



# Third quarter results 2020

Investor presentation

28 October 2020

# Key takeaways

Robust quarter in a challenging environment while delivering on strategy and operational targets



## Delivering on strategy in a challenging economical environment

- Return on optimized equity above 10% target
- Solid core income growth of 6.2%
- Improved operating efficiency demonstrated in lower operating expenses of 10.7% and strong cost-to-income ratio



## Diversified income streams and distribution channels demonstrate value in volatile markets

- Pressure on certain products countered by strength in other areas
- Strong digital distribution channels have sustained full product offering throughout
- Accelerated transformation of branches to sales and service centres with focus on providing customer service and advice with full product suite



## Significant balance sheet strength and dividend capacity

- CET1 and total capital ratios among highest in Europe
- Leverage ratio significantly stronger than European peers
- Over ISK 40 billion of surplus capital



## Broad market access provides a unique value proposition in supporting the rebound of the Icelandic economy

- The only bank in Iceland with international shareholders. Sustained marketing of the group and the Icelandic economy to investors across the globe
- Access to domestic and international investors across the capital structure
- Forms a key part of building a strong rebound for the Icelandic economy in coming years



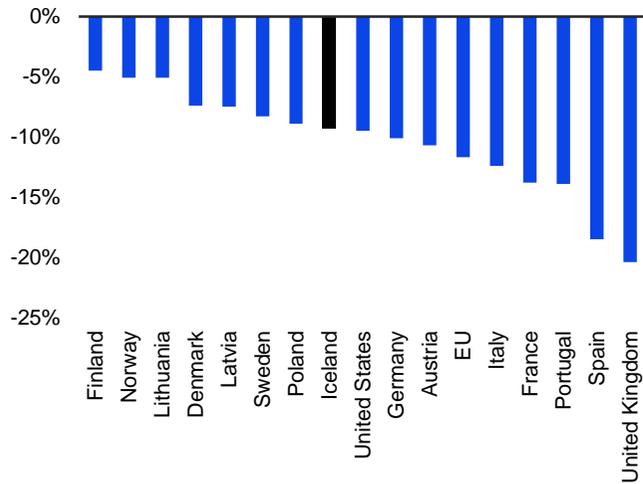
# Icelandic economy – dealing with the effects of the pandemic

The spread of Covid-19 and subsequent travel bans have had a negative effect on the Icelandic economy, especially tourism

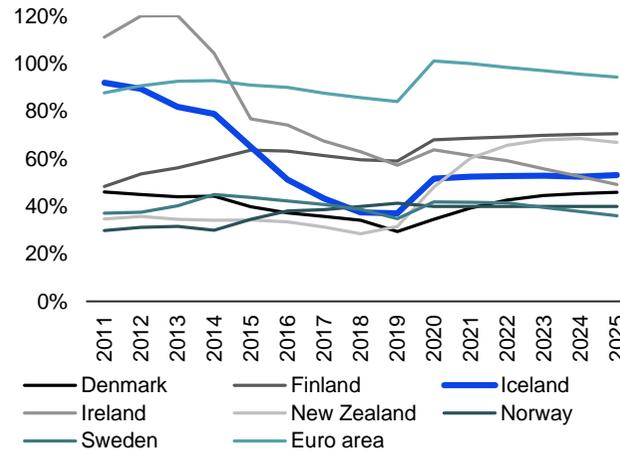
Strong leverage position of the government treasury coupled with the fiscal and monetary responses soften the economic blow

The pandemic has a significant negative impact on GDP but medium and long term outlook is strong

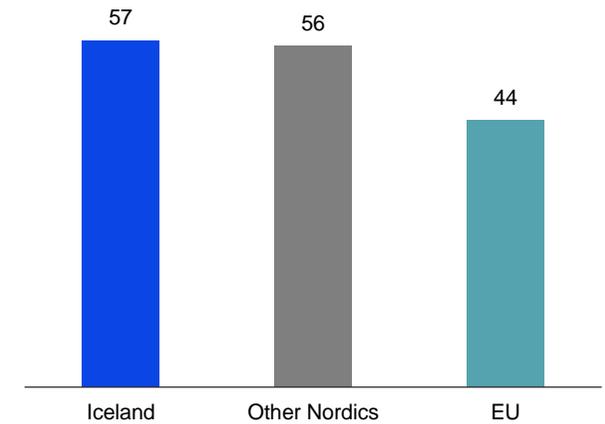
**GDP changes in Q2 (%-change, quarter on quarter)**



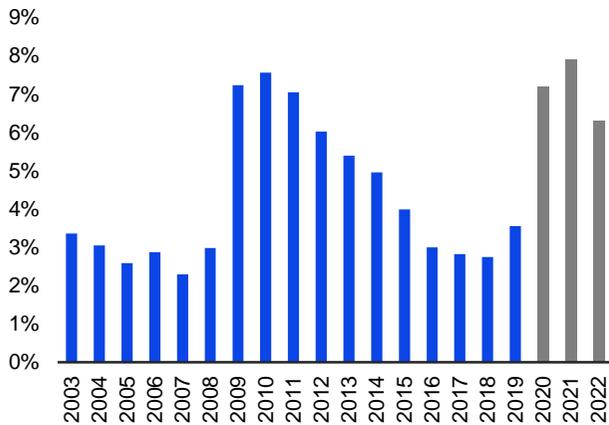
**Central government gross debt (% of GDP)**



