9M 2018 Financial Results

íslandsbanki.is

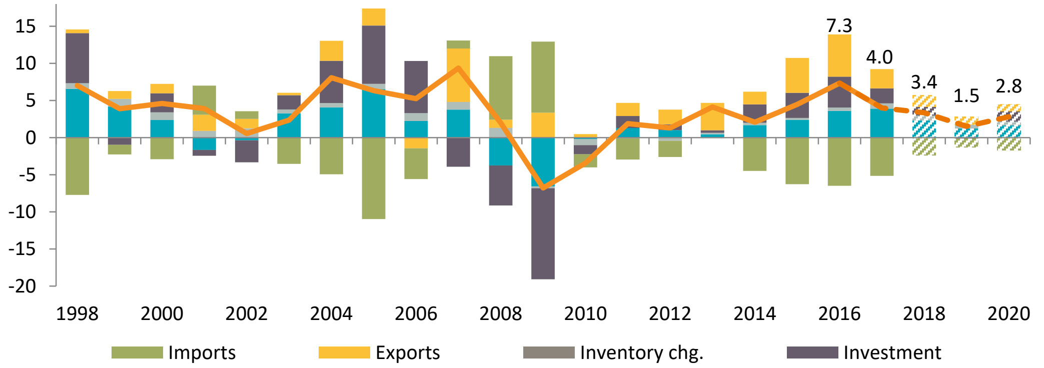
Table of Contents

1. 9M 2018 highlights

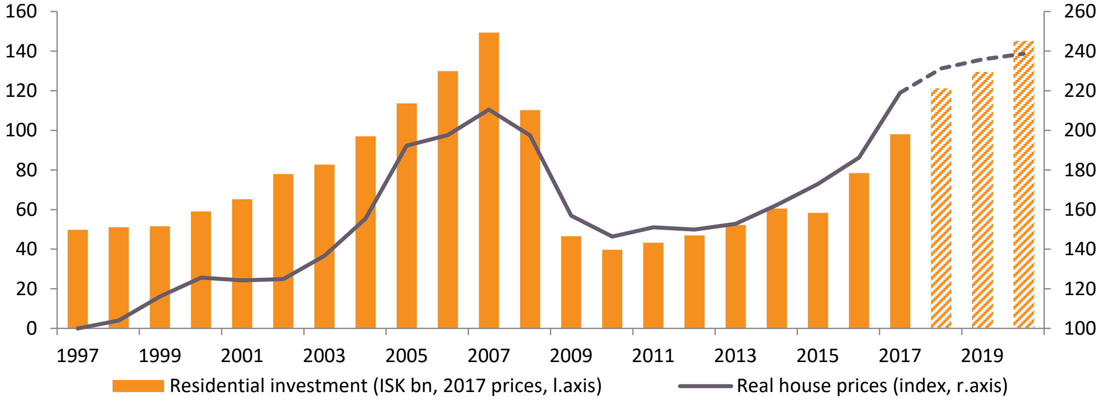
Economic highlights

A year of adjustment ahead following a long upswing period

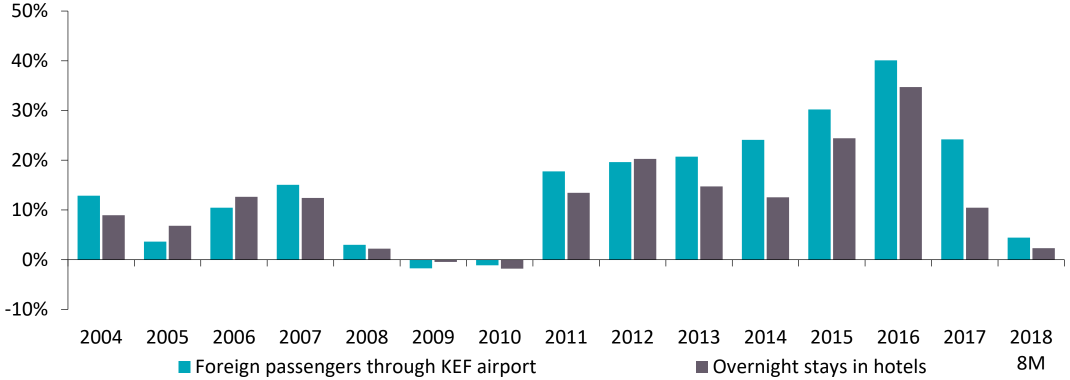
Slower GDP growth ahead due to less increase in domestic demand…



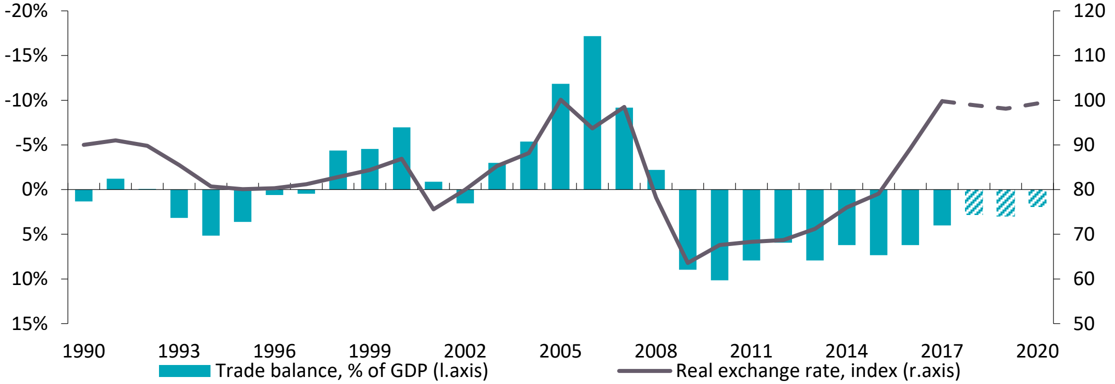
…rapid supply increase is facilitating a more balanced housing market…



..and the tourism sector is maturing following a high growth period…



..while ISK depreciation will help to keep the current account in surplus



Source: Central bank of Iceland, Statistics Iceland

Financial highlights

Key figures & ratios

		9M18	9M17	3Q18	3Q17	2017
PROFITABILITY	ROE 16% CET1 (regular operations)[1]	**9.0%**	9.7%	**8.1%**	7.9%	10.3%
	ROE (after tax)	**7.1%**	7.7%	**4.9%**	4.7%	7.5%
	Net interest margin (of total assets)	**2.9%**	2.9%	**3.0%**	2.8%	2.9%
	Cost to income ratio[2]	**65.6%**	60.2%	**62.1%**	62.7%	62.5%
	After tax profit, ISK m	**9,241**	10,114	**2,111**	2,073	13,226
	Earnings from regular operations, ISK m[3]	**8,979**	10,178	**2,929**	2,812	13,848

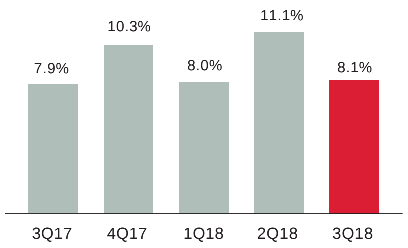
		30.9.2018	30.6.2018	31.3.2018	31.12.2017
CAPITAL	Total equity, ISK m	**174,630**	172,182	166,337	181,045
	Tier 1 capital ratio	**19.9%**	20.5%	20.3%	22.6%
	Total capital ratio	**21.7%**	21.6%	21.4%	24.1%
	Leverage ratio	**14.0%**	14.5%	14.3%	16.2%
BALANCE SHEET	Total assets, ISK m	**1,162,639**	1,111,742	1,088,308	1,035,822
	Loans to customers, ISK m	**835,582**	799,938	776,149	755,175
	Deposits from Customers, ISK m	**608,646**	578,414	575,196	567,029
	Customer deposit / customer loan ratio	**72.8%**	72.3%	74.1%	75.1%

1. Return from regular operations on normalised CET1 of 16%, adjusted for risk free interest on excess capital. From January 2018 the definition of regular operations has been revised to include profit from discontinued operations as the Bank has successfully divested most non-core business related assets.
The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%).
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.

Financial highlights

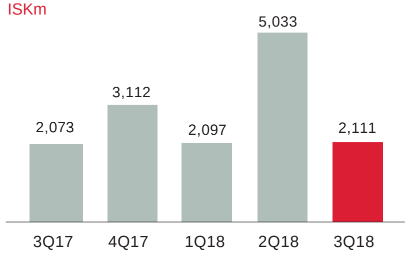
Key figures & ratios (cont'd)

ROE reg. operations CET1 16%[1]

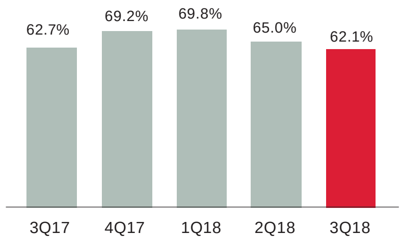


Profit after tax

ISKm

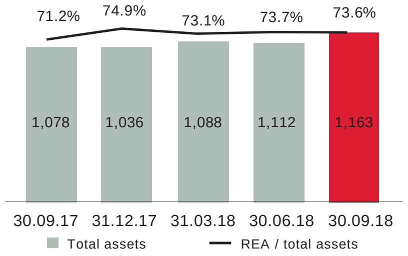


Cost / income ratio[2]



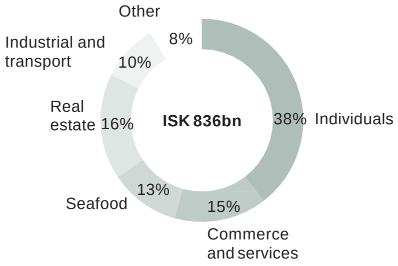
REA / total assets

ISKbn



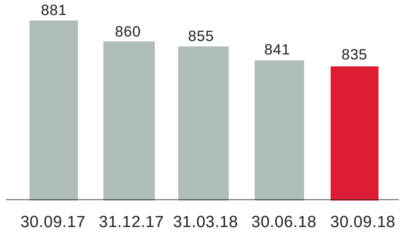
Loans to customers – sector split

As of 30.09.18



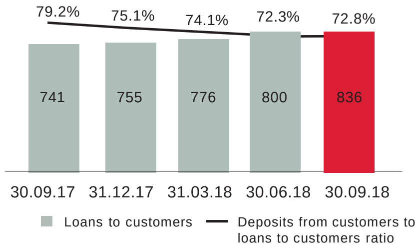
Number of FTE's for Parent Company

Excluding seasonal employees

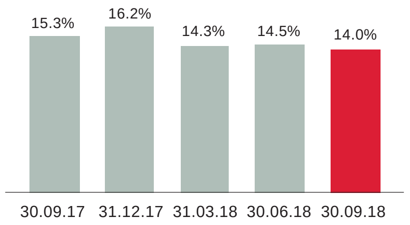


Loans to customers

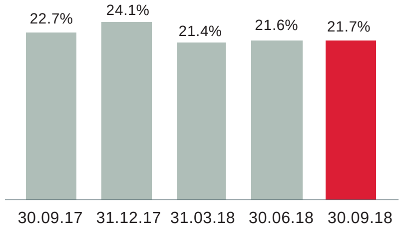
ISKbn



Leverage ratio



Total capital ratio



[1]Earnings on regular income now includes profit from discontinued operations. The Bank has introduced a new long term minimum capital target of 16% (CET1 16%) resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%).

[2]The cost/income ratio for 3Q18 for the parent company is 57%.

This is Íslandsbanki

A leader in financial services in Iceland, Íslandsbanki is a universal bank with a proven strategy

Recognition

Leading the **Icelandic CustomerSatisfaction Index** for **5** consecutive years

The Banker
Bank of the year in Iceland 2014, 2016, 2017

Strategic vision

Driven by the vision to be #1 for service, our relationship banking business model is propelled by three business divisions that manage and build relationships with our customers. A clear focus is on growth, simplifying our operations and unify our objectives with society - or as we like to say it - we **MULTIPLY**, **SIMPLIFY** and **UNIFY**

Universal banking

ergo
ÍSLANDSSJÓÐIR

Credit ratings

BBB+/A-2
S&P Global Ratings
Stable outlook

BBB/F3
FitchRatings
Stable outlook

9M18 Key figures

ROE (Regular operations)[1]	9,0%
Cost to income ratio[2]	65,6%
Total Capital Ratio	21.7%
Total Assets	ISK 1,163bn / EUR 8.5bn

Employees

91% Job satisfaction among Íslandsbanki's employees

835 Number of FTE's for parent company at end 9M2018

4 training courses a year per employee

Market share[3]

32% Individuals

36% SMEs

32% Large companies and investors

Ways to bank

78,000 APP users

112,000 Online Banking users

14 Branches and 1 self service branch

54 ATMs

1.Return from regular operations on normalised CET1 of 16%, adjusted for risk free interest on excess capital. From January 2018 the definition of regular operations has been revised to include profit from discontinued operations as the Bank has successfully divested all non-core business related assets. The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%).
2. Calculated as (Administrative expenses + Contribution to the Depositors´ and Investors´ Guarantee Fund – One off items) / (Total operating income – one off items). The cost/income ratio for the parent company and core subsidiary Íslandssjóðir is 57.8%.
3. Based on Gallup survey regarding primary bank.

