-2017
- Developments in key indicators suggest a further slowdown ahead. Consumer sentiment has declined significantly, real wage growth has slowed, and payment card turnover in Q1 2019 was the slowest in 6 years
- The Icelandic labour market shows signs of cooling, with unemployment edging up and real wage growth slowing due to rising inflation and more moderate nominal wage growth
- Population growth is also slowing, with 1.8% growth expected in 2019 following 2.5% growth in 2018
- Icelandic households have responded to slower real wage growth and darkening outlook by consolidating instead of taking on additional debt to finance spending
- Private consumption growth was 4.8% in 2019. ISB Research's January forecast predicted 2.7% growth for 2019. Recent developments indicate that may be somewhat optimistic

Unemployment and wage growth



Private consumption and related indicators

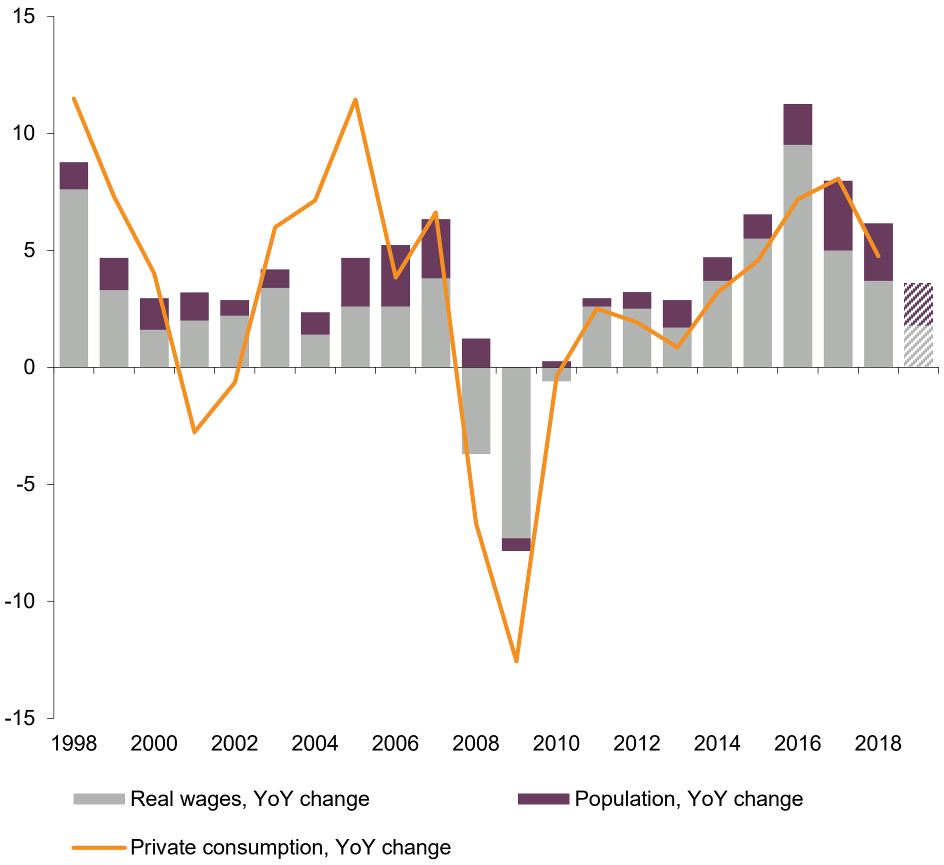
YoY change (l.axis) and index (r.axis)



1. *Shaded areas indicate ISB Research/ forecasts*
Source: Statistic Iceland and ISB Research

Real wages, population and private consumption

YoY change (%)