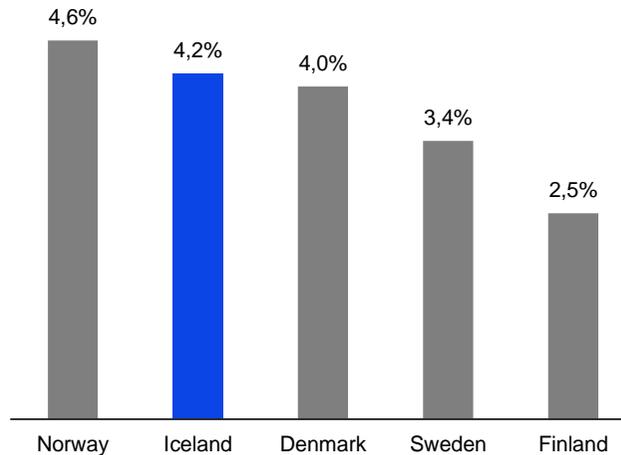
**GDP per capita in 2020 (US dollars, thous. IMF's estimates)**



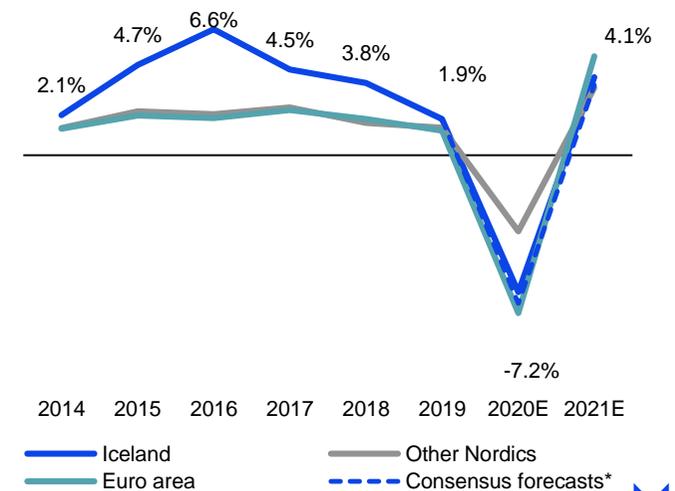
**Unemployment rate (Arion Bank's estimates)**



**Pandemic response (international comparison of fiscal measures\*)**



**GDP growth**



Sources: IMF, Icelandic Tourist Board, Statistics Iceland, Arion Bank. \* IMF's latest forecast. \*\* Based on domestic analysts, both in the public and private sector.



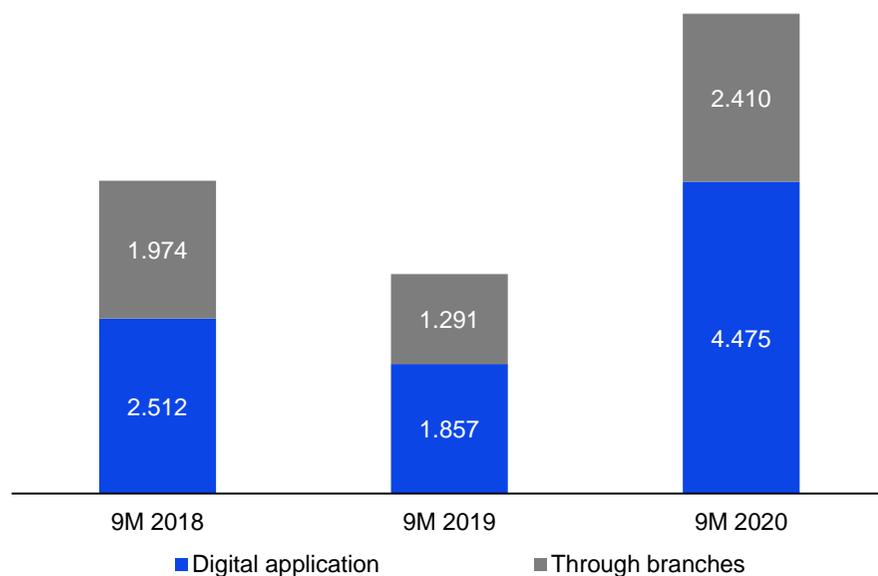
# COVID-19 has accelerated growth in digital channels

The Bank has been able to fully operate and service its customers with all branches closed and most staff working from home

- The bank's strong position in digital channels provided a robust platform for managing through recent impact of Covid-19
- Record volume in mortgage applications have been processed seamlessly through digital channels
- Number of digital applications in 9m 2020 exceeds total applications during same period 2019 and roughly equals 2018