Operational highlights

Eventful third quarter 2018 for Íslandsbanki

1H2018 → 7 → 8 → 9 → Q4

July

- Euromoney names Íslandsbanki as **Iceland's best bank** for the fifth time
- S&P Global Ratings **affirms Íslandsbanki rating** of BBB+/A-2 rating with stable outlook
- The Bank´s **Kreditkort branch** replaced with **online service platform**
- Íslandsbanki selected as advisor for the **sale of Icelandair Hotels** and to advise on the **merger of Kjarnafæði and Norðlenska**

August

- **Record ISK 155 million** raised for charities in the Íslandsbanki Reykjavik Marathon
- The Bank issued a **SEK 500 million 10NC5 Tier 2 bond** at a spread of STIBOR +250 bp. This was the Bank's second Tier 2 bond issue
- **Electronic signatures** for loan documents offered by the Bank
- **More than half of overdraft applications** now processed through the Íslandsbanki app with over 11.000 applications automatically approved
- Íslandssjóðir's **covered bonds funds reached a size of ISK 10 billion -** by far the largest funds of their kind in the market

September

- New **core payment and deposit system, Sopra launched**. One of the largest IT projects ever completed in Iceland
- The FME **lowered the minimum requirement for total capital** for Íslandsbanki from 19.8% to 18.8%, credited to the Bank's lower risk profile
- Announcement of new Bank solution that will allow users to pay for goods and services at all point-of-sale (POS) terminals **using their mobile phone** (October)
- The Bank issued various new reports, including a new **SME report,** a revised **economic forecast** (October) and new report on the **domestic residential market** (October)
- New **online chat service** launched on the Íslandsbanki website – first of its kind in Iceland (October)

The future ready bank

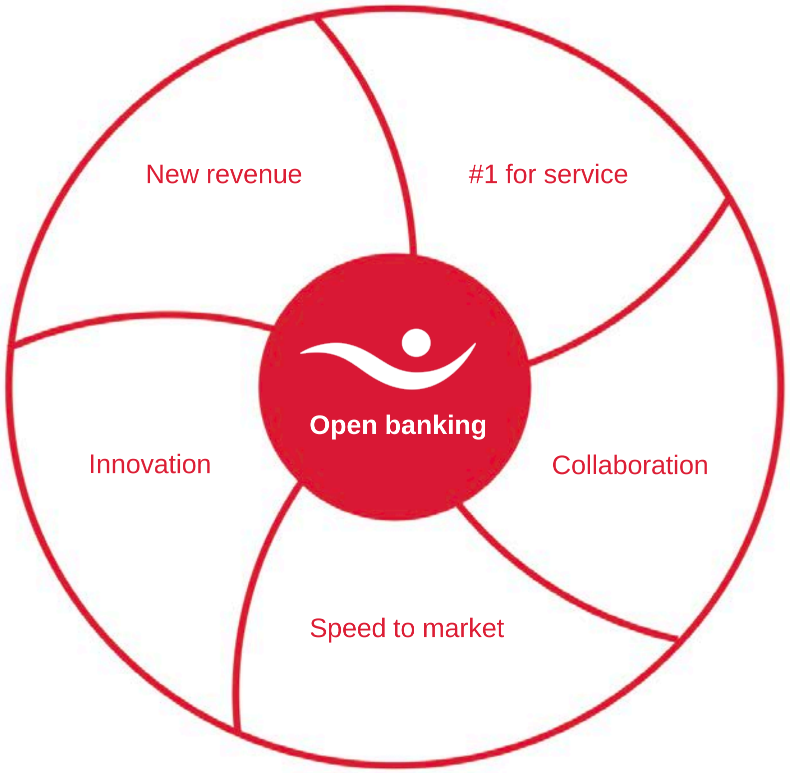
New core system for payments and deposits (Sopra) went live in Q3 which will prepare the Bank for future challenges and enable it to benefit from new opportunities

Successful launch of new core system in September

- Íslandsbanki IT architectural system has gone through extensive overhaul in the past few years
- A major milestone was reached when a new system for payments and deposits from **Sopra** went live in September 2018, replacing 40 year old systems
- **The future bank** is open, modern, secure and agile enough to allow for seamless integration of applications, API management and cloud based services
- The future ready bank, drivers for change:
  - Reduce future IT costs
  - Increase speed to market for new products
  - Standardised international platform
  - Preparation for a data rich world with expanding data volumes
  - Customer expectations and behaviour – on demand banking

Open Banking as means to new revenues and value added services

- Sopra offers **more flexibility** when partnering with innovators, fintechs and start-ups in an open banking environment
- The Bank is **building up partnerships** with innovators, fintech's and start-ups to develop better banking services
- The goal is to define the **future of financial services** in Iceland and beyond, as well as and identify opportunities for future revenue growth
- A sandbox will officially be opened for selected third party providers (TPP's) at the end of 2018, providing access to some of the Bank's API's



#1 for service and digital development

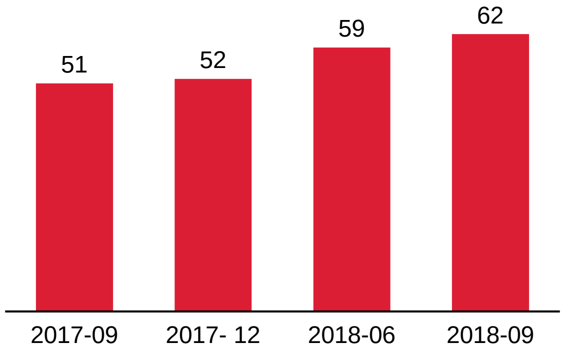
Enhanced focus on servicing individuals through digital channels

Digital innovation enhancing the customer experience

- Contactless payments by phone currently being tested by users
- New online secured chat service – first of its kind in Iceland
- Multiple solutions possible through the Íslandsbanki app, including changes to overdraft where over 11.000 applications have been automatically approved

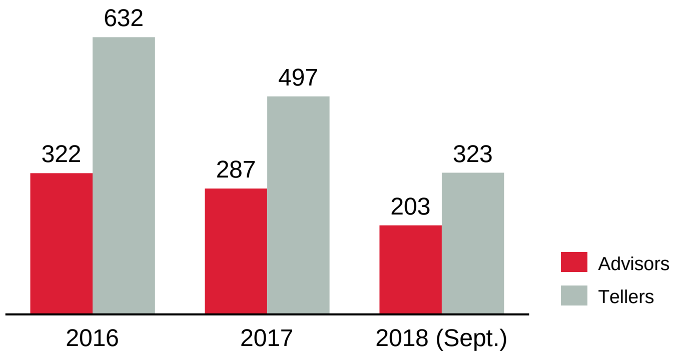
App users

Thousands (active users[1])



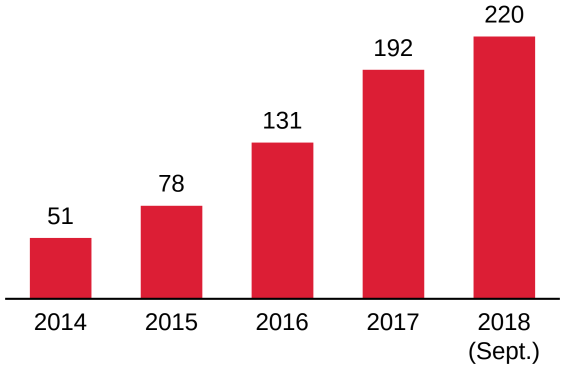
Branch visits to tellers and advisors

Thousands



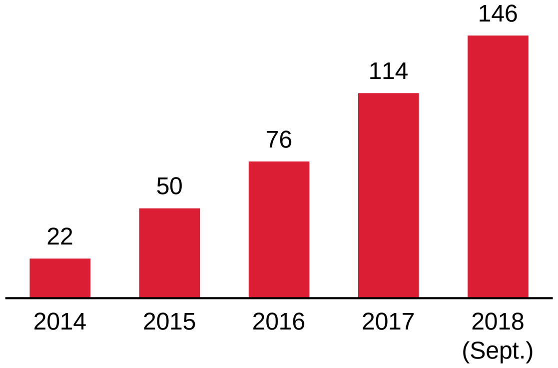
Bank transfers through app

Thousands per month



Bill payments through app

Thousands per month



1. Customers that have used the app in the last 90 days

2. **Income statement**

Income statement

Continued positive net impairments in 9M18 despite slowdown in the economy

ISK m	9M18	9M17	Δ	3Q18	3Q17	Δ
Net interest income	**23,643**	22,661	982	**8,301**	7,450	851
Net fee and commission income	**8,749**	10,118	(1,369)	**2,939**	3,305	(366)
Net financial income	**(325)**	(975)	650	**(420)**	(1,084)	664
Net foreign exchange gain	**(75)**	446	(521)	**(8)**	76	(84)
Other operating income	**1,664**	506	1,158	**64**	291	(227)
Total operating income	**33,656**	32,756	900	**10,876**	10,038	838
Salaries and related expenses	**(11,453)**	(10,936)	(517)	**(3,501)**	(3,168)	(333)
Other operating expenses	**(8,732)**	(8,377)	(355)	**(2,962)**	(2,879)	(83)
Administrative expenses	**(20,185)**	(19,313)	(872)	**(6,463)**	(6,047)	(416)
Depositors' and Investors' Guarantee Fund	**(874)**	(795)	(79)	**(295)**	(280)	(15)
Bank tax	**(2,541)**	(2,278)	(263)	**(944)**	(806)	(138)
Total operating expenses	**(23,600)**	(22,386)	(1,214)	**(7,702)**	(7,133)	(569)
Profit before net impairment on financial assets	**10,056**	10,370	(314)	**3,174**	2,905	269
Net impairment on financial assets	**1,881**	587	1,294	**(53)**	147	(200)
Profit before tax	**11,937**	10,957	980	**3,121**	3,052	69
Income tax expense	**(3,616)**	(3,335)	(281)	**(1,136)**	(1,072)	(64)
Profit for the period from continuing operations	**8,321**	7,622	699	**1,985**	1,980	5
Profit from discontinued operations net of income tax	**920**	2,492	(1,572)	**126**	93	33
Profit for the period	**9,241**	10,114	(873)	**2,111**	2,073	38

Highlights

- Total income amounted to ISK 33.7bn in 9M18, an increase of 2.7% between years as a result of strong interest income and the sale of properties
- Net interest income totalled ISK 23.6bn, an increase of 4.3% from the previous year
- Positive changes in the CPI index and strong loan and deposit growth contribute to higher net interest income
- The net interest margin was 2.9% for 9M18, which is at comparable levels to 9M17
- Overall net fee income showed a 13.5% decline year on year, principally due to lower activity levels from two of the Bank's fee generating subsidiaries
- Net impairment on financial assets generated a gain of ISK 1.9bn in 9M18, compared to ISK 0.6bn gain in 9M17, mostly deriving from the lifting of the Bank's prior commitments in relation to foreign currency-based loans

Operating income

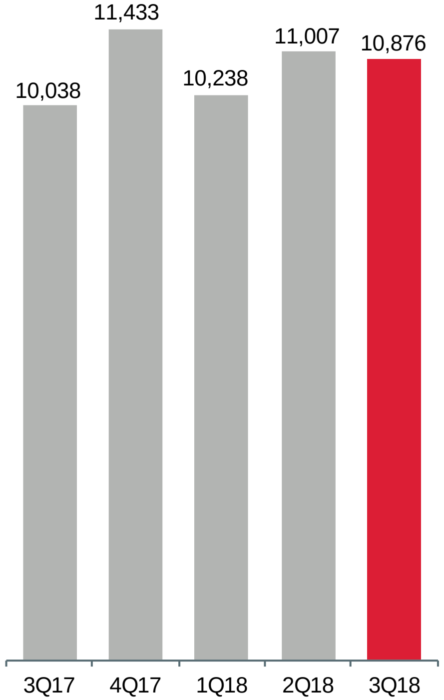
Income up by 2.7% compared to 9M17 as a result of strong interest income and sale of properties

NII on the rise as well as NFC for the Bank and Íslandssjóðir

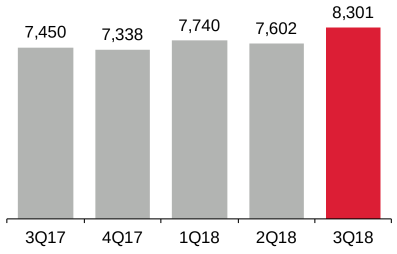
- Net interest income was ISK 23.6bn (9M17: ISK 22.7bn), an increase of 4.3% between years and the net interest margin was 2.9% (9M17: 2.9%)
- Net fee & commission income for the Bank and Íslandssjóðir was ISK 7.9bn (9M17: ISK 7.1bn), an increase of 6.1% between years

Income trends

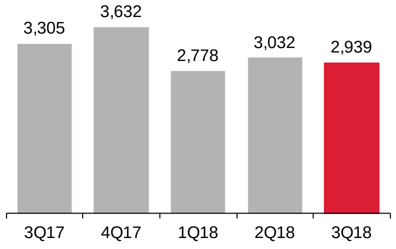
Total operating income (excluding one-off income)
ISKm



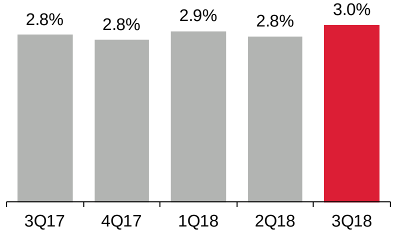
Net interest income (NII)
ISKm



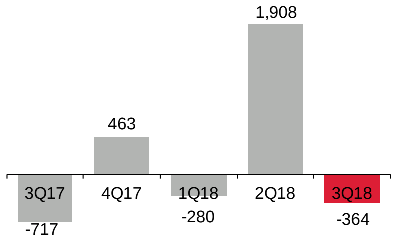
Net fee and commission income
ISKm



Net interest margin (NIM)
%



Other income
ISKm



Earnings from regular operations

Excludes one-off items, ROE calculation now adjusted to normalised CET1 of 16%

Resilient ROE from regular operations

ISKm	9M18	9M17	Δ	3Q18	3Q17	Δ
Reported after tax profit	**9,241**	10,114	(872)	**2,111**	2,073	37
One-off revenue	**(2,546)**	0	(2,546)	**0**	0	0
One-off costs[1]	**0**	377	(377)	**0**	36	(36)
Bank tax	**2,541**	2,278	263	**944**	806	138
Profit (loss) from discontinued ops	**(920)**	(2,492)	1,572	**(126)**	(93)	(33)
Tax impact of adjustments	**662**	(98)	760	**0**	(9)	9
Earnings from regular operations[2]	**8,979**	10,178	(1,200)	**2,928**	2,812	116
ROE 16% CET1 (regular operations)[3]	***9.0%***	*9.7%*		***8.1%***	*7.9%*	
ROA from regular operations (after tax)	***1.1%***	*1.3%*		***1.0%***	*1.1%*	
Net interest margin adj. 16% CET1	***2.8%***	*2.7%*		***2.8%***	*2.6%*	
Cost / income ratio adj. 16% CET1	***64.3%***	*63.3%*		***63.8%***	*65.8%*	

Earnings from regular operations

- Definition was changed as of 1Q18 to exclude profit from discontinued operations as the Bank has successfully divested all non-core business-related assets
- Had profit from discontinued operations been included the profit from regular operations would total ISK 8,979m, providing a ROE 16% CET1 of 8.1%
- The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%). This has been applied to all historical results.

