Earnings Press Release, 28 October 2020

Arion Bank’s Q3 2020 financial results

- Arion Bank reports net earnings of ISK 3,966 million, a significant improvement from Q3 2019
- Net earnings of ISK 4,961 million from continuing operations, an improvement of 31% from Q3 2019
- Return on equity was 8.3%, compared with 1.6% in Q3 2019
- Net interest margin was 2.9% and improves between years despite low interest rate environment
- Core revenues increased by 6.2% between years
- Operating expenses decreased significantly, mainly due to organizational changes in Q3 2019
- Impairments on loans increased, mainly as a result of more negative assumptions due to Covid-19
- Financial restructuring of Valitor has significantly reduced the negative financial effect on the Group
- The Bank’s total assets increased by 14% from year-end 2019 where the loan book increased by 7% and deposits by 22%
- The Bank’s capital ratio was 27.6% and the CET1 ratio was 22.5% at the end of September, assuming 50% dividend payments of net earnings in line with the dividend policy

Arion Bank reported net earnings of ISK 4,961 million from continuing operations in the third quarter and ISK 8,637 million from continuing operations during the first nine months of the year. Net earnings amounted to ISK 3,966 million for the quarter and ISK 6,708 million for the first nine months. Return on equity was 8.3% for the quarter and 4.7% for the first nine months of the year. Return on equity, assuming 17% CET1 ratio, was 10.4% for the quarter.

Total assets amounted to ISK 1,236 billion at the end of September 2020, compared with ISK 1,082 billion at the end of 2019. Liquid assets increased as the proposed ISK 10 billion dividend payment did not materialize, the Bank issued AT1 in February and deposits increased. Loans to customers increased slightly from year-end 2019, mainly due to mortgage lending. Deposits increased by 22% from year-end 2019. Total equity amounted to ISK 192 billion at the end of September, compared with ISK 190 billion at the end of 2019.

The Bank’s capital ratio was 27.6% at the end of September 2020, assuming 50% dividend payments of net earnings, compared with 24.0% at the end of 2019. The CET 1 ratio was 22.5% at the end of September 2020, assuming 50% dividend payments of net earnings, compared with 21.2% at the end of 2019. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 27.3% and the CET1 ratio was 22.2%. The Bank’s capital ratios comfortably exceed the requirements set by law and the Financial Supervisory Authority of the Central Bank. The Group's own funds increased by ISK 29.9 billion from year-end 2019.

The Bank is committed to its medium-term targets.

Benedikt Gíslason, CEO of Arion Bank

“It’s pleasing to see a strong performance from the Bank’s continuing operations during the third quarter and solid net earnings. Income has increased by more than 6%, while expenses are down almost 11% compared with last year, a trend which is line with the focuses in the business over the last year and which will continue in the future. An integral component of our strategy is to offer our customers a wide range of financial services. Our business is therefore highly diverse and income is generated from numerous sources, which is advantageous in the current economic environment. Demand for mortgages in the quarter has been unusually strong, which is one of the reasons for the growth of the Bank’s loan portfolio. The Bank’s liquidity and capital position continues to gain strength and is stronger than ever. In fact the Bank has excess capital on which it is almost impossible to generate returns in line with our targets.

The winter ahead is filled with uncertainty, a situation clearly indicated by the impairments in our loan portfolio and impairments of the Bank’s assets held for sale in the third quarter. This is simply a reflection of the reality we are currently facing. We will work with our customers and make every effort to support them through this period.

In the past few months we have successfully helped companies raise equity and debt on the markets, underlining our belief that thriving Icelandic companies should be able to get the best available financing at any given time from various sources. We will continue on this path to the benefit of our customers.

Our business, how we develop products, manage capital and make decisions increasingly take into account environmental and social factors. This is clearly reflected in the ESG rating given to the Bank recently by the Icelandic ratings company Reitun. We received an outstanding rating, scoring 86 of out of a possible 100 points. The rating is based on the Bank’s performance in terms of environmental, social and governance factors and we are proud to have received such positive testimony to our progress in this area from Reitun. We are developing a green framework around our lending business and our green deposits have been welcomed by our customers. We also launched green mortgages recently, and we are committed to further developing our product and service offering in this direction.”