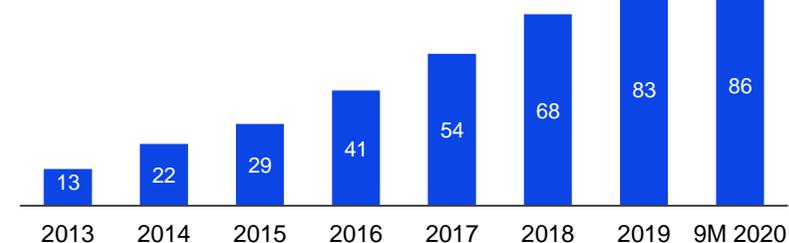
## Mortgage applications

# applications

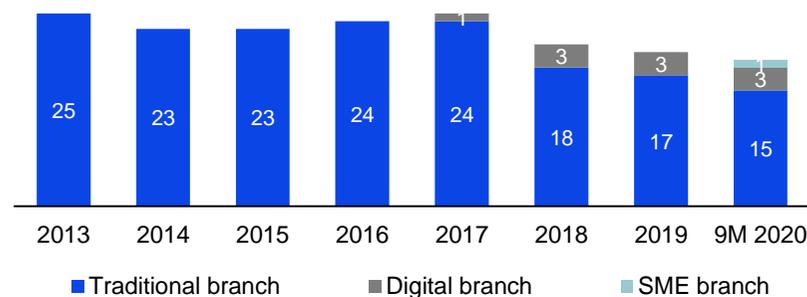


## Active Arion App users

000s

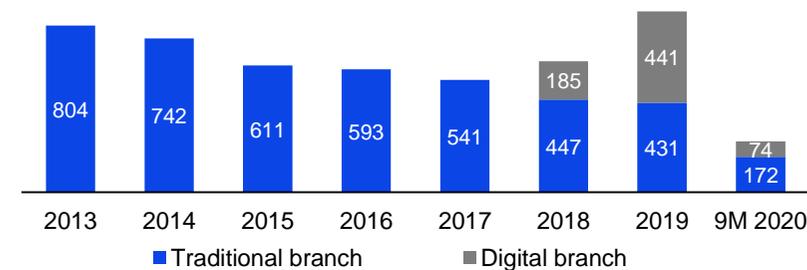


## Number of branches



## Number of visits to branches<sup>1</sup>

000s



# ESG strategy influences product development

## Green deposits



- **First bank in Iceland** to offer Green Deposits
- The accounts are based on a **green framework** and is intended to support the UN Sustainable Development Goals number 7,9,11 and 13
- 1,100 new green deposit accounts since June

## Green Mortgages



- Our customers now **pay zero loan origination fees** on mortgages when investing in residential property which has been **environmentally certified** by one of the following:
  - Swan Ecolabel
  - BREEAM - Very Good
  - LEED Gold

## Green car financing



- Customers do not pay any arrangement fees for financing vehicles which run **entirely on electricity or other 100% renewables**
- There is a **50% discount** on arrangement fees on loans for hybrid vehicles which emit less than 99g/km in carbon dioxide equivalents
- Green car financing was around **20%** of all car financing in the first nine months of 2020

## Outstanding results in ESG ratings



- In September 2020 Arion Bank achieved outstanding results in Reitun's ESG rating (Icelandic ratings company), **scoring 86 points out of a possible 100** and placing it in category A3
- Approximately 30 Icelandic issuers have been rated by Reitun and the average score is 60 points

## Recent international and domestic commitments

- Arion bank is a **founding signatory** to the **Principles for Responsible Banking (PRI)**
- In September 2020 Arion bank signed a **declaration of intent on investment for a sustainable recovery, post Covid-19**

## Arion Bank's Environment and Climate Policy

- We are **evaluating our loan portfolio** according to green criteria, setting ambitious targets and adopting a policy on loans to individual sectors **and evaluating our suppliers**

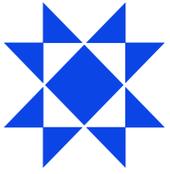
## Gender equality

- First bank in Iceland to gain the **equal pay symbol** from the Ministry of Welfare
- **UN Women and UN Global Compact Women's Empowerment Principles**

## Corporate governance

- Since 2015 Arion Bank has been recognized on **guidelines on corporate governance issued by the Icelandic Chamber of Commerce**