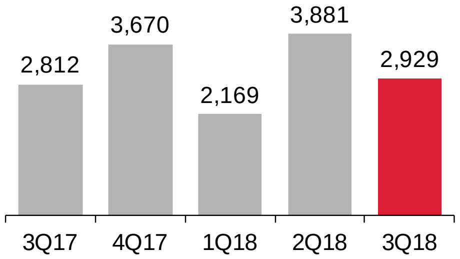
One off items 2018

- ISK 1.5bn in income from the sale of property in April deemed one-off income and ISK 1.0bn as the statute of limitation for some disputed foreign currency-linked loan contracts passed
- ISK 377m in one-off costs in 2017 are a result of ombudsman extra charges

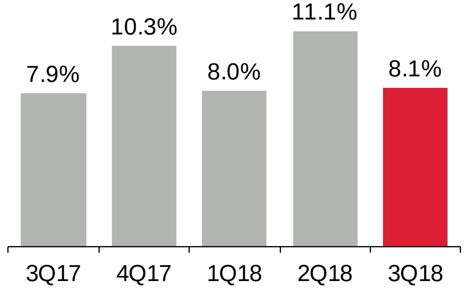
Earnings from regular operations

- Regular earnings decreases, as a result of underperformance from two of the Bank's fee generating subsidiaries

Earnings from regular operations
ISKm



ROE reg. operations CET1 16%
%



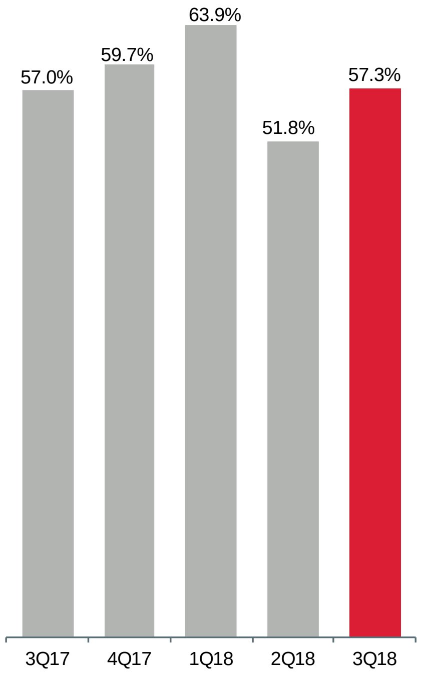
1. One-off costs include the impact of organisational changes, extra ombudsman charges and expenses related to the old headquarters
2. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs due to headquarters
3. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital
The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%)

Administrative expenses

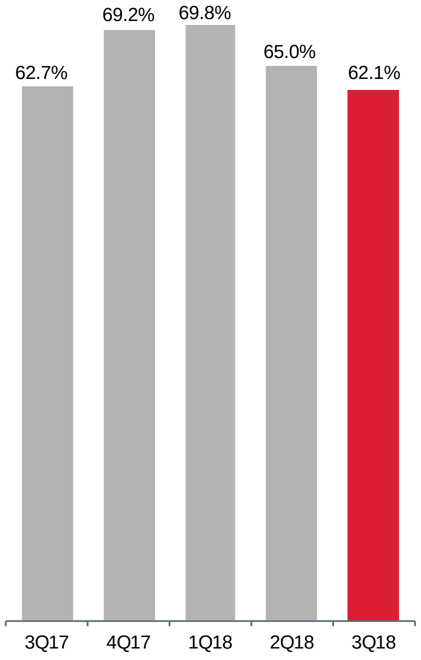
Cost to income ratio for the Bank and Íslandssjóðir not far off from long term target of 55%

Efficiency – Cost to income ratio[1]

The Bank & Islandssjóðir
%

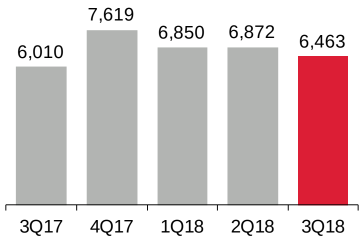


The Group[2]
%

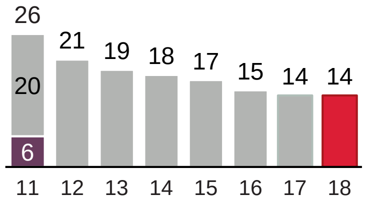


Cost structure improving overall

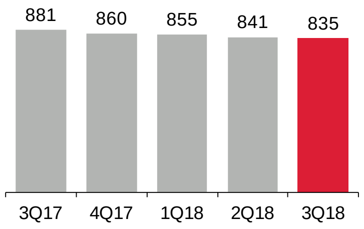
Administrative expenses[3]
ISK m



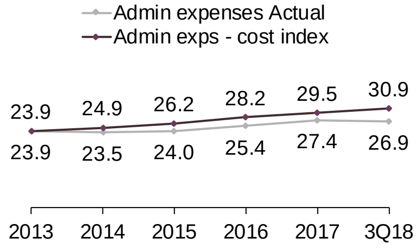
Branch network
#, Byr branches due to merger in dark blue



Period end FTE numbers[4]
#, Parent company



Annualised admin. expenses vs cost index[5]
ISK bn, excl. one-off cost, parent company



1. The cost-to-income ratio excludes Bank tax and one-off cost and revenue items
2. The Group consists of the Bank, Íslandssjóðir, Borgun and Hringur

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

3. Balance sheet

Assets

Total assets are 12.2% up from year-end 2017

ISK m	**30.9.2018**	30.6.2018	31.3.2018
Cash and balances with CB	**156,251**	166,194	177,029
Bonds and debt instruments	**63,324**	48,603	49,140
Shares and equity instruments	**13,995**	13,581	10,208
Derivatives	**3,479**	3,209	4,673
Loans to credit institutions	**67,047**	59,858	47,220
Loans to customers	**835,582**	799,938	776,149
Investment in associates	**533**	614	672
Property and equipment	**5,079**	5,058	7,025
Intangible assets	**4,910**	4,774	4,412
Other assets	**11,205**	8,512	10,732
Non-current assets held for sale	**1,234**	1,401	1,048
Total assets	**1,162,639**	1,111,742	1,088,308

Highlights

Liquid assets

— Three line items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 287bn, some ISK 254bn of which are liquid assets

Loans to customers

— New lending amounted to ISK 176.5bn since year-end 2017

— Loans to customers grew by 10.6% since year-end

Asset encumbrance

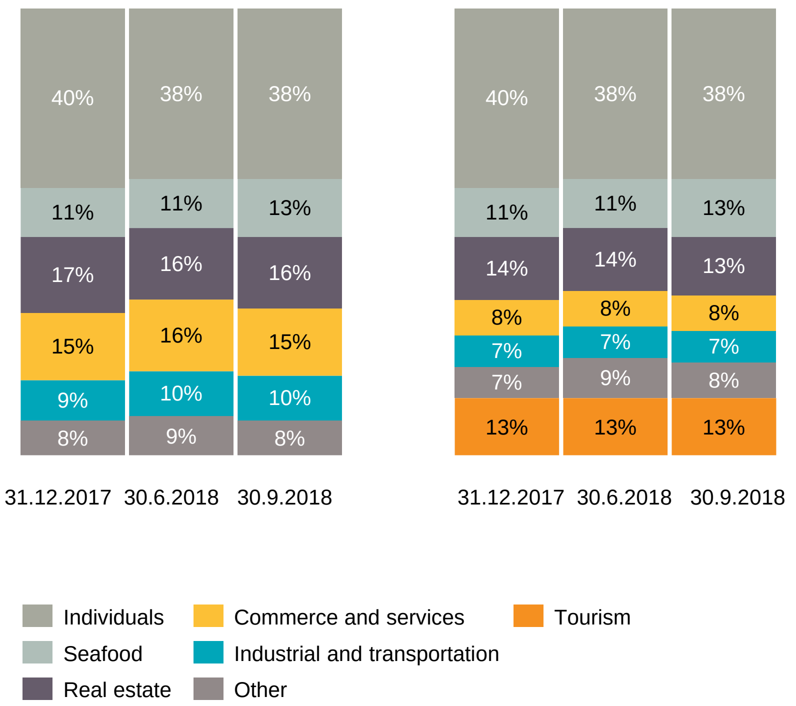
— The Bank's asset encumbrance ratio was 16.7% at quarter end, compared to 16.5% at end June 2018

Diversified loan portfolio

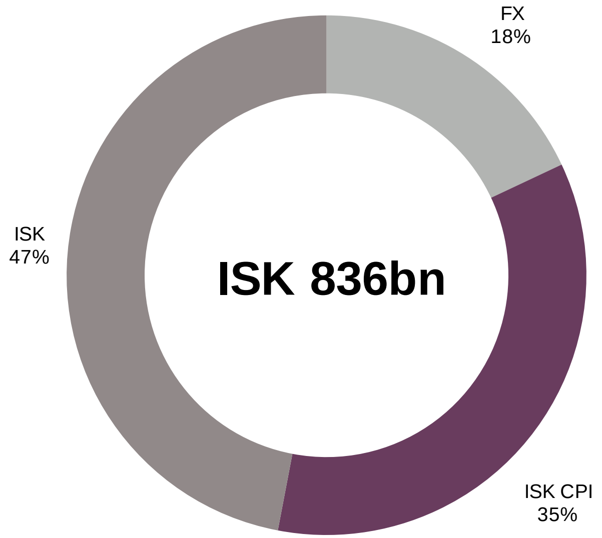
Loans to customers grew by 10.6% in the first 9 months of 2018

Loans to customers
by sector, consolidated

Standard sectors **Including tourism**



Loans to customers
by currency, consolidated



Highlights

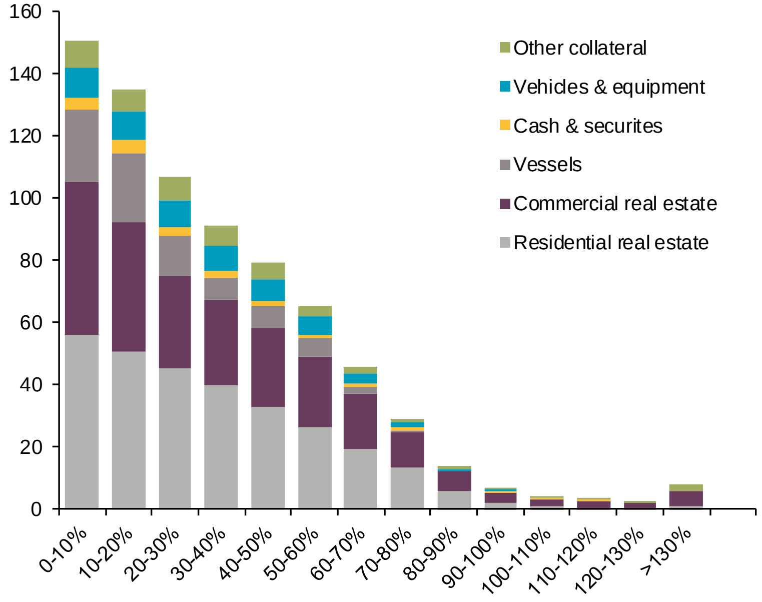
- Strong demand for loans across all sectors for the first 9 months
- The mortgage portfolio increased by 7.6% since year-end 2017. Mortgages comprised 29.1% of loans to customers at 3Q 2018, compared to 29.8% in 4Q 2017
- Exposure to tourism is unchanged from year end 2017, 13%
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism

LTV distribution of loan portfolio

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

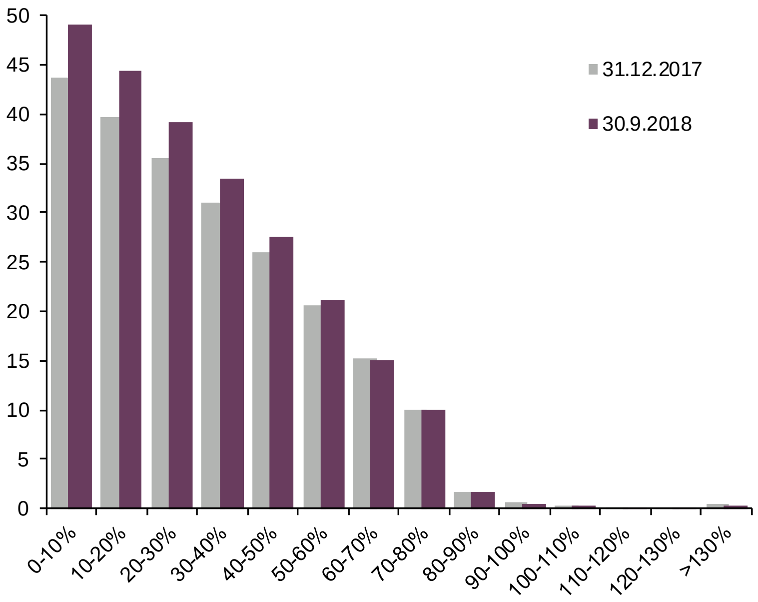
LTV distribution by underlying asset class

ISK bn, by type of underlying asset, as of 30.09.2018



LTV distribution of mortgages to individuals

ISK bn, as of 30.09.2018 – avg LTV 61% (63% 31.12.2017)[1]



Highlights

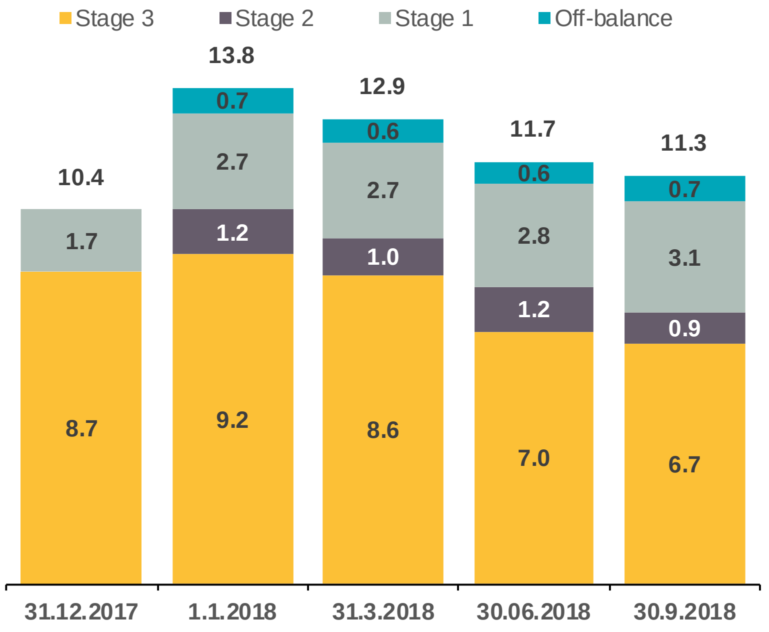
- Most of the Bank's collateral is in the form of residential and commercial real estate
- The second most important collateral type is vessels, mostly fishing vessels
- For seasoned mortgages, the LTV distribution is calculated from tax value of properties, which is published annually in June, but for newly granted mortgages the purchase price of the property can be used as a valuation in the beginning while it is considered more accurate
- LTV has decreased since year end 2017 which is mainly due to the newly published tax value of properties that raised housing valuations of about 12.8% from its previous publication

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.