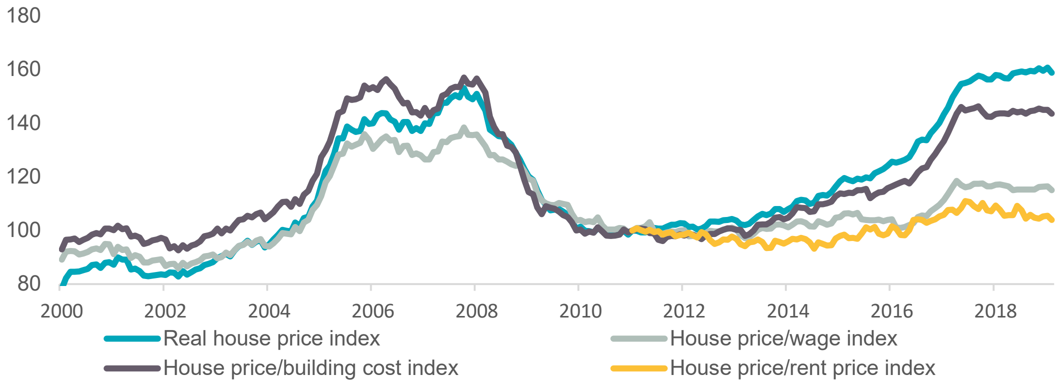


Real estate market balancing

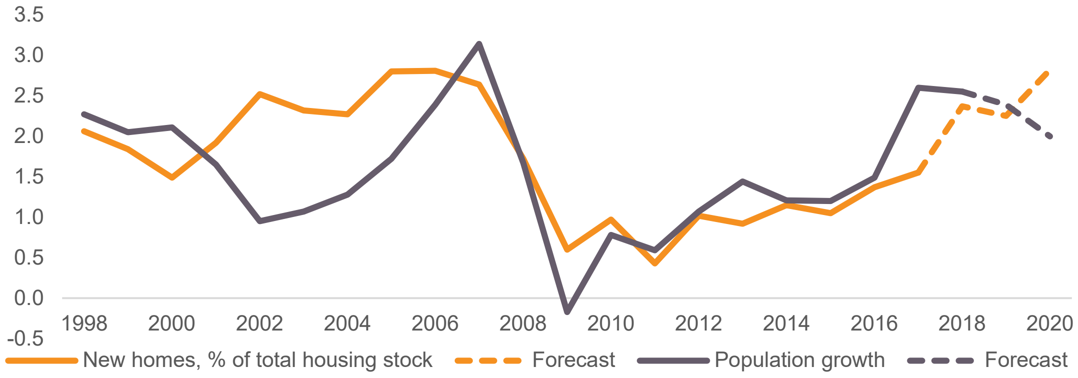
Supply is increasing, demand has been easing and the pace of residential price rises is moderating