# Financials



# Operational highlights of the third quarter 2020

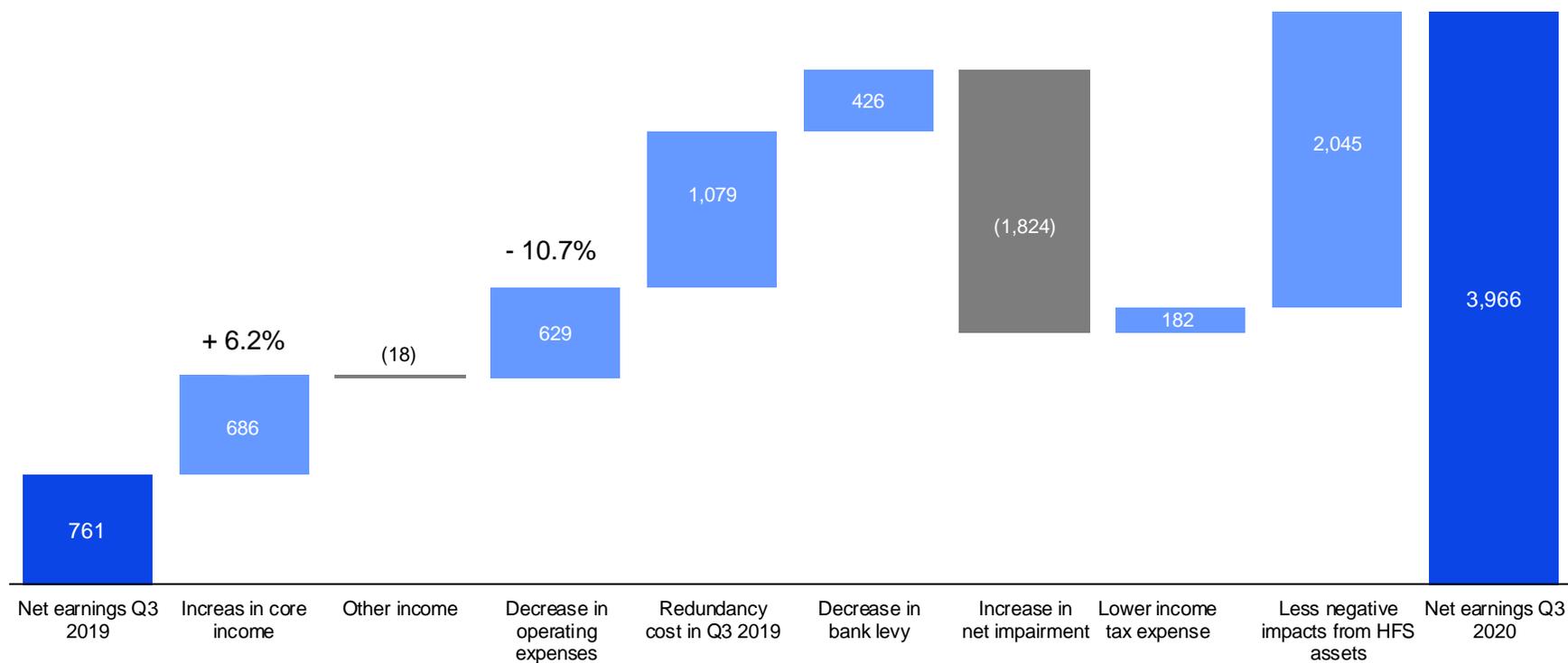
- Arion Bank's strategy results in core operations trending positively
  - NIM improves 30 bps YoY
  - NII to Credit risk improves YoY and is stable from Q2 despite increased credit risk
  - Core revenues up 6.2%
  - OPEX is down 25% and 10.7% when excluding one-off redundancy expenses in Q3 2019
- Valitor operational performance during the first nine months has improved significantly or by ISK 2.2 billion between years following structural changes
- The balance sheet and loan book increase from year end 2019 but REA remains relatively stable
- Surplus CET1 Capital of ISK 40 billion on top of the Bank's 17% CET1 capital target

	<b>Q3 2020</b>	<b>9M 2020</b>	<b>Target</b>
<b>Return on equity</b>	8.3%	4.7%	Exceed 10%
<b>ROE assuming 17% CET 1</b>	10.4%	5.5%	Exceed 10%
<b>Operating income / REA</b>	7.2%	6.7%	Exceed 6.5%
<b>Cost-to-income ratio</b>	40.2%	49.5%	Below 50%
<b>CET 1</b>	22.5%	22.5%	17.0%



# Net earnings improve significantly YoY

Positive trends in core operations



# Income statement Q3 2020

Strong earnings with 8.3% return on equity in the quarter

- Core income; NII, NCI and Net insurance income, increases 6.2% YoY and 4.3% from Q2
  - Net interest income improves from last year on a similar loan book despite a lower interest rate environment
- Other operating income in Q3 2020 largely profit from sale of real estate
- Decrease in salaries is mostly due to one-off redundancy expense in Q3 2019 (ISK 1,079 million). Decrease of 11% in FTE's YoY and unusually high vacation allowance in the quarter also has a positive effect
- Uncertainty persists regarding impairments going forward
  - Calculated impairments were 19 bps during Q3 2020, 76 bps calculated on annualized basis
  - Additional mark down on held for sale assets, mark down on HFS assets in Scandinavia ISK 1.1 billion during the quarter

	Q3 2020	Q3 2019	Diff%	Q2 2020	Diff%
Net interest income	7,989	7,382	8%	7,857	2%
Net commission income	2,762	2,639	5%	2,688	3%
Net insurance income	1,043	1,087	(4%)	761	37%
Net financial income	692	934	(26%)	2,691	(74%)
Share of (loss) profit of associates	51	30	70%	(5)	-
Other operating income	475	272	75%	71	569%
<b>Operating income</b>	<b>13,012</b>	<b>12,344</b>	<b>5%</b>	<b>14,063</b>	<b>(7%)</b>
Salaries and related expenses	(2,504)	(4,130)	(39%)	(3,577)	(30%)
Other operating expenses	(2,728)	(2,810)	(3%)	(2,818)	(3%)
<b>Operating expenses</b>	<b>(5,232)</b>	<b>(6,940)</b>	<b>(25%)</b>	<b>(6,395)</b>	<b>(18%)</b>
Bank levy	(383)	(809)	(53%)	(324)	18%
Net impairment	(1,340)	484	-	(918)	46%
<b>Earnings before income tax</b>	<b>6,057</b>	<b>5,079</b>	<b>19%</b>	<b>6,426</b>	<b>(6%)</b>
Income tax expense	(1,096)	(1,278)	(14%)	(1,468)	(25%)
<b>Net earnings from continuing operations</b>	<b>4,961</b>	<b>3,801</b>	<b>31%</b>	<b>4,958</b>	<b>0%</b>
Discontinued operations, net of tax	(995)	(3,040)	(67%)	(45)	-
<b>Net earnings</b>	<b>3,966</b>	<b>761</b>	<b>421%</b>	<b>4,913</b>	<b>(19%)</b>