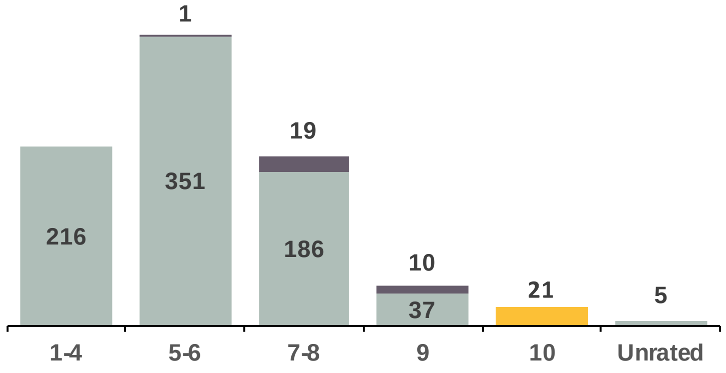
Asset quality

Asset quality improving with NPL ratios continuing downward trend

Loans to customers & off-balance sheet items: impairment allowance account[1]
Development of allowance account. ISK bn



Loans to customers, gross carrying amount
Risk class and impairment stage. ISK bn 30.09.2018



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	795	93,9%	3,1	0,4%	792	94,7%
Stage 2	31	3,6%	0,9	2,8%	30	3,6%
Stage 3	21	2,5%	6,7	32,0%	14	1,7%
Total	846	100,0%	10,6	1,3%	836	100,0%

Highlights

- With the adoption of IFRS 9, facilities are now categorised in one of three stages and receive an impairment accordingly. Consequently, specific and collective impairments are no longer reported
- In addition off-balance sheet exposures now contribute to the impairment allowance account
- During the first 9 months of 2018 the impairment allowance has decreased, mainly due to write-offs of facilities in Stage 3
- At the end of 3Q18, gross carrying amount of loans in Stage 3 as a proportion of the total gross carrying amount of loans to customers was 2.5%, compared to 2.9% at end of 1H18
- 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 2.0% at the end of 3Q18, compared to 3.6% average for European banks[2]

1. The impairment allowance for 31.12.2017 is based on IAS 39 but other dates are based on IFRS 9
2. Source European Banking Authority

Liabilities

Diversified funding strategy

ISK m	30.9.2018	30.6.2018	31.3.2018
Deposits from CB and credit inst.	**15,530**	15,391	13,563
Deposits from customers	**608,646**	578,414	575,196
Derivatives and short positions	**5,585**	7,075	8,104
Debt issued and other borrowed funds	**297,318**	288,360	269,255
Subordinated loans	**15,531**	8,872	8,838
Tax liabilities	**10,311**	8,925	7,908
Other liabilities	**35,014**	32,447	39,028
Non-current liabilities held for sale	**74**	76	79
Total liabilities	**988,009**	939,560	921,971
Total equity	**174,630**	172,182	166,337
Total liabilities and equity	**1,162,639**	1,111,742	1,088,308

Highlights

Deposits

— Customer deposits are up by 7.3% to ISK 609bn in end September 2018
  – The increase was due mainly to an increase in pension fund positions but also from individuals and SMEs

— The customer deposit to customer loan ratio was 72.8%

Debt issued and other borrowings

— Includes covered bonds, commercial papers and bonds in foreign currency

— Market access for covered bonds remain solid, with issuance of ISK 21.1bn in the first nine months of 2018, reinforcing the Bank’s position as Iceland’s largest covered bond issuer

Other liabilities

— 69% of other liabilities are attributable to credit card liabilities to retailers through the Bank's subsidiary Borgun

Equity

— Íslandsbanki’s dividend pay-out ratio target is 40-50% of after tax profits. Due to its strong capital position, a higher dividend payment of ISK 13bn was approved during its March Annual General Meeting (AGM), bringing the Bank's total dividend payments to ISK 76bn since 2013

Deposits remain the main source of funding

Core deposits continue to be stable

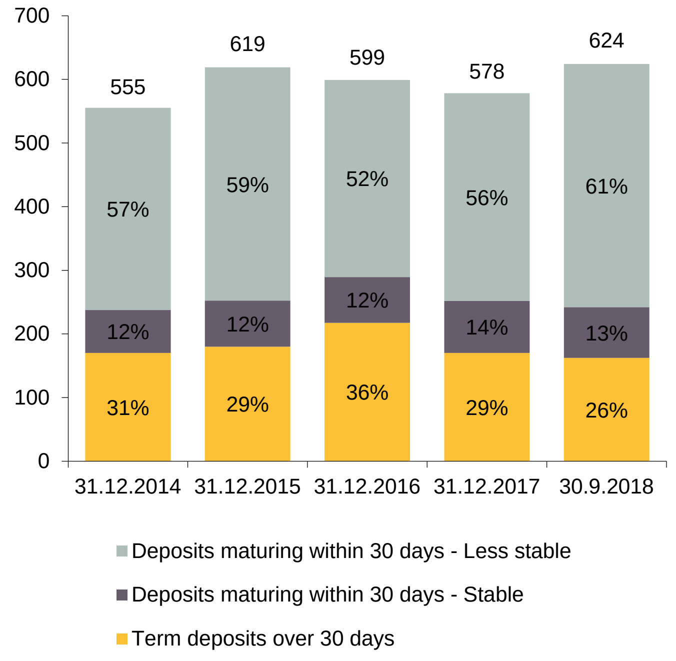
Deposit by LCR category

30.09.2018 compared with year end-2017, consolidated

ISK bn	Less stable	Δ	Stable	Δ	Term deposits	Δ	Total deposits	Δ
Retail	**135**	16	**61**	(2)	**67**	(2)	**263**	11
SMEs	**65**	10	**16**	1	**7**	(0)	**88**	10
Operational relationships	**3**	1	**-**	-	**-**	-	**3**	1
Corporations	**72**	8	**-**	-	**23**	(4)	**95**	3
Sovereigns, Central Bank and public sector entities	**9**	2	**-**	-	**1**	(1)	**10**	1
Financial institutions in composition	**2**	(1)	**-**	-	**-**	-	**2**	(1)
Pension funds	**53**	21	**-**	-	**26**	(3)	**79**	19
Domestic financial entities	**28**	(3)	**-**	-	**29**	2	**57**	(1)
Foreign financial entities	**3**	(2)	**-**	-	**8**	3	**11**	1
Other foreign entities	**13**	4	**2**	(1)	**3**	(3)	**18**	1
Total deposits	**382**	56	**80**	(2)	**162**	(8)	**624**	46

Deposit composition

ISK bn, consolidated



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, 71% of the deposits were in non-indexed ISK, 15% CPI linked and 14% in foreign currencies

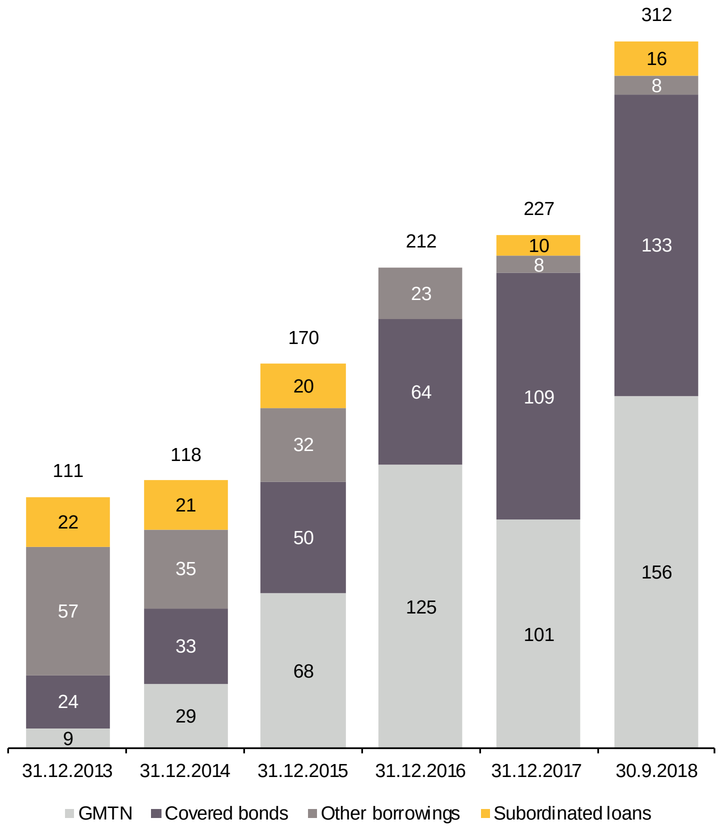
Deposits concentration remains stable

- At the end of September 2018,16% of the Bank's deposits belonged to the 10 largest depositors and 38% belonged to the 100 largest depositors. Compared to 15% and 39% respectively for year-end 2017

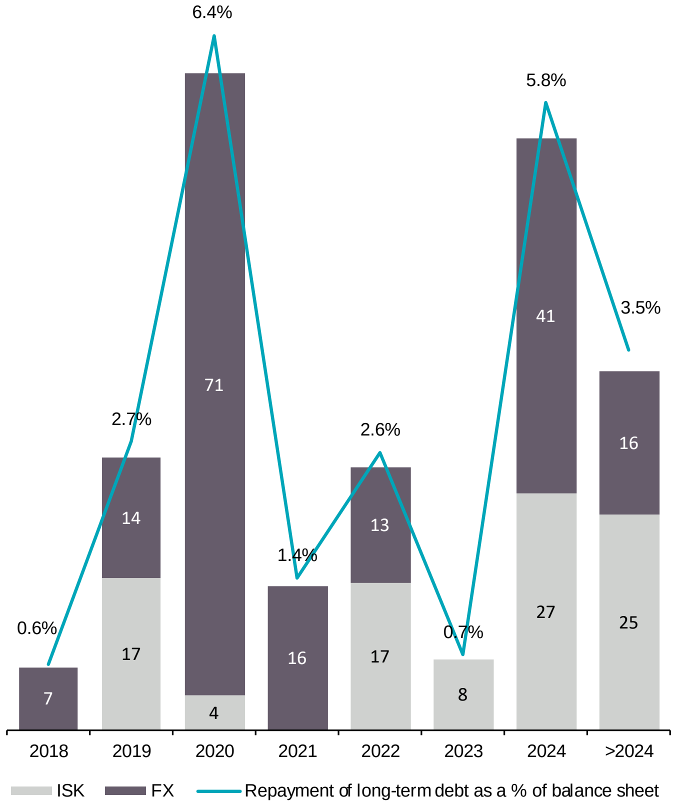
Borrowings

Successful international and domestic market transactions

Borrowing sources
Book value, ISK bn



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



Highlights

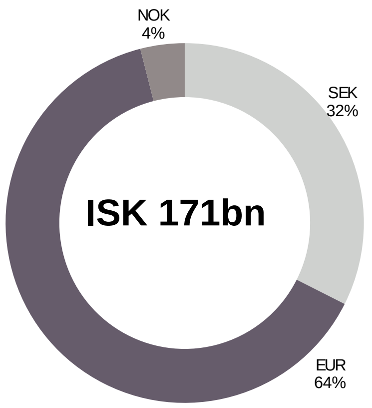
Íslandsbanki is the largest issuer of covered bonds in the domestic market

- Total covered bonds issuance in Q3 was ISK 5.5bn

Successful international funding in Q318

- SEK 500m Tier II issued in August
- In July and August, the Bank issued a number of private placements under its GMTN Programme totalling SEK 1.3bn

Currency split of FX borrowing sources
Nominal value, ISK bn

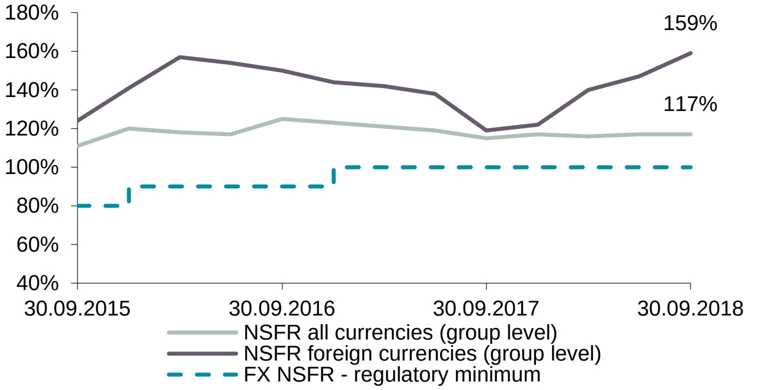


1. Final maturity assumed for callable bonds

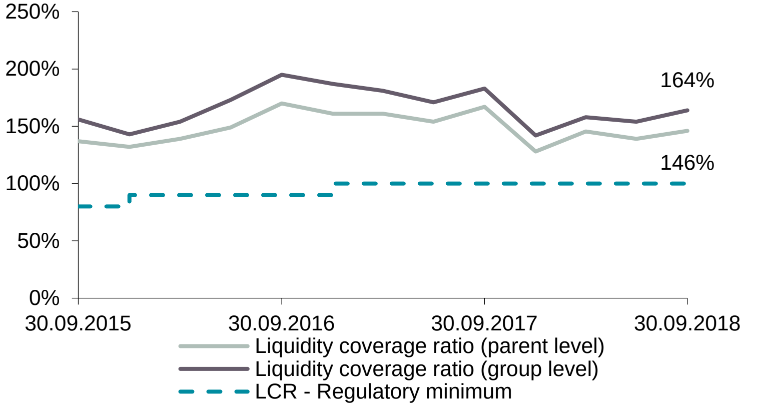
Sound management of liquidity

Liquid assets of ISK 254bn are prudently managed

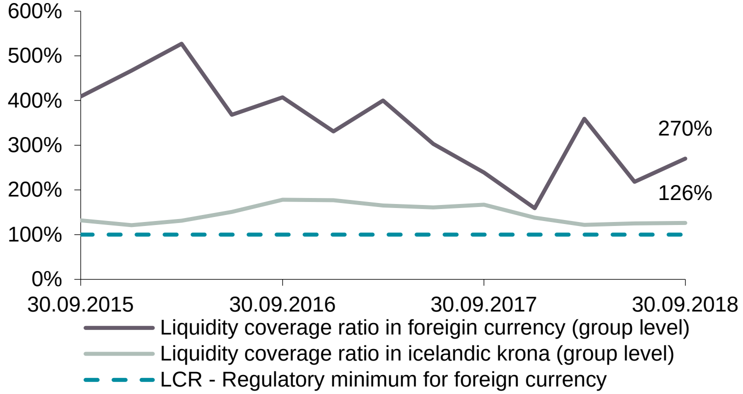
Net stable funding ratio (NSFR)