Residential capital region house prices and determinants

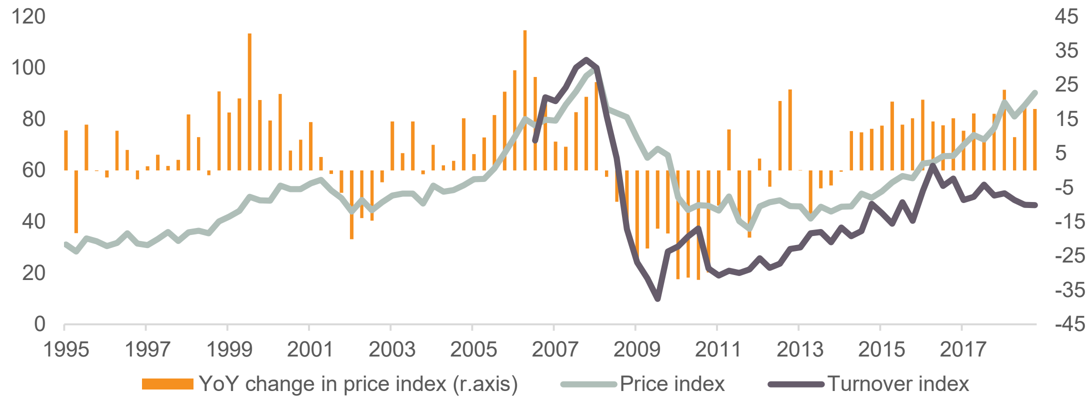
Indices



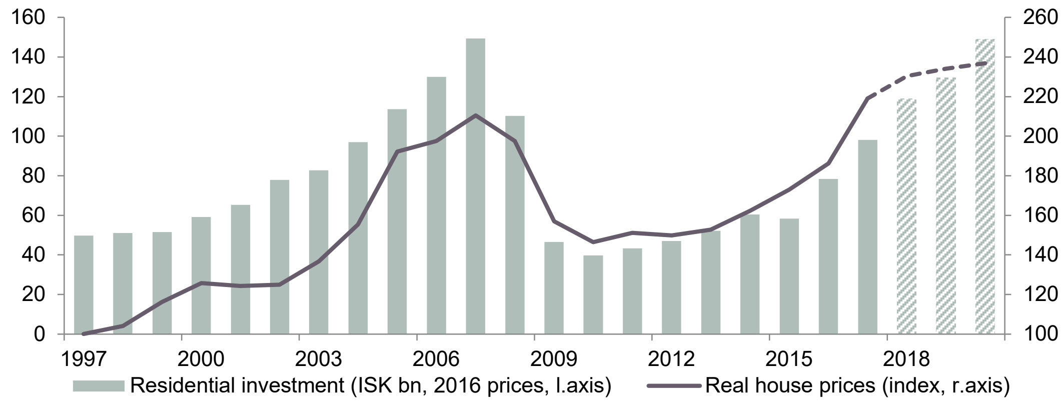
New apartments and population increase in the capital region [1]



Commercial real estate real price and turnover index



House prices and residential investment



1. Dotted lines: forecasts by Statistics Iceland and the Federation of Icelandic Industry
Source: Statistic Iceland and ISB Research

8 May 2019

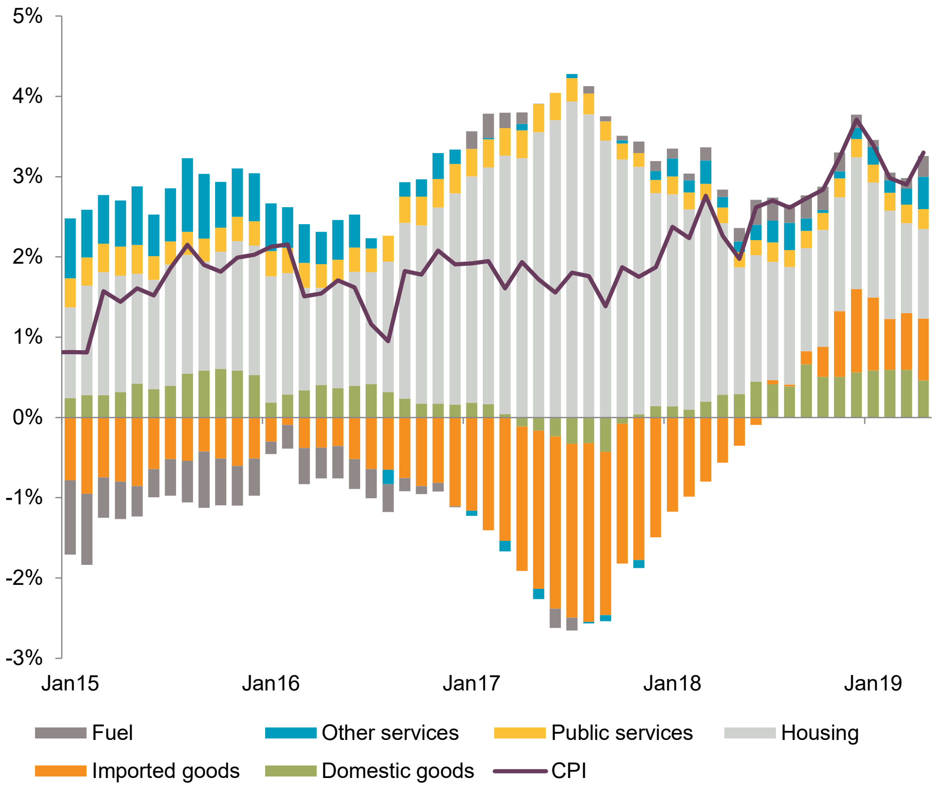
Inflation likely to peak in mid-2019

Policy rate could decrease in coming quarters

- After measuring 3.7% over 2018, inflation in Iceland has subsided to 3.3% as of April 2019
- The composition of inflation has changed: Housing cost, imported inflation and domestic cost pressures each account for roughly 1/3 of current inflation
- The outlook is for inflation to peak at 3,4% in Q2/Q3 and subside gradually thereafter
- Inflation expected to measure 2.9% at the end of 2019 and to average 3.1% in 2020
- The Central Bank of Iceland's policy rate is currently 4.5%, following a 0.25% rate hike in November 2018
- Increased probability of rate cuts in coming months as inflation pressures subside, housing prices rise more moderately, inflation expectations stabilize and economy cools