# Income statement 9M 2020

Strong performance in core operations

- Core income; NII, NCI and Net insurance income, increases 5.6% YoY
  - NCI increased mainly due to capital volatility in the loan book
- Operating expenses reduce by 12.7% and by 7.8% excluding redundancy expense of ISK 1,079 million in Q3 2019
- The bank levy has been lowered from 0.376% to 0.145% which has a noticeably positive effect. The bank levy is still high in international comparison
- Increase in net impairment is mainly due to more negative assumptions in IFRS 9 models.
  - Impairments were 72 bps during the first nine months, which calculates into 96 bps on annualized basis
- Income tax expense and income tax rate higher than 9M 2019 due to combination of revenue items
- Effect of discontinued operations still high but down from very difficult 9M last year

	9M 2020	9M 2019	Diff	Diff%
Net interest income	23,099	22,624	475	2%
Net commission income	8,526	7,335	1,191	16%
Net insurance income	2,305	2,163	142	7%
Net financial income	1,383	2,723	(1,340)	(49%)
Share of profit of associates	22	750	(728)	(97%)
Other operating income	716	677	39	6%
<b>Operating income</b>	<b>36,051</b>	<b>36,272</b>	<b>(221)</b>	<b>(1%)</b>
Salaries and related expenses	(9,211)	(11,565)	2,354	(20%)
Other operating expenses	(8,622)	(8,855)	233	(3%)
<b>Operating expenses</b>	<b>(17,833)</b>	<b>(20,420)</b>	<b>2,587</b>	<b>(13%)</b>
Bank levy	(1,038)	(2,627)	1,589	(60%)
Net impairment	(5,118)	(1,585)	(3,533)	223%
<b>Net earnings before income tax</b>	<b>12,062</b>	<b>11,640</b>	<b>422</b>	<b>4%</b>
Income tax expense	(3,424)	(2,791)	(633)	23%
<b>Net earnings from continuing operations</b>	<b>8,638</b>	<b>8,849</b>	<b>(211)</b>	<b>(2%)</b>
Discontinued operations, net of tax	(1,929)	(4,974)	3,045	(61%)
<b>Net earnings</b>	<b>6,709</b>	<b>3,875</b>	<b>2,834</b>	<b>73%</b>



# Net interest income

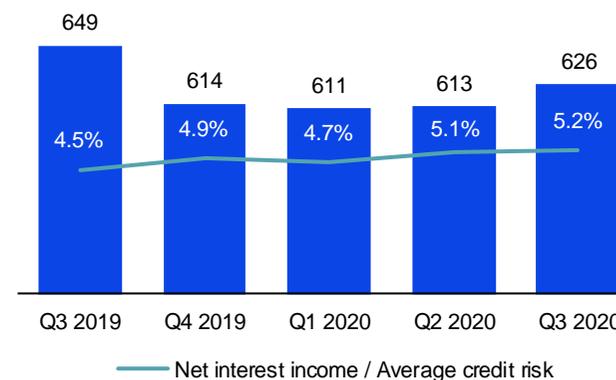
NIM is up 30 bps YoY in a more challenging rate environment

- Net interest income increased by 8.2% from Q3 2019 whilst interest bearing assets increased by only 0.6%
- Strong net interest margin in light of:
  - Policy rate, which was at historic low during the period
  - Issuance of Tier 2 subordinated bonds in 2019 and AT1 in Q1
  - Excessive liquidity
- Net interest income / average credit risk continues to be strong despite increase in credit risk
- Positive effect of inflation, which was 4.2% during the quarter compared with 1.8% in Q3 2019
- Increase in deposits and a corresponding reduction of wholesale funding have positive effect on NIM
- NII increases YoY as lower interest expense on deposits, borrowings, inflation and good liquidity management make up for lower interest income from loans to customers and credit institutions in the low interest rate environment