Liquidity coverage ratio – all currencies



Liquidity coverage ratio – foreign currencies and Icelandic krona



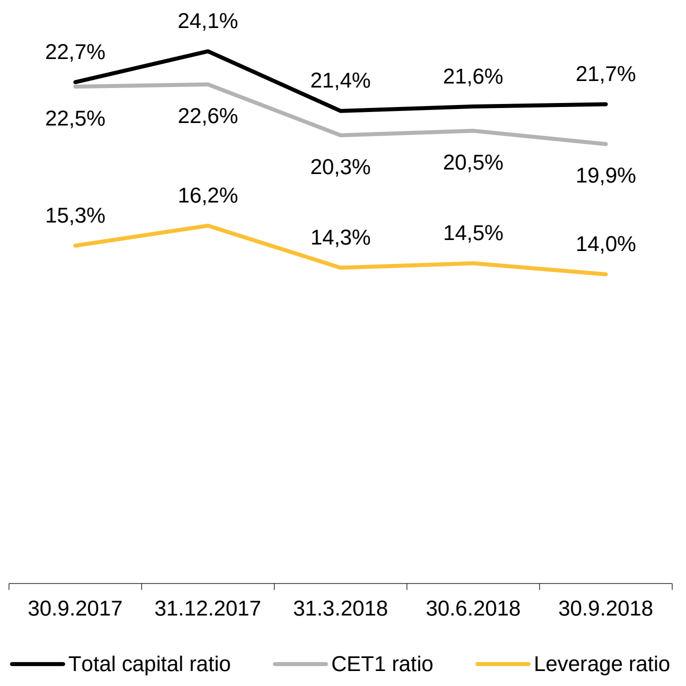
Highlights

- 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 as the annual regulatory stress test
- Liquidity Contingency Plan is in place which shall be tested regularly

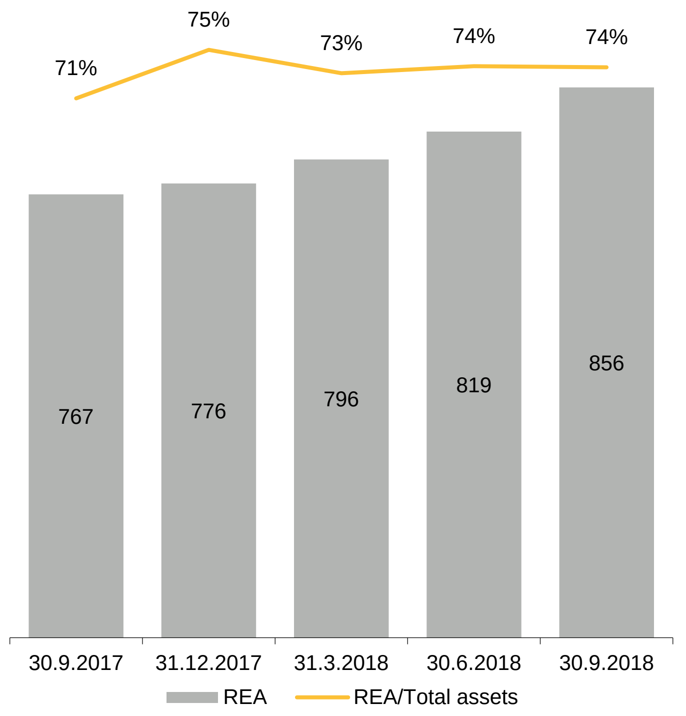
Sound capital position

The capital ratio in line with target and leverage is low

Capital and leverage ratios



Risk exposure amount (REA)
ISK bn



Highlights

Capital ratios

— The capital base was ISK 186bn and the CET1 capital was ISK 170bn at 30 September 2018, compared to ISK 187bn and ISK 176bn respectively at year-end 2017

— The decrease in CET1 capital is mainly due to an ISK 13bn dividend payment in March, offset by retained earnings for the period.

— The issuance of Tier 2 subordinated debt amounting to SEK 500 m in August contributed to an increase in the capital base, offsetting further the dividend payment, leaving the capital base at a level comparable to year end figures

— The RAC ratio for the Bank was 19.4% at end June 2018 according to S&P Global Ratings

Risk exposure amount (REA)

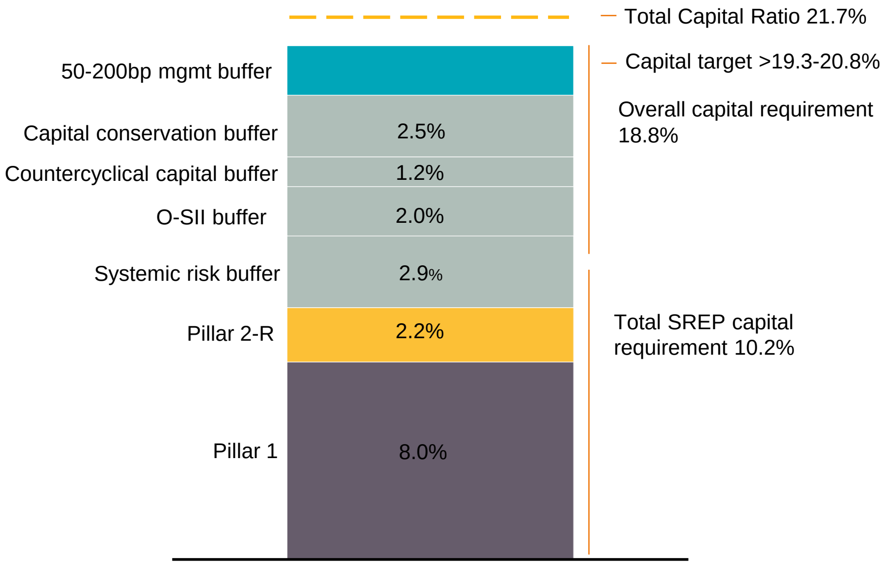
— The REA growth is mainly due to increase in loans to customers during the year

— The ratio of REA of total assets remains fairly stable at 74%

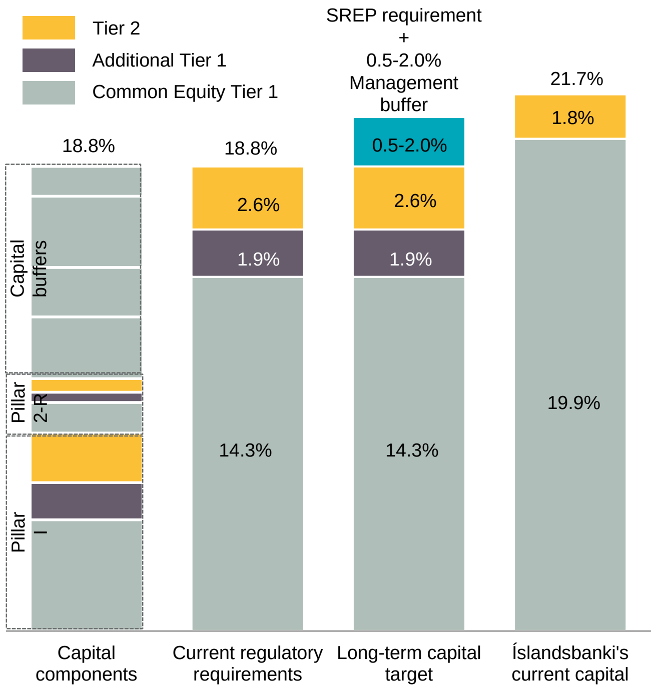
Íslandsbanki's capital target

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

Íslandsbanki's capital target



Capital requirement composition



Highlights

- 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 FME has increased the countercyclical capital buffer 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
- In light of recent changes to regulatory requirements and an updated assessment of the business environment, the Bank has decided to revise its management buffer from 0.5-1.5% to 0.5-2.0%
- 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 credit ratings

Ratings affirmed from both Fitch and S&P in late 2017 and mid-2018

Íslandsbanki

	S&P	FITCH
Long-term	BBB+	BBB
Short-term	A-2	F3
Outlook	Stable	Stable
Rating action	July 18	Dec 17

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

FITCH
BBB/F3 Stable Outlook

Press Release 15 December 2017

In December, Fitch Ratings **affirmed** Íslandsbanki's ratings of **BBB/F3** with a **stable outlook**. Fitch had in January 2017, upgraded the Bank to this rating

According to Fitch, the ratings for Íslandsbanki reflect the Bank's **leading domestic position** with a market share of around 30 per cent and the Bank's **satisfactory asset quality, stable liquidity position and high reported capital ratios**

Furthermore, Fitch noted that Íslandsbanki's strategy to target **continued organic growth in Iceland**, combined with its **sound risk management framework**, would continue to strengthen the Bank's **asset quality**, with the Bank having seen a sharp **decline in its non-performing loans since 2010**

4. Financial targets and next steps

Financial targets

Medium and long term strategies structured around achieving key financial targets

	Target	9M18	2017	2016	Guidance
ROE regular operations[1]	8-10%	✔ 9.0%	✔ 10.3%	✔ 10.7%	— Based on risk free rate + 4-6% which is considered to be CBI current account rate, currently at 4.25% (average in 2017 = 4.4%) — As the Bank retains a large pool of liquid assets, interest rate level in Iceland can have a substantial impact on ROE levels — The bank tax, excluded thus far from target returns, will have an impact on profitability if kept at current high levels
Cost/ Income ratio[2]	<55%	65.6%	62.5%	56.9%	— 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	✔ 19.9%	✔ 22.6%	✔ 24.9%	— Current SREP requirement of 18.8% plus management buffer means currently a target 14.8-16.3% CET1 ratio
Total capital ratio	> 19.3 – 20.8%	✔ 21.7%	✔ 24.1%	✔ 25.2%	— 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%	✔ 100%	✔ 50%	✔ 50%	— 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 13 billion in dividend for the 2017 financial year which is higher than the dividend payout target due to a strong capital position

1. Return from regular operations on normalized CET1 of 16%, adjusted for risk free interest on excess capital. Earnings from regular operations is defined as earnings excluding one-off items e.g. net loan impairment before collective impairment, fair value gain deriving from changes in accounting treatment, Bank tax, and one off costs.
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

The Bank's core investments have created a strong platform for offering enhanced digital and personalised services while maintaining low risk and reducing overhead costs in an increasingly competitive environment

Maintain profitability and limit costs

- Focus on continued strong core operations and stable fee and commission income
- Continue growing the loan portfolio while maintaining high levels of asset quality and diversification
- Further exploit operational efficiency gains to decrease costs

Focus on digital growth

- Focus on digitalisation of retail banking services to meet customers needs for automated services
- Emphasis is on adding features and services to the Bank´s app, the payments app and Kass
- New services such as contactless payments via mobile phone and online chat will strengthen the Bank's digital offering
- Open banking platform will foster new ideas from fintechs

Optimise capital structure

- The Bank has already issued two Tier 2 bonds
- Capital optimisation process likely to continue with additional Tier 1 or Tier 2 issuances in order to normalise the capital structure
- The Bank expects to continue paying out dividend payments in line with Bank's financial targets

Maintain moderate risk profile and implement international regulations and best practices

- Íslandsbanki´s market risk continues to be low in respect of main risk factors and the FME´s conservative capital requirements are the lowest for Íslandsbanki
- Implementation ongoing or underway for multiple international regulation, including IFRS 9, MIFID II, PSD II, GDPR, BRRD and MREL

Completed core investments by Íslandsbanki

- Launch of new core payment and deposit system and investments in other core IT infrastructure
- Move completed to new headquarters bringing operations from 4 separate locations under one roof
- New customer focused organisational structure
- Branch network limited to only 14 strategically branches that are located in greater capital area of Reykjavik and around Iceland
- Stronger risk management and culture within the Bank through a new "three lines of defense" approach
- Successful restructuring of new balance sheet from Glitnir

Annex – Icelandic economy update

2019: A year of adjustment

Investment, private consumption and service exports take a breather

- After a long period of economic upswing, the end of the growth period appears to be in sight
- Íslandsbanki Research expects GDP growth to measure 3.4% this year and 1.5% in 2019
- Weaker growth in 2019 is due to a contraction in business investment, modest private consumption growth, and relatively weak growth in services exports
- In essence, then, these main drivers of the past few years' growth spurt will take a break next year
- The outlook is for growth to rise to about 2.8% in 2020, buoyed by increased private consumption growth, a resumption of growth in business investment, and continued growth in other investment and exports

GDP and the contribution of major subitems [1]

YoY change (%)

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

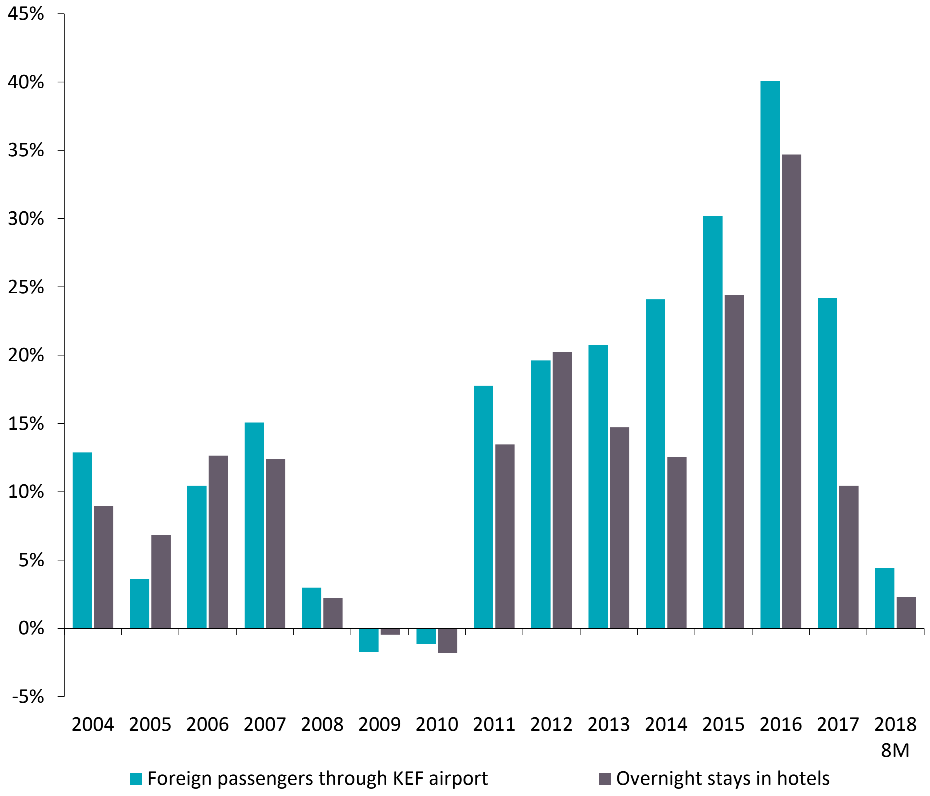
Tourism sector growth slows as sector matures