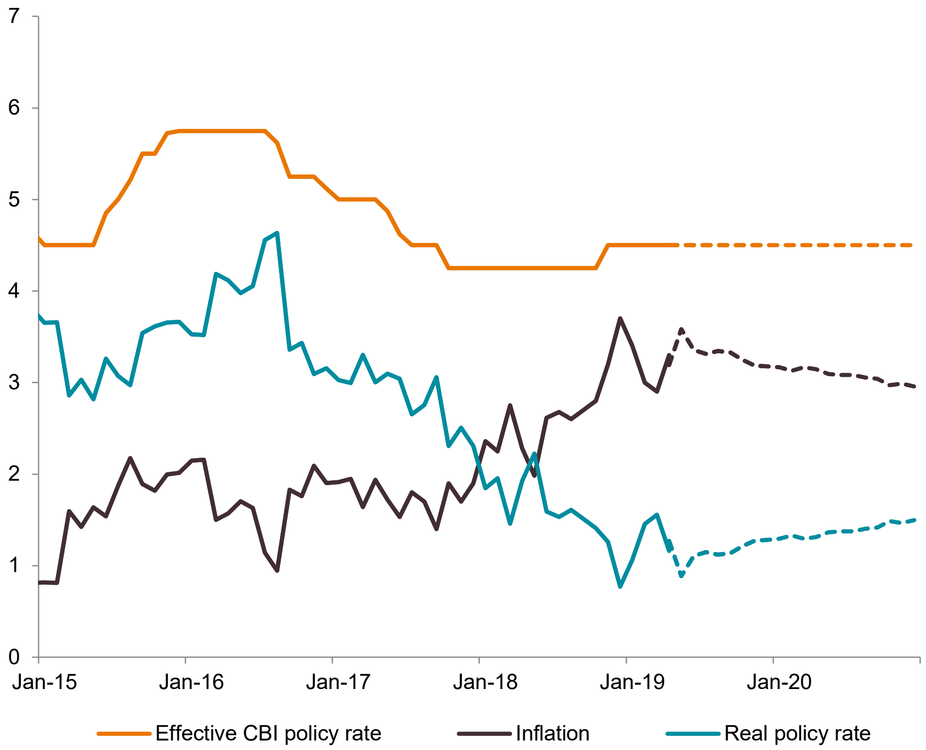
Inflation and contribution of main subitems

%



Inflation, policy rate and real policy rate

%



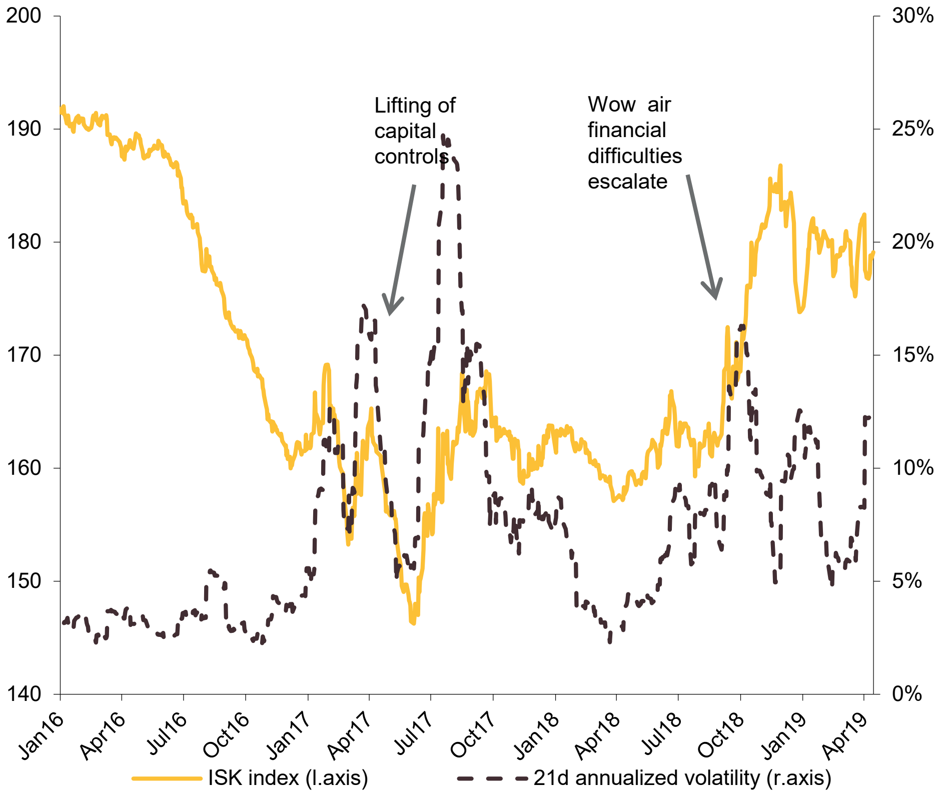
Source: Statistic Iceland, the Central Bank of Iceland and ISB forecasts