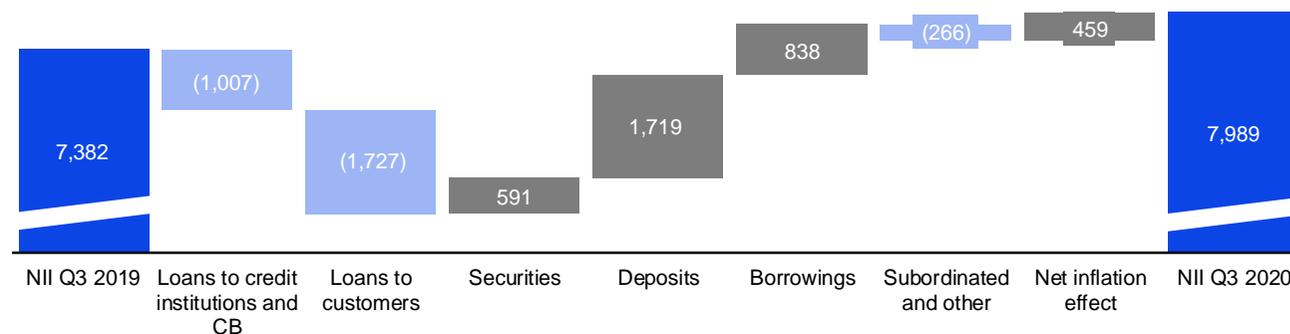
## Net interest income



## Credit risk



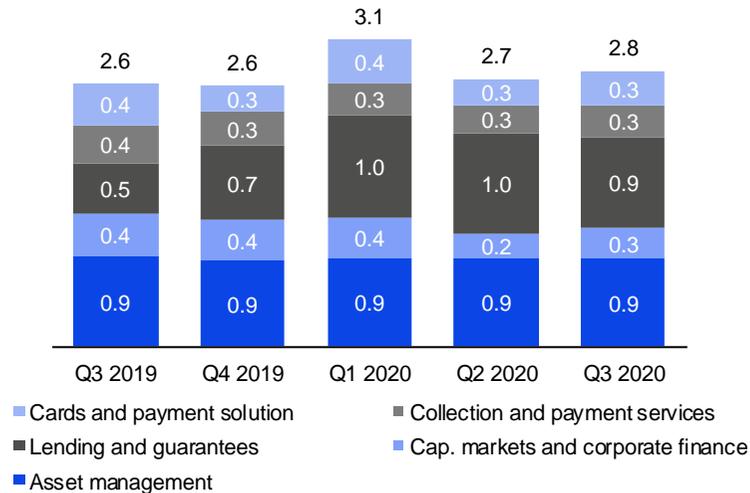
## Net interest income Q3 2020 vs Q3 2019 (ISK million)



# Net fee and commission income and net insurance income

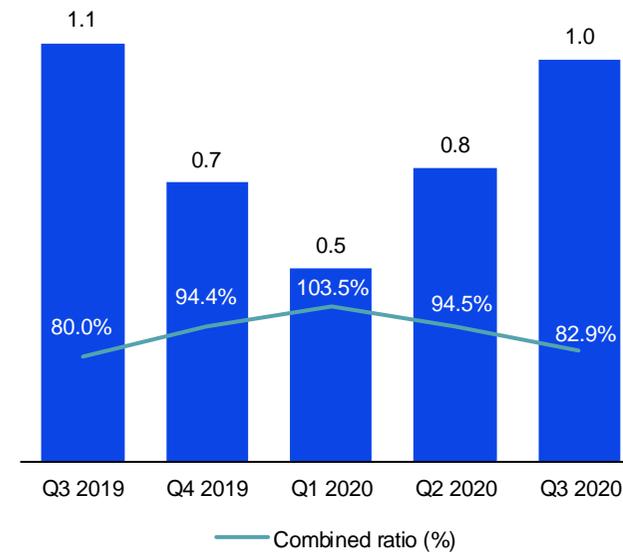
Net fee and commission income is trending positively despite reduced retail banking activity due to Covid-19

## Net fee and commission income



- Income from lending and guarantees exceptionally strong, mainly driven by prepayment of loans and loan service agreements
- Cards and payment solutions decrease from Q3 2019 as turnover decreased due to Covid-19
- Strategy calls for increased fee and commission income going forward

## Net insurance income



- Strong quarter but a slight decrease from Q3 2019. Increase from Q2, mainly due to a discount of 1/3 on premiums in May in relation to Covid-19 (ISK 262 million)
  - Constant premium growth of 6-8% during the year compared with prior year, when taking into account the discount but claims are marginally up YoY
- Combined ratio of 82.9% in Q3 and 93.6 YTD (91.0% excluding discount in Q2 in relation to Covid-19)

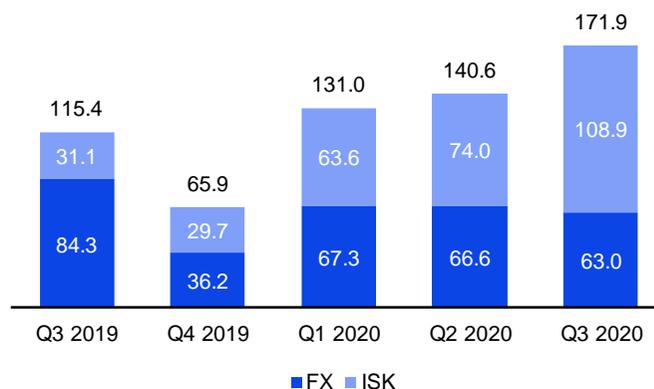


# Net financial income

Significant increase in bond holdings due to strong liquidity position

- Net financial income in Q3 driven by:
  - Equity holdings measured at fair value as markets were positive following a difficult first quarter
  - Continued positive development of fixed income in the lowering interest rate environment
- Bond holdings increase as the Bank's liquidity position strengthens
- Equity holdings remain stable YoY
- Total portfolio of Vördur included in the Group figures is ISK 22.1 billion; ISK 14.8 billion of bonds and ISK 7.3 billion in equity instruments