Streamlining and mergers take over from rapid growth and supply-side increases

- The tourism sector is still growing by most measures, although the pace has fallen back from its 2015-2016 peak
- This year is the first year without an appreciation of the ISK since the tourism boom started. As a result, Iceland is not significantly “more expensive” this year than it was in 2017
- In the first 8 months of 2018, the number of foreign tourists increased by 4.4% YoY and overnight hotel stays went up by 2.3%
- 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
- 2019 will provide a testing ground for how successfully the sector handles its newfound maturity. There is every reason to believe it will do so without major mishaps

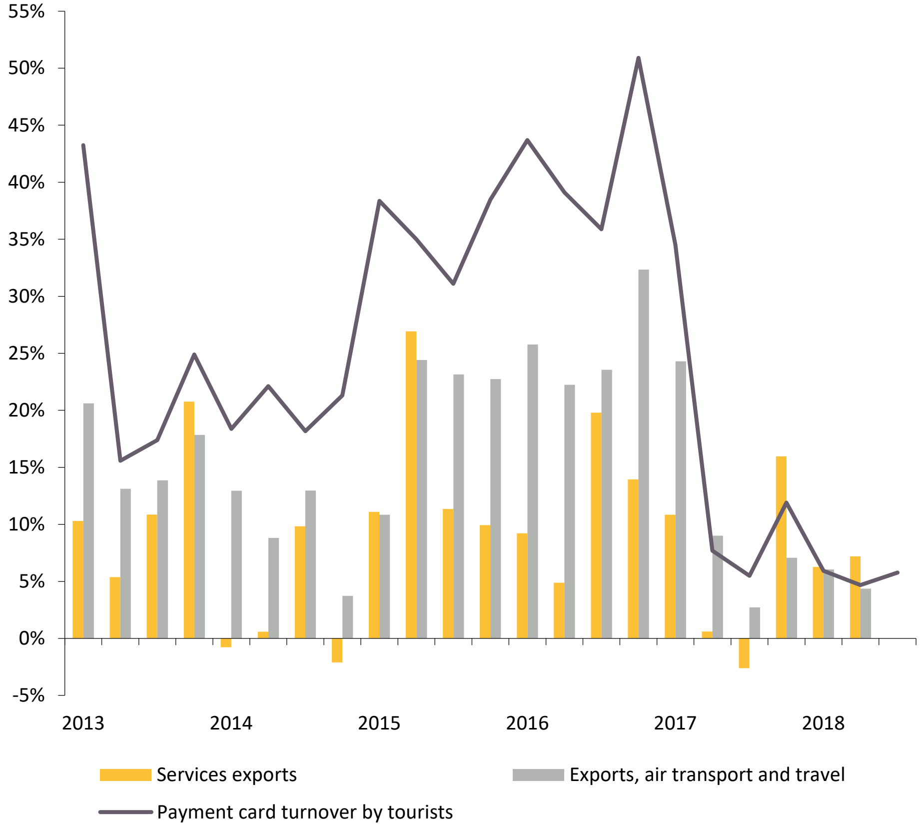
Foreign visitors and overnight hotel stays

YoY change



Services exports and foreign card turnover

YoY change



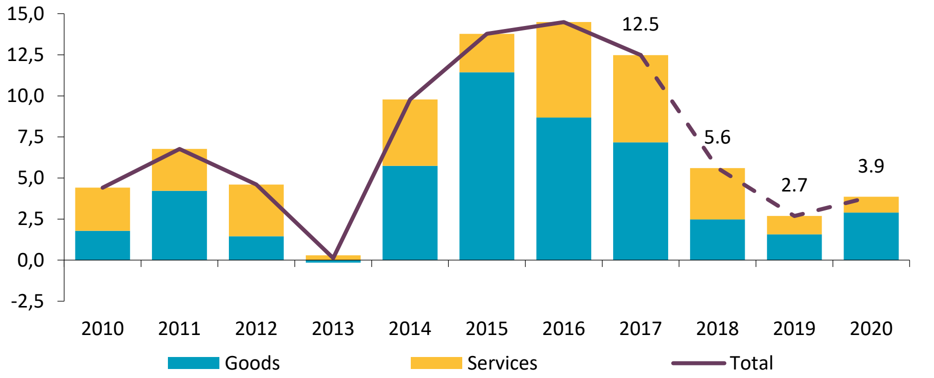
Source: Statistics Iceland, Centre for Retail Studies and Icelandic Tourist Board

Current account expected to remain in surplus

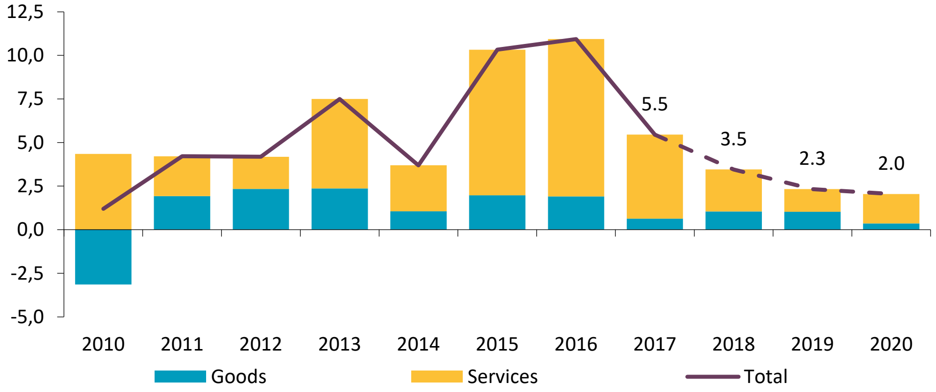
Net external position to continue improving throughout decade

- Both import and export growth to keep tapering off early in the forecast horizon
- Export growth at 3.5% and import growth at 5.6% this year, followed by 2.3% and 2.7%, respectively, in 2019 and 3.9% and 2.0%, respectively, in 2020
- Services exports — tourism in particular — will continue to be one of the mainstays of export growth. Increased fishing industry exports will also be a major contributor. The reverse will be true for imports, however, with goods imports carrying much of the weight
- Improved outlook for the current account balance, due largely to a lower real exchange rate and weaker growth in domestic demand in the coming term
- 2020 will be the ninth year in a row with a current account surplus
- Iceland's net external position will therefore continue to improve through the end of the decade, everything else being equal. As of mid-2018, external assets exceeded external liabilities by nearly 10% of GDP

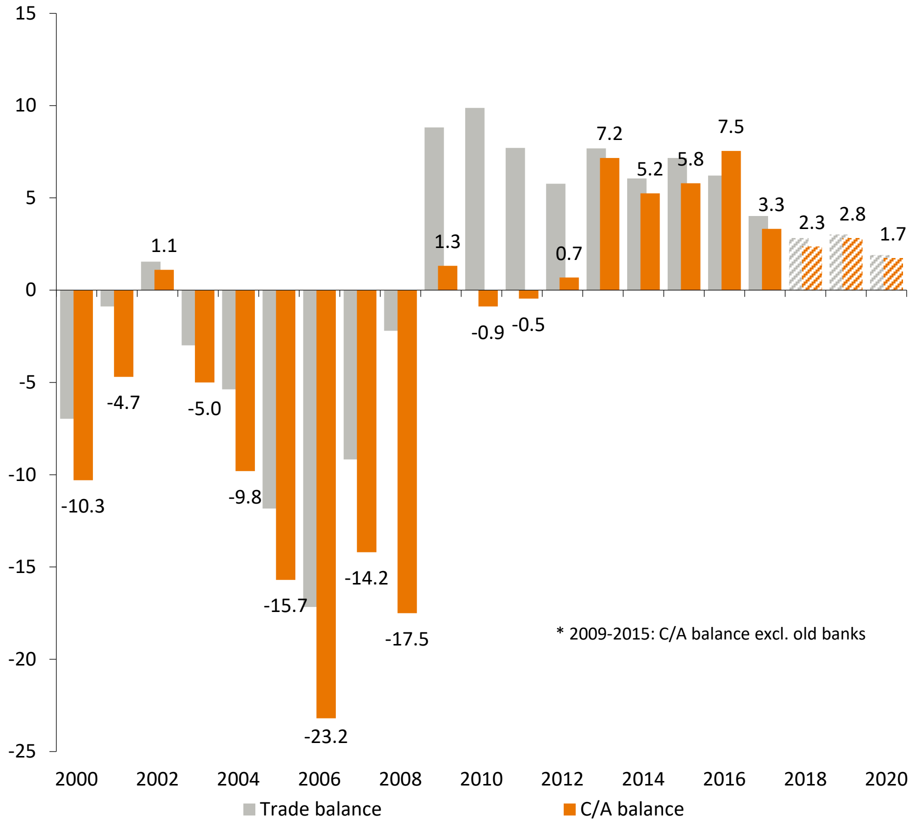
Imports, YoY change (%)



Exports, YoY change (%)



Current account balance
% of GDP

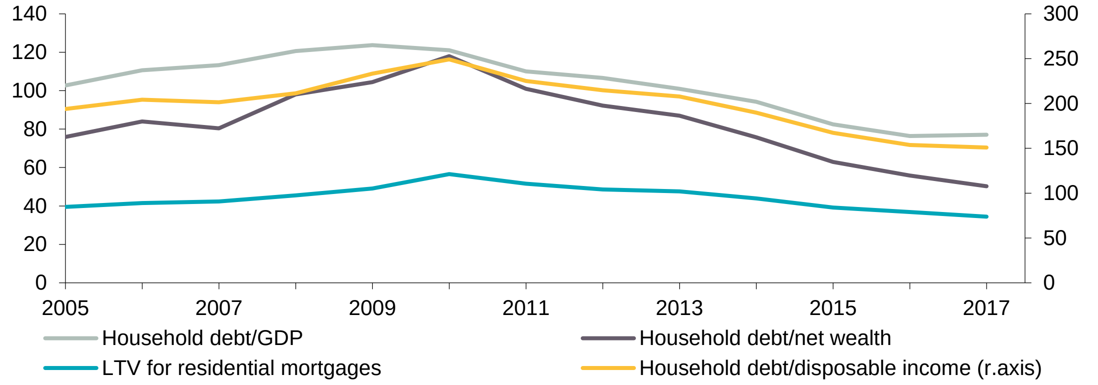


1. Shaded areas and dotted lines indicate ISB Research/ forecasts
Source: Central bank of Iceland, Statistics Iceland and ISB Research

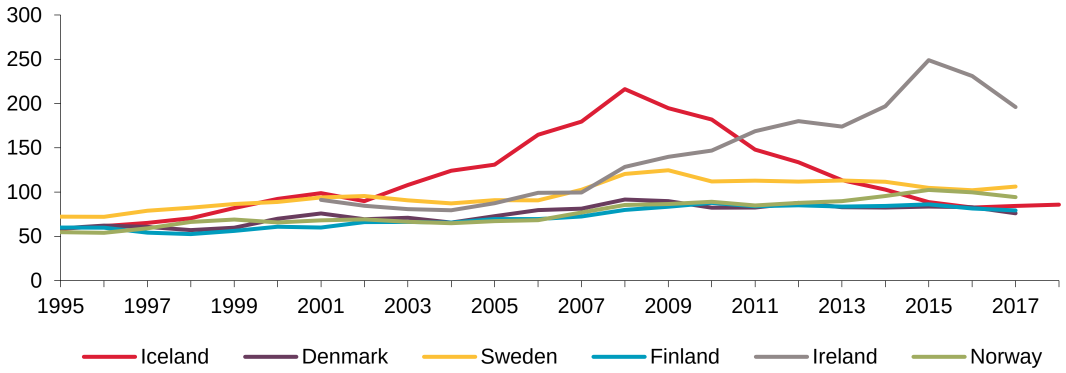
Domestic balance sheets remain robust

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

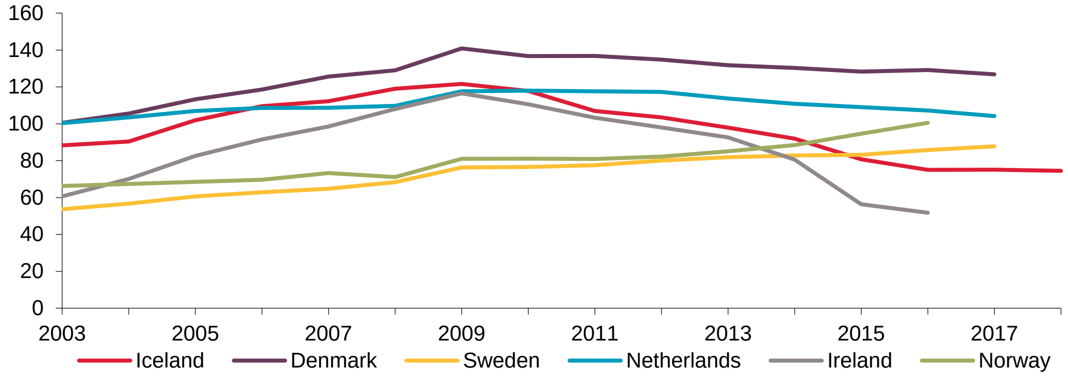
Household debt - domestic
%



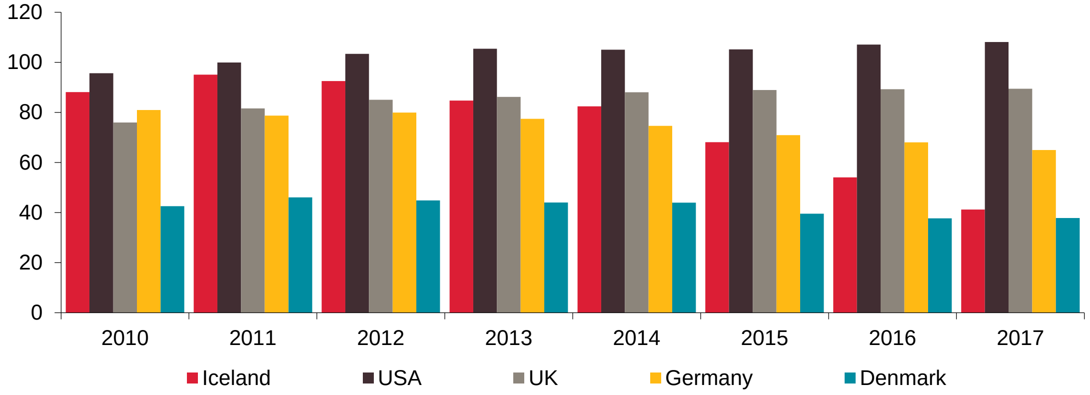
Corporate debt – international comparison
% of GDP