ISK may have found a short-term equilibrium

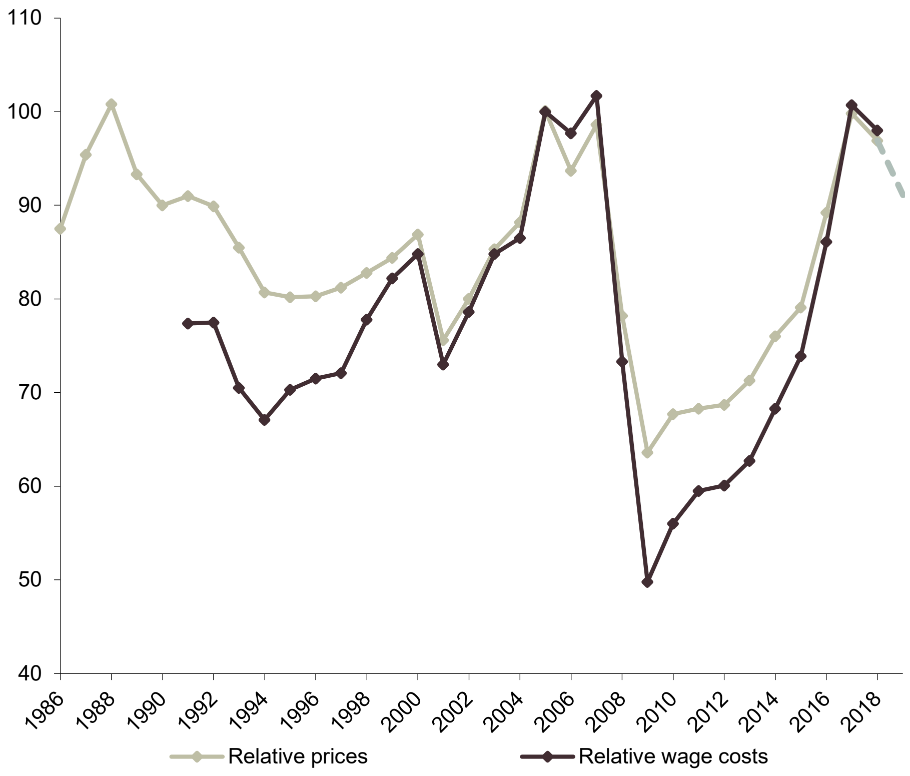
Real exchange rate likely to remain relatively high through this decade

- The ISK depreciated by nearly 7% in H2of 2018, after a twelve-month period of relative stability
- This depreciation was broadly a positive development, conducive to reducing the risk of growing external imbalances in the short term
- Current exchange rate seems to facilitate balanced FX flows as ISK has been relatively stable YtD
- Foundations for the ISK stronger than in recent decades due to positive net external asset position, decreased leverage economy-wide, large FX reserves and benign medium term growth outlook
- Despite deteriorating export outlook in 2019, inward investment should broadly suffice to offset FX outflows due to portfolio diversification by domestic investors
- Real exchange rate upward pressure due to large wage and price increases would likely lead to a corresponding depreciation pressure on the nominal ISK exchange rate