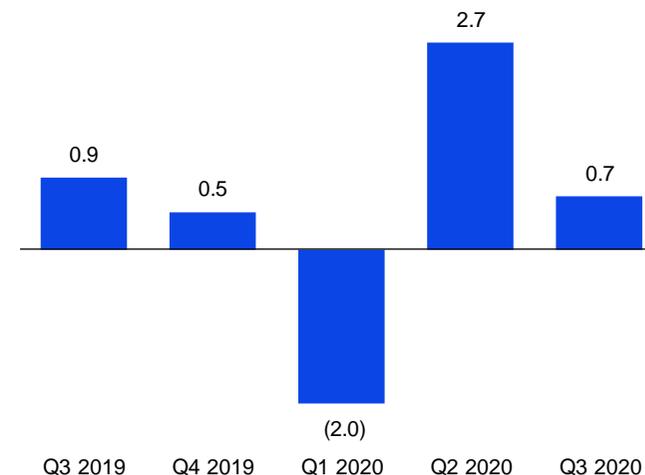
**Bond holdings**



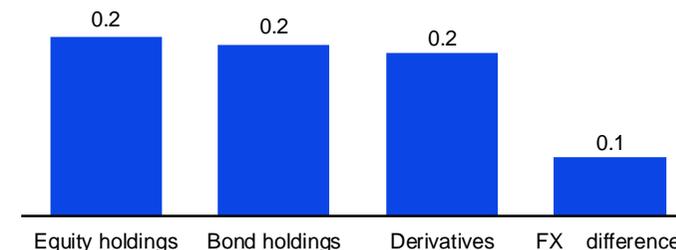
**Equity holdings**



**Net financial income**



**Net financial income by type in Q3 2020**

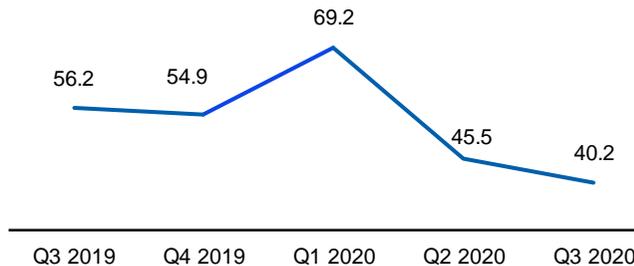


# Total operating expenses

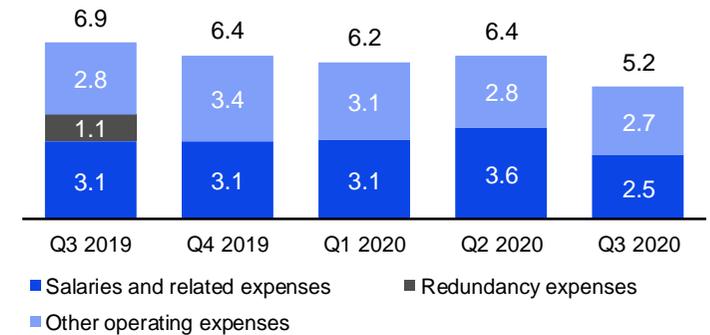
Cost-to-income ratio during the first nine months was 49.5% but further cost reduction remains a core focus point

- Total operating expenses decreased by 10.7% excluding one-off redundancy payment in Q3 2019
- Number of FTEs unchanged from Q2 but down 2% from the same period last year (5% at parent company)
- Salaries and related expenses reduced significantly from previous quarters, explained by reduction of FTEs and seasonality due to holiday allowance. General wage inflation in Iceland was 6.0% from Q3 2019 to Q3 2020
  - Salaries and related expenses were affected by capitalized salaries which amounted to ISK 145 million in Q3 (ISK 118 million in Q3 2019) relating to investment in the Sopra core system
- Other operating expenses stable from Q2 2019. IT expenses increased significantly both due to Covid-19 and depreciation of the ISK, as many IT services are imported. Other expense items decreased and the Bank will continue to focus on OPEX over the coming quarters

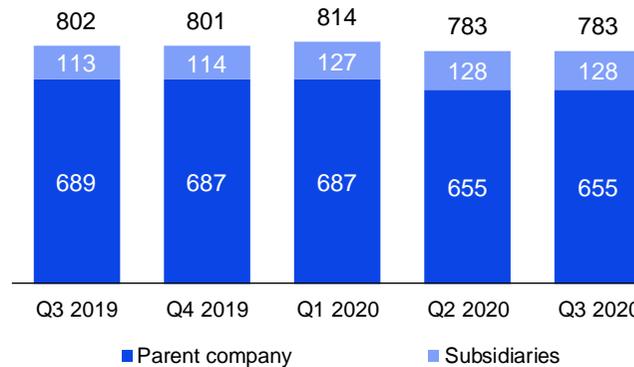
Cost-to-income ratio (%)