Income Statement

In ISK millions	Q3 2020	Q3 2019	Δ	Δ %	9M 2020	9M 2019	Δ	Δ %
Net interest income	7,989	7,382	607	8%	23,099	22,624	475	2%
Net commission income	2,762	2,639	123	5%	8,526	7,335	1,191	16%
Net insurance income	1,043	1,087	(44)	(4%)	2,305	2,163	142	7%
Net financial income	692	934	(242)	(26%)	1,383	2,723	(1,340)	(49%)
Other operating income	526	302	224	74%	738	1,427	(689)	(48%)
Operating income	**13,012**	**12,344**	**668**	**5%**	**36,051**	**36,272**	**(221)**	**(1%)**
Salaries and related expenses	(2,504)	(4,130)	1,626	(39%)	(9,211)	(11,565)	2,354	(20%)
Other operating expenses	(2,728)	(2,810)	82	(3%)	(8,623)	(8,855)	232	(3%)
Operating expenses	**(5,232)**	**(6,940)**	**1,708**	**(25%)**	**(17,834)**	**(20,420)**	**2,586**	**(13%)**
Bank levy	(383)	(809)	426	(53%)	(1,038)	(2,627)	1,589	(60%)
Net impairment	(1,340)	484	(1,824)	-	(5,118)	(1,585)	(3,533)	223%
Net earnings before income tax	**6,057**	**5,079**	**978**	**19%**	**12,061**	**11,640**	**421**	**4%**
Income tax expense	(1,096)	(1,278)	182	(14%)	(3,424)	(2,791)	(633)	23%
Net earnings from cont. operations	**4,961**	**3,801**	**1,160**	**31%**	**8,637**	**8,849**	**(212)**	**(2%)**
Discontinued operations, net of tax	(995)	(3,040)	2,045	(67%)	(1,929)	(4,974)	3,045	(61%)
Net earnings	**3,966**	**761**	**3,205**	**421%**	**6,708**	**3,875**	**2,833**	**73%**

KFI's	Q3 2020	Q3 2019	9M 2020	9M 2019
Return on equity (ROE)	8.3%	1.6%	4.7%	2.6%
Return on equity, continuing operations	10.4%	7.8%	6.1%	6.0%
Return on equity assuming 17% CET 1	10.4%	1.5%	5.5%	2.6%
Return on total assets (ROA)	1.3%	0.2%	0.8%	0.4%
Earnings per share (in ISK)	2.31	0.42	3.90	2.14
Cost to income ratio (C/I)	40.2%	56.2%	49.5%	56.3%
Net interest margin (NIM)	2.9%	2.6%	2.9%	2.7%
Operating income / REA	7.9%	6.2%	6.4%	6.1%

Net interest income increased by 8% compared with the third quarter of 2019. The net interest margin (NIM) as a percentage of average interest-bearing assets was 2.9% during the third quarter of 2020, compared with 2.6% for the same period in 2019. The main reasons for the increase in net interest income despite the lowering interest environment is significantly higher inflation and activities both in the corporate loan book and on the funding side.

Net commission income from lending and guarantees has been exceptionally strong, mainly driven by the prepayment of loans and loan service agreements, whereas turnover based fees have decreased due to the pandemic.

Insurance premiums earned at the insurance company Vördur have been increasing, but volatility in net insurance income is mainly due to seasonal fluctuations in the claim rate. The combined ratio for the third quarter of 2020 was 82.9%, compared with 80.0% for the same period in 2019 and is highly competitive in the domestic market.

Other operating income increased significantly in the third quarter of 2020 compared with the same period in 2019, mainly profit from the sale of real estate in the branch network, which the Bank has been optimizing over the last few years.

Operating expenses decreased by 10.7% when excluding the one-off redundancy cost in the third quarter of 2019. Salaries and related expenses decreased mainly due to redundancy expenses in the third quarter of 2019 and the decrease in the number of FTEs following the organizational changes of the Bank in September 2019. At the end of September 2020 the number of full-time equivalent positions (FTEs) was 783 at the Group and 655 at the Bank. Other operating expenses are stable compared with the same period in 2019. IT expenses increased significantly both due to the pandemic and the depreciation of the ISK whereas other operating expenses have been trending down.

Net impairment is mainly due to more negative assumptions in IFRS 9 models. The calculated cost of risk was 19 bps of loans to customers, of which 6.5 bps (34% of net impairment) is due to changes in economic scenarios in IFRS 9 models, 6.2 bps (33% of net impairment) is due to specific impairment (Stage 3), 6.7 bps (35% of net impairment) is due to an increase in tourism exposure and -0.4 bps (-2% of net impairment) is due to other increases in credit risk. Uncertainty persists regarding the valuation of assets due to the pandemic.