Household debt – international comparison
% of GDP



Central government gross debt – international comparison
% of GDP



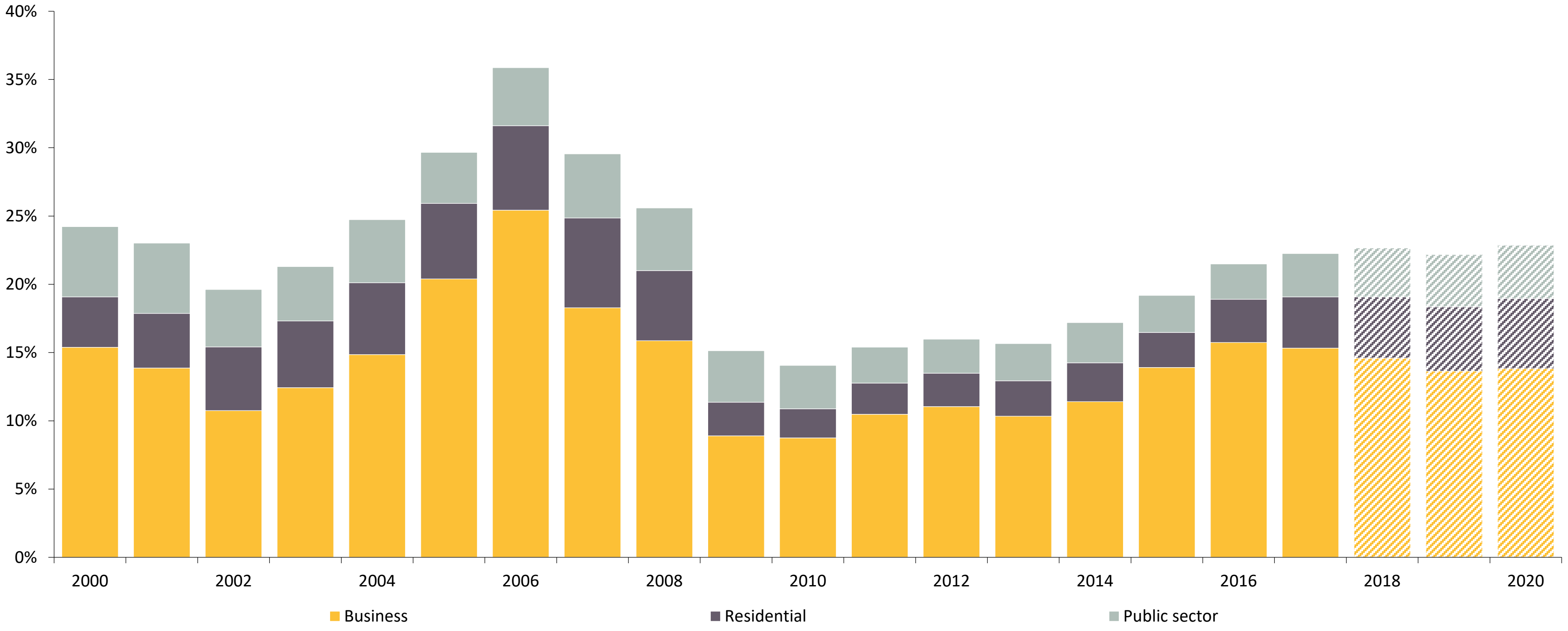
Source: Central bank of Iceland, Statistics Iceland

Outlook for similar investment level in coming years

Growth shifts from business investment to residential investment and public sector investment

- Investment in Iceland picked up strongly in the middle of the decade, after a steep contraction at the end of the 2000s
- Business investment was particularly robust early in the growth period
- The investment-to-GDP ratio was 22% in 2017, after bottoming out at just over 14% in 2010
- Main source of growth is shifting to residential investment and public investment
- Investment level likely to remain just over 1/5 of GDP until the end of the decade

Investment [1]
% of GDP



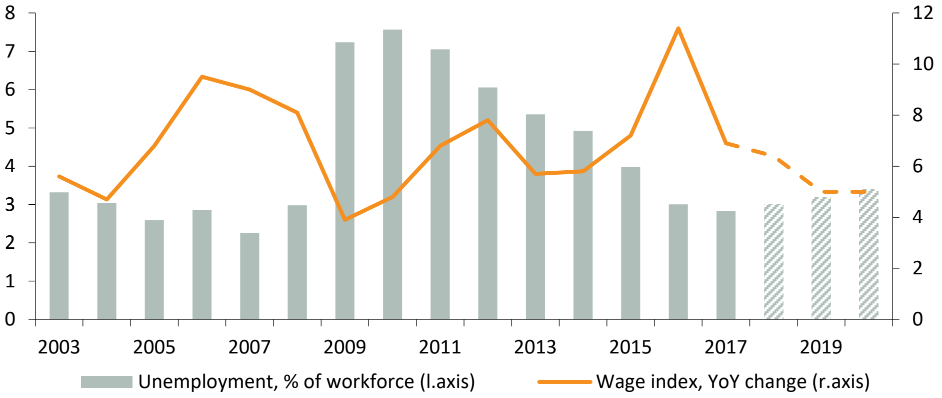
1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Households take their foot of the accelerator

Private consumption growth eases, but labour market is strong

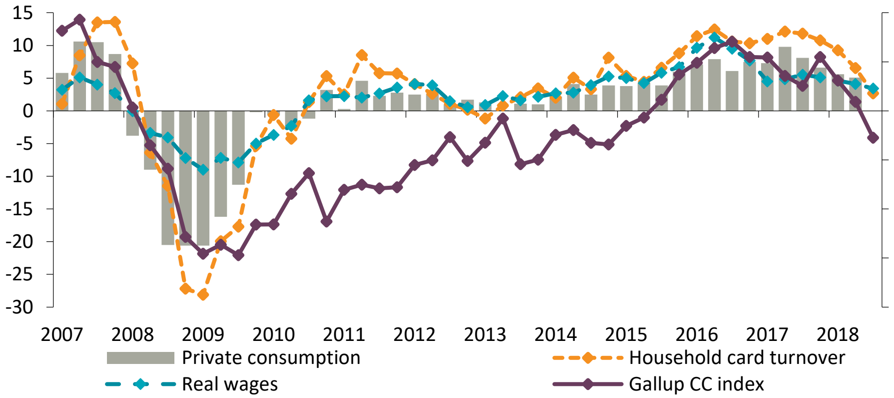
- In the recent past, private consumption growth has levelled off
- Key indicators of private consumption trends suggest that growth will continue to slow down
- Real wage growth is slowing, consumer confidence has declined, payment card turnover is growing at a slower pace
- Households do not appear likely to increase debt-finance consumption to a substantial degree
- The Icelandic labour market has been strong in recent years. Wages have risen swiftly, and the unemployment rate has fallen steadily
- Tension in the labour market peaked in 2016-2017. In 2016, the wage index rose by 9.5%, and in 2017 unemployment bottomed out at 2.8%
- Unemployment likely to continue rising marginally for the remainder of the decade and real wage growth will slow down from its recent pace
- We forecast private consumption growth at 4.7% in 2018, 2.4% in 2019, and 3.2% in 2020

Unemployment and wage growth



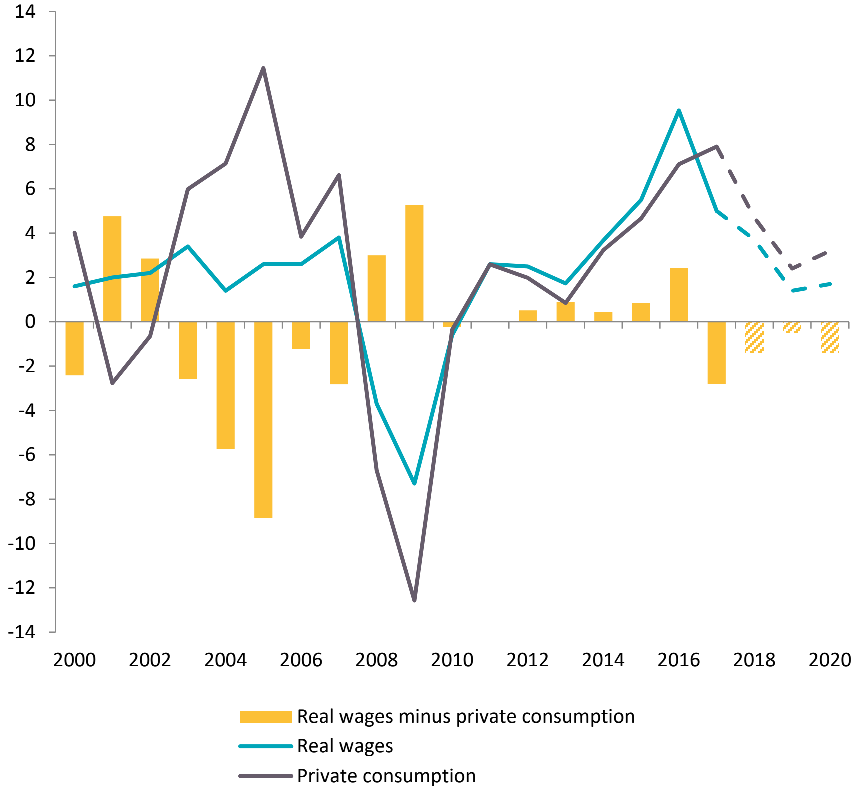
Private consumption and related indicators

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



Real wages and private consumption

YoY real change (%)



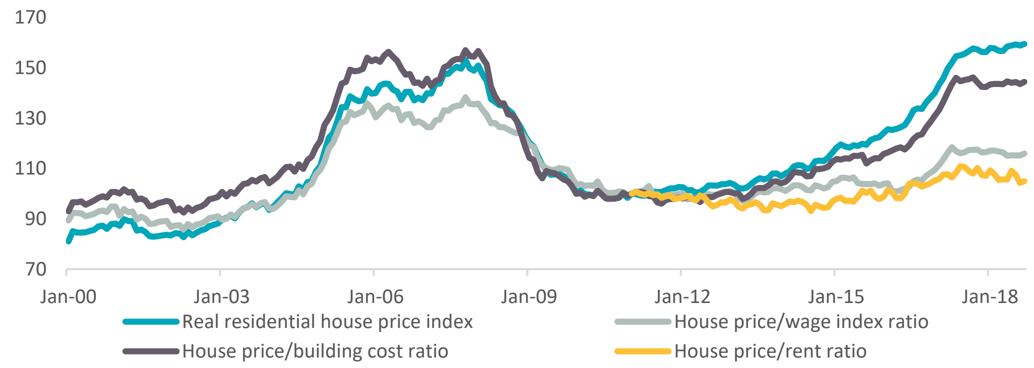
1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Real estate market moving gradually toward balance

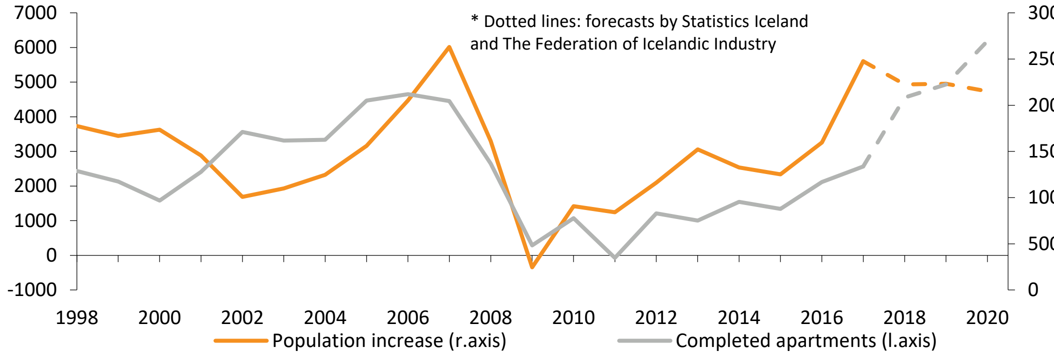
Supply is increasing and main drivers of recent price rises are losing momentum

Real residential capital region house prices and defining factors

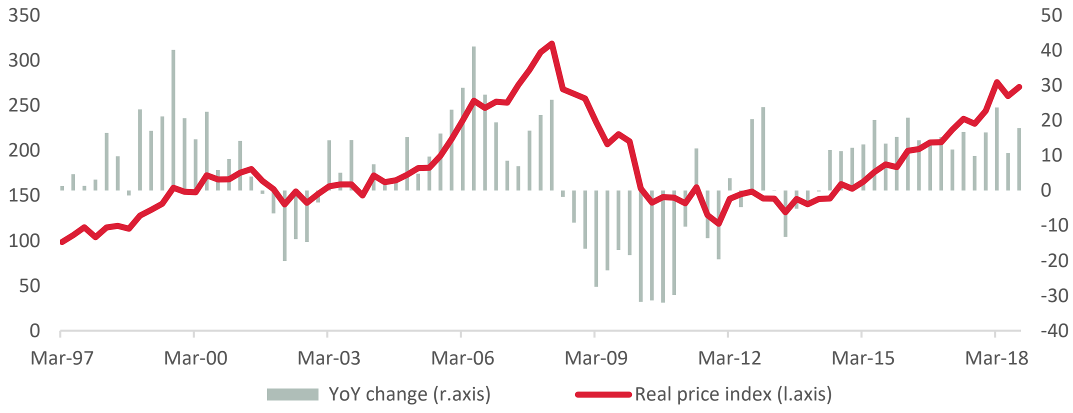
indices



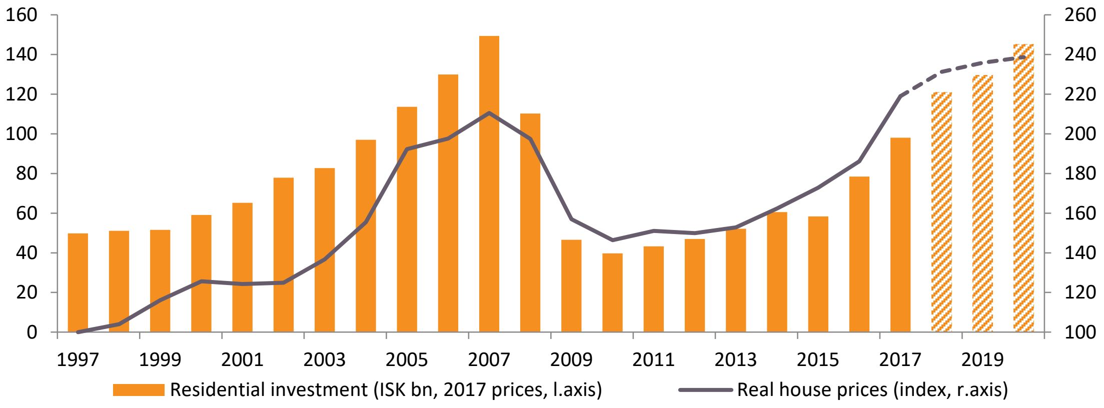
New apartments and population increase in the capital region [1]