ISK exchange rate, daily values and volatility



Real exchange rate indices

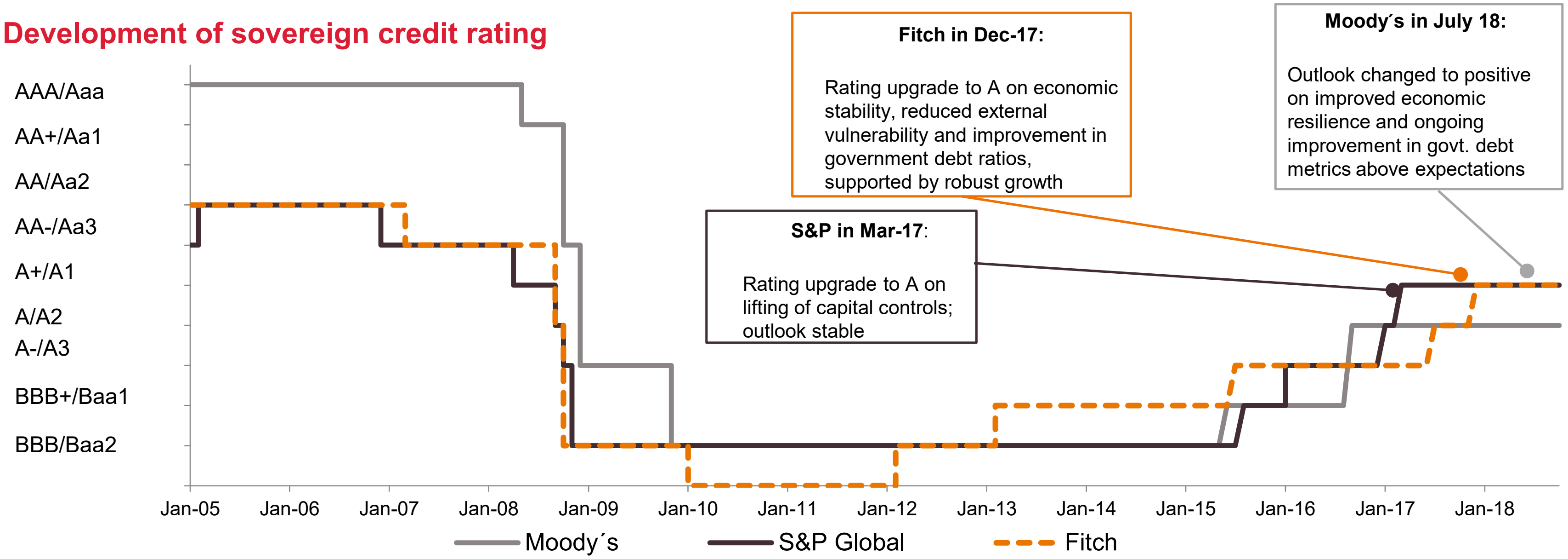


Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research

Iceland’s credit rating has improved markedly

Upgrades from S&P and Fitch following lifting of capital controls

Development of sovereign credit rating



MOODY’S IN JULY 2018

- The positive outlook also reflects progress made in the past two years on the major preconditions we laid out at the time of the upgrade to A3 in September 2016, including the smooth removal of capital controls and the settlement of the offshore krónur situation.

FITCH IN JUNE 2018

- The outlook is stable.
- The A rating balances the economy’s high income per capita, strong performance on governance, human development and doing business indicators against its high commodity export dependence, vulnerability to external shocks and experience of macroeconomic and financial volatility.

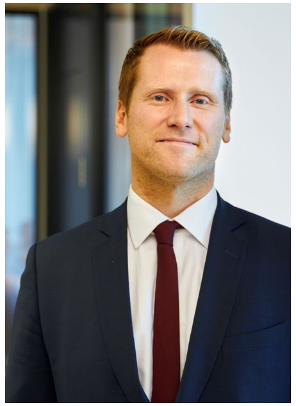
S&P IN JULY 2018

- S&P Global Ratings affirmed its 'A/A-1' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Iceland. The outlook is stable.
- The stable outlook balances the risks stemming from the domestic economy overheating against the potential for more rapid improvements in the government and external balance sheets over the next few years.

Source: Moody´s, S&P, Fitch Ratings and Central Bank of Iceland

More about Íslandsbanki

Learn more about the Bank on the Investor Relations website and through our contacts



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Investor material

Further investor information can be found at the Íslandsbanki IR website
https://www.islandsbanki.is/en/landing/about/investor-relations

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