Income tax, as reported in the financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1 billion. The effective income tax rate was 18.1% for the third quarter of 2020, compared with 25.2% for the same period in 2019. In general, the combination of income is the main driver for the fluctuation in the effective tax rate.

The reasons for the negative results of discontinued operations in past quarters are chiefly twofold: negative operational results of Valitor and valuation changes of Stakksberg and Sólbjarg. During the third quarter of 2020 mark down on held for sale assets in Scandinavia was the main contributor of loss. The operating performance of Valitor has improved significantly between years, following the structural changes made at the end of 2019 and the sale of the omni operations in Denmark and the UK. This improvement of ISK 2.2 billion between years, taking into account group eliminations, is despite the negative effect of Covid-19 in 2020.

Balance sheet

The balance sheet increased by 14% from year-end 2019 with liquid assets being the main driver of the increase. The liquidity position has mainly increased due to the postponement of a dividend payment, the issuance of AT1 in February and an increase in deposits.

Assets

In ISK millions	**30.09.2020**	**31.12.2019**	Δ	**Δ %**	**30.06.2020**	Δ	**Δ %**
Cash & balances with CB	87,517	95,717	(8,200)	(9%)	103,432	(15,915)	(15%)
Loans to credit institutions	39,484	17,947	21,537	120%	33,597	5,887	18%
Loans to customers	807,866	773,955	33,911	4%	779,902	27,964	4%
Financial assets	234,937	117,406	117,531	100%	197,141	37,796	19%
Intangible assets	9,398	8,367	1,031	12%	9,077	321	4%
Assets and disposal groups HFS	30,821	43,626	(12,805)	(29%)	30,732	89	0%
Other assets	26,193	24,837	1,356	5%	28,368	(2,175)	(8%)
Total assets	**1,236,216**	**1,081,855**	**154,361**	**14%**	**1,182,249**	**53,967**	**5%**

KFI's							
REA / Total assets	58.9%	66.5%			60.6%		
Share of stage 3 loans, gross	3.2%	2.5%					

Loans to customers increased by 4.4% from the end of 2019, mainly mortgage lending. Corporate lending measured in ISK has for the most part held up as FX loans increased in value with the depreciation of the ISK from year-end. The loan book continues to be well balanced between individuals and corporates. Loans to individuals increased by 6.6% during the third quarter and 12.4% from year-end 2019, with mortgages to individuals being 44% of the loan portfolio. Loans to corporates increased by 0.6% during the third quarter but decreased by 2.9% from year-end 2019, partly due to prepayments of large corporate loans in line with strategy and additional impairments.

There was a significant turnover in the loan book during the first nine months, both refinancing and new loans. Proportionally, the change is greatest in mortgage loans to individuals as almost half of the mortgage loan portfolio is new or was refinanced during the first nine months of 2020, or ISK 151 billion. During the third quarter, new mortgage loans amounted to ISK 68 billion, while the net increase, taking into account prepayments, amounted to ISK 26 billion.

Arion Bank has been supporting its customers and working with the Icelandic authorities to develop government guaranteed loan facilities targeted at corporates that are going through temporary difficulties. At the end of September 2.52% of individual loans (by amount), predominantly mortgages, and 3.36% of corporate loans were in payment moratorium. At the end of September the Bank had made 217 loans with the government guarantee amounting to ISK 1.9 billion.

The Bank's liquidity position is very strong with total LCR ratio 213% and ISK LCR ratio 177%. That is reflected in strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments.

Assets and disposal groups held for sale comprise the subsidiaries Valitor Holding ehf., Stakksberg ehf. and Sólbjarg ehf. Valitor's contribution to the Group's assets was ISK 18,135 million at the end of September 2020.