Commercial real estate real price index



House prices and residential investment



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

8 November, 2018

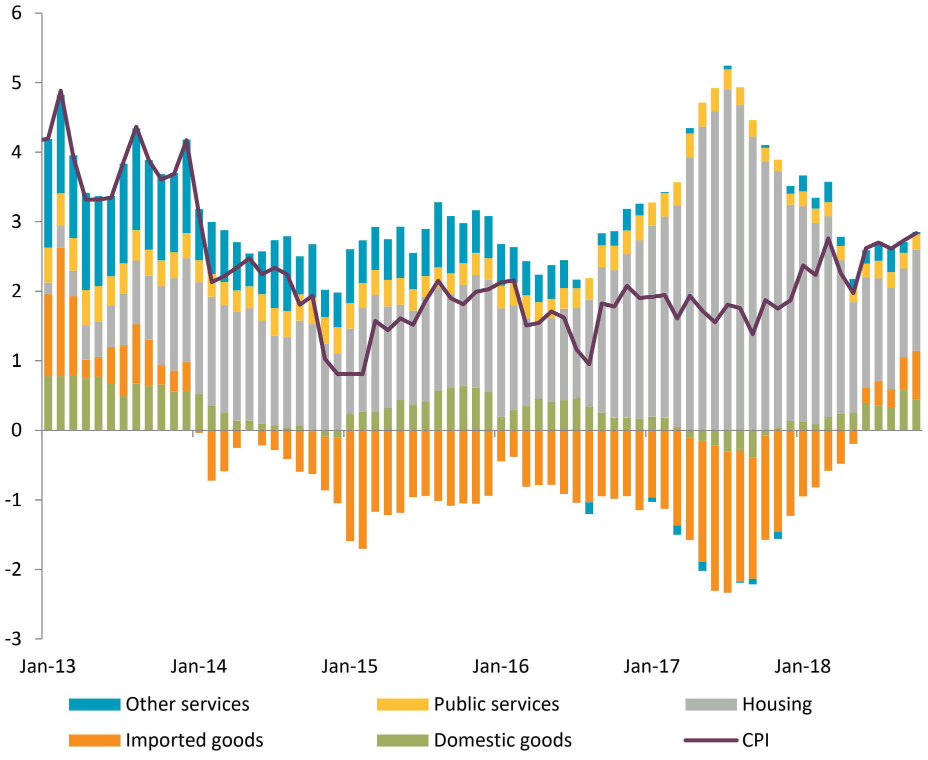
Period of sub-target inflation has ended

Inflation to peak in 2019 following ISK depreciation as domestic cost pressures remain considerable

- Inflation has been close to the CBI's 2.5% inflation target in the recent term, after a four-year stint below target
- Upward pressure on the CPI from the housing component has subsided. At the same time the impact of the steep appreciation of the ISK in 2016-2017 on import prices has tapered off
- The outlook is for rising inflation in coming quarters. The recent depreciation of the ISK will push import prices higher. Furthermore, house price inflation is still tangible, if not as strong as before, and other cost pressures are growing steadily
- Outlook for average inflation of 3.5% in 2019 and 3.2% in 2020
- Moderating inflation further ahead, assuming that house price rises and wage increases slow gradually
- Uncertainty about wage cost pressures to the upside as wage demands in upcoming labour market bargaining are large

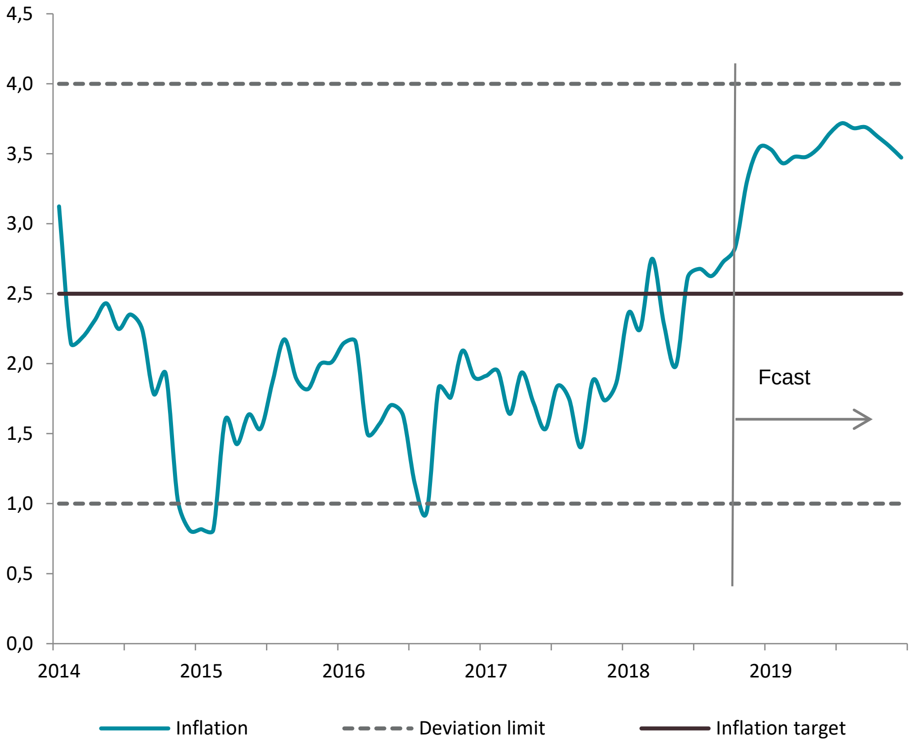
Inflation and contribution of main subitems

%



Inflation and CBI inflation target

%

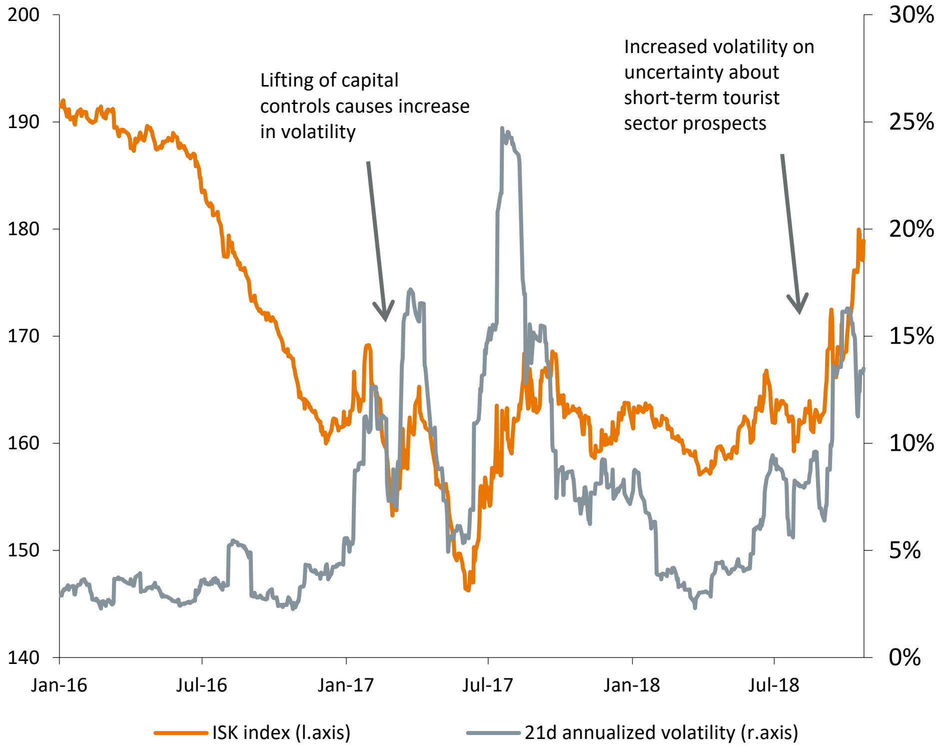


Period of sub-target inflation has ended

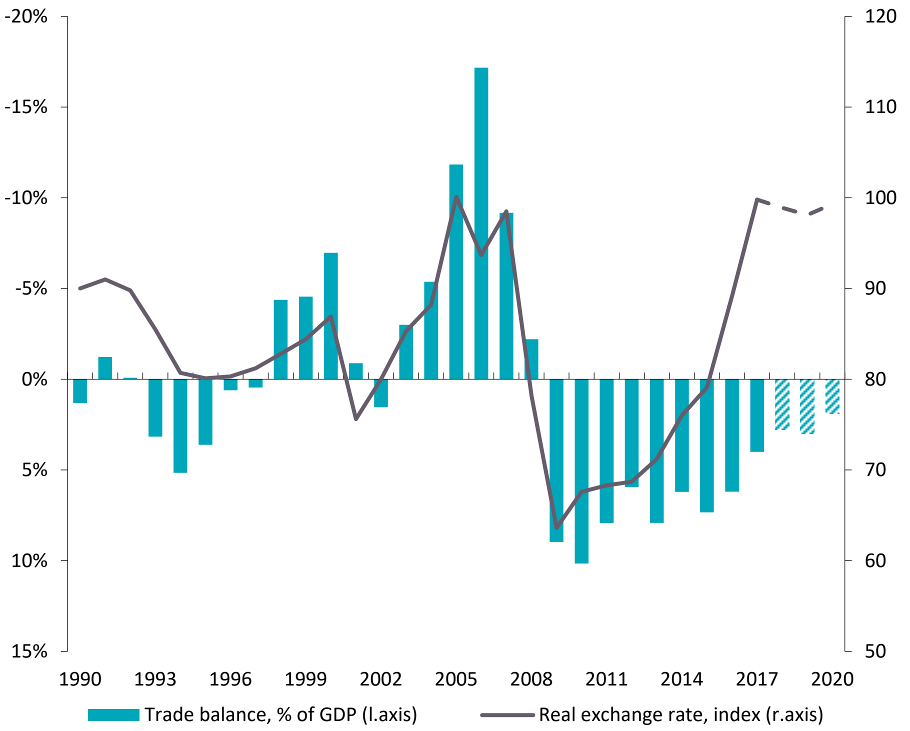
Real exchange rate set to remain high through this decade

- Following a 12 month period of relatively stable ISK, the currency has depreciated by 10% since end-August
- Increased volatility and speed of the depreciation has had negative impact on local sentiment
- Current ISK levels conducive to reducing risk of growing external imbalances by tempering growth in imported consumption and improving the competitiveness of the tourist sector
- Outlook for a relatively high real exchange rate throughout decade
- The net asset position of the economy is at its best in decades, the Central Bank (CBI) has large FX reserves at its disposal and outlook for continued C/A surplus
- 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



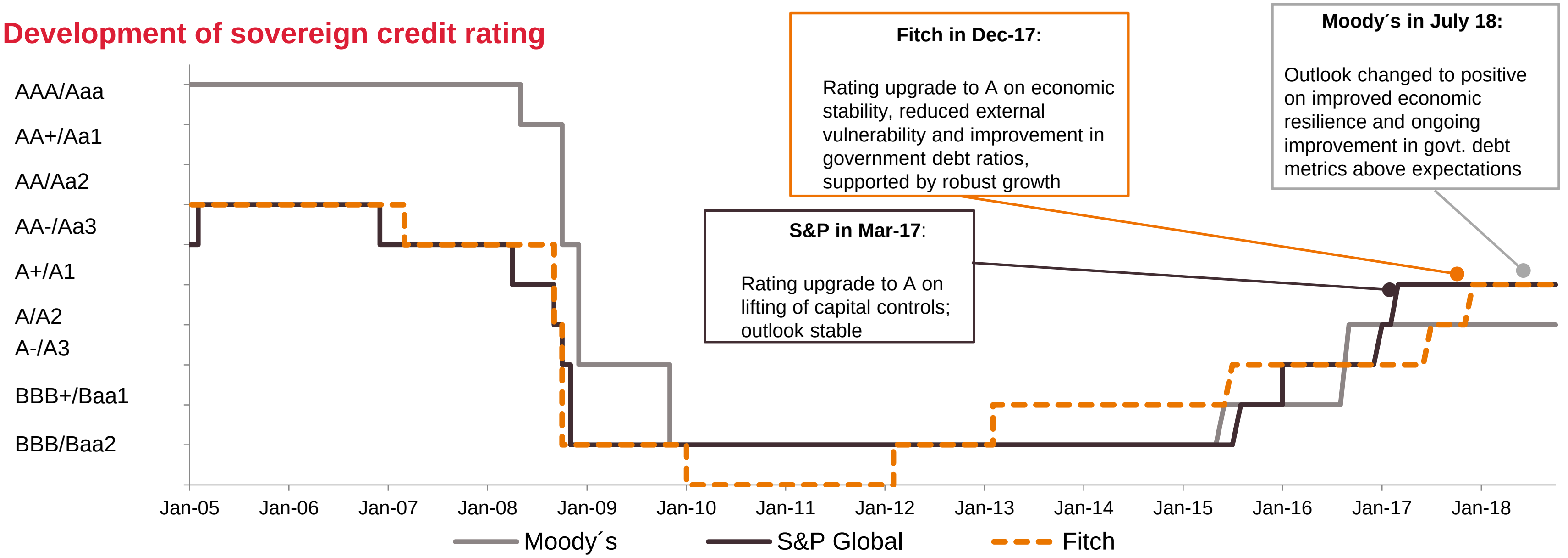
Trade balance and real exchange rate



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

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https://www.islandsbanki.is/um-islandsbanka/fjarfestatengsl/

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Takk fyrir!

8 November, 2018