Liabilities and equity

In ISK millions	30.09.2020	31.12.2019	Δ	Δ %	30.06.2020	Δ	Δ %
Due to credit institutions & CB	10,802	5,984	4,818	81%	7,661	3,141	41%
Deposits from customers	602,842	492,916	109,926	22%	555,855	46,987	8%
Other liabilities	58,103	39,672	18,431	46%	51,478	6,625	13%
Borrowings	308,913	304,745	4,168	1%	314,952	(6,039)	(2%)
Subordinated liabilities	36,867	20,083	16,784	84%	36,494	373	1%
Liabilities associated w/disposal groups HFS	26,193	28,630	(2,437)	(9%)	26,982	(789)	(3%)
Total liabilities	**1,043,720**	**892,030**	**151,690**	**17%**	**993,422**	**50,298**	**5%**
Shareholders equity	192,324	189,644	2,680	1%	188,656	3,668	2%
Non-controlling interest	172	181	(9)	(5%)	171	1	1%
Total equity	**192,496**	**189,825**	**2,671**	**1%**	**188,827**	**3,669**	**2%**
Total liabilities and equity	**1,236,216**	**1,081,855**	**154,361**	**14%**	**1,182,249**	**53,967**	**5%**

KFI's							
Loans to Deposits ratio	134.0%	157.0%			140.3%		
CET1 ratio	22.5%	21.2%			22.9%		
Capital adequacy ratio	27.6%	24.0%			28.1%		

Deposits from customers remain the most important source of funding for Arion Bank and the greater focus on deposit funding has resulted in a significant increase. The increase is in all the main classes i.e. from individuals, corporates and public entities.

The increase in *borrowings* is primarily due to the depreciation of the ISK against foreign currencies. During Q3 the Bank paid on due date smaller issues in SEK and NOK without any need for new borrowings. A comfortable liquidity position and limited refinancing needs mean that the Bank does not need to access the international wholesale funding markets in 2020, but is at the same time preparing for the EUR 500 million maturity in 2021.

The Bank issued its first AT1 instrument during the first quarter of 2020 in the amount of approximately ISK 13 billion (USD 100 million). The Bank has previously issued a number of Tier 2 subordinated bonds in line with its capital strategy and has now issued the required subordinated bonds.

Shareholders' equity increases slightly due to the financial results for the period, which are partly offset by the purchase of own shares in the amount of ISK 4.4 billion. The share buy-back program continued until the AGM in March 2020. The leverage ratio was 14.3% at the end of September 2020, compared with 14.1% at the end of 2019, which is very high in all comparisons in the international banking market. At 30 September 2020 the Group had ISK 65 billion of CET1 capital in excess of regulatory requirements and ISK 40 billion in excess of the Group's target CET1 ratio of 17%.

For further information on the accounts please visit the Arion Bank's website.

Investor webcast on 29 October at 9:30 CET (8:30 GMT)

Arion Bank will be hosting a webcast on Thursday 29 October at 9:30 CET (8:30 GMT) where CEO Benedikt Gíslason, CFO Stefán Pétursson, Deputy CFO Eggert Teitsson and Head of Investor Relations Theodor Fridbertsson will present the results and answer questions from participants. The webcast will take place in English and will be streamed live.

The webcast will be accessible live on *financialhearings.com* and a link will also be made available on the Bank's website under *Investor Relations*.

To participate in the webcast via telephone and ask questions please call in using the relevant number indicated below before the start of the webcast:

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For further information please contact Theodór Fridbertsson, Head of IR, tel.+354 856 6760, and for media enquiries Haraldur Gudni Eidsson, Head of Corporate Communications, tel. +354 856 7108.

Financial calendar

The Bank's Financial Statements are scheduled for publication as stated below. The calendar may be subject to change.

Q4 2020 / 12M 2020 Financial results	10 February 2021
AGM 2021	16 March 2021
Q1 2021 Financial results	5 May 2021
Q2 2021 Financial results	28 July 2021
Q3 2021 Financial results	27 October 2021

This is information that Arion Bank hf. is obliged to make public pursuant to the EU Market Abuse Regulation. The information was submitted for publication through the agency of the contact persons set out above.

Forward-looking statements

This release contains forward-looking statements that reflect management's current views with respect to certain future events and potential financial performance. The information in the release is based on company data available at the time of the release. Although Arion Bank believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Accordingly, results could differ materially from those set out in the forward-looking statements as a result of various factors. The most important factors that may cause such a difference for Arion Bank include, but are not limited to: a) the macroeconomic development, b) change in inflation, interest rate and foreign exchange rate levels, c) change in the competitive environment and d) change in the regulatory environment and other government actions. This release does not imply that Arion Bank has undertaken to revise any forward-looking statements, beyond what is required by applicable law or applicable stock exchange regulations if and when circumstances arise that will lead to changes after the date when this release was made. Arion Bank assumes no responsibility or liability for any reliance on any of the information contained herein. It is prohibited to distribute or publish any information in this release without Arion Bank's prior written consent.