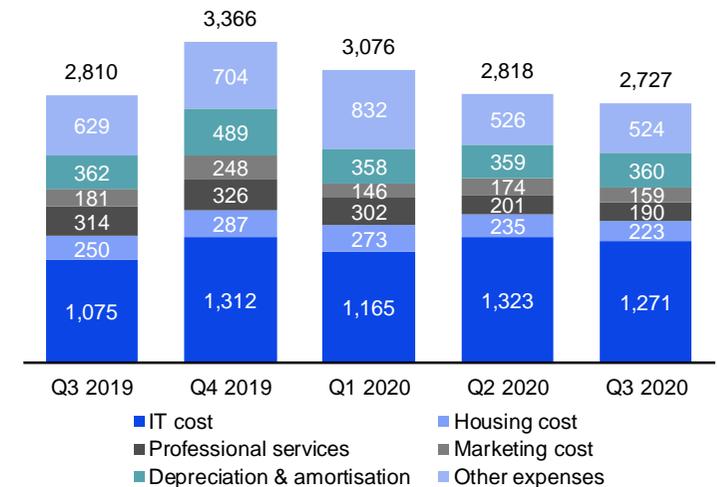
Total operating expenses



Number of employees



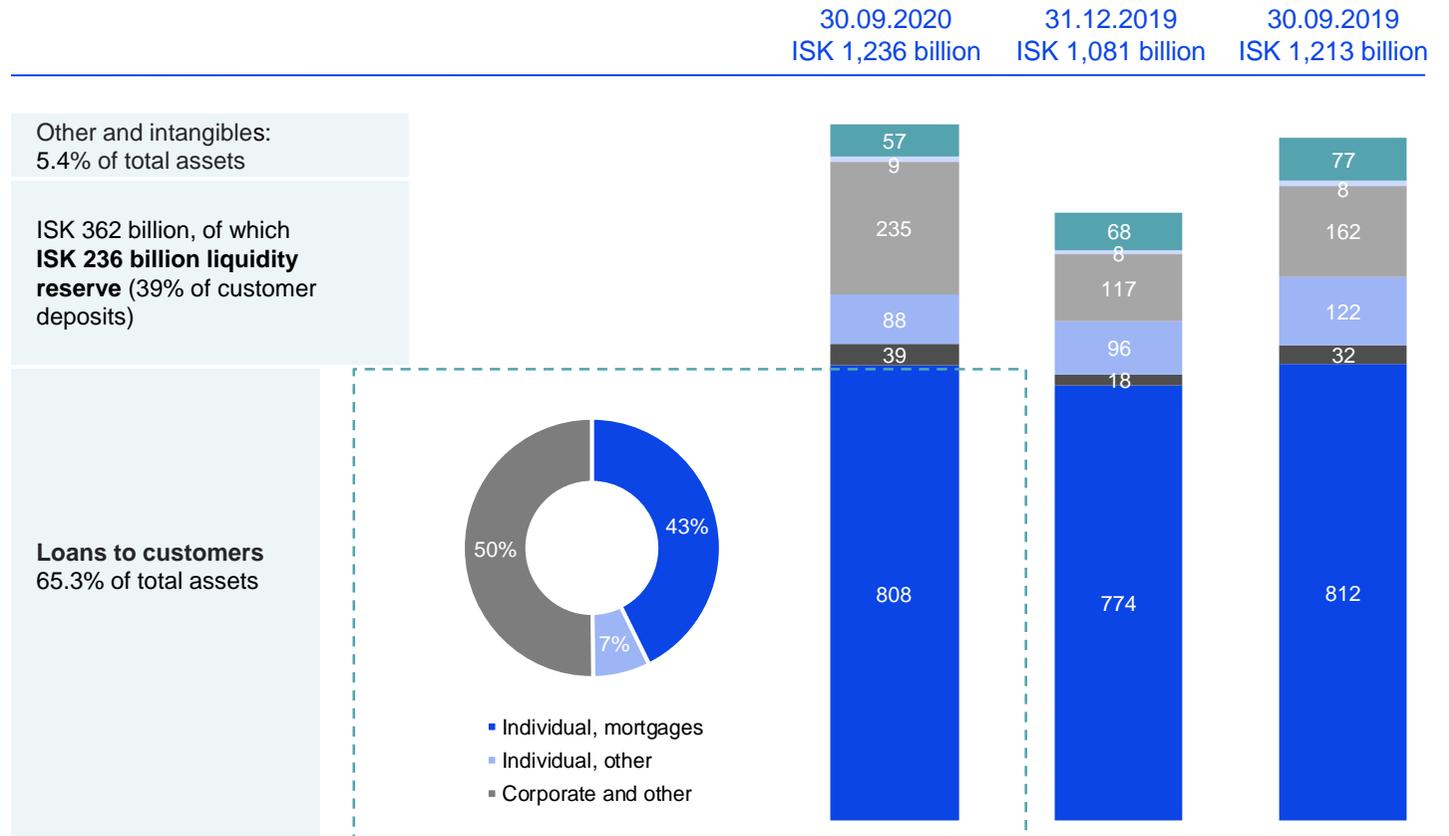
Other operating expenses (ISK million)



# Balance sheet – Assets

The balance sheet is extraordinarily strong which is not efficient in the long term

- The Balance sheet grew by 14.3% from YE 2019, the increase mainly being liquid assets
  - REA has increased 1.8% from YE 2019 while the balance sheet has increased 14.3% during the same period
- Loans to customers increased by 4.4% from the end of 2019, mainly mortgage lending. Corporate lending measured in ISK is for the most part held up as FX loans increased in value with the depreciation of the ISK from year end
- Increase in liquid assets due to postponement of dividend payment, issuance of AT1 and increase in deposits
  - The Bank has used liquidity to repay bonds at maturity and buy back senior bonds
- Very strong liquidity position
  - Total LCR ratio is 213% and ISK LCR ratio is 177%
- The Bank is very well positioned to distribute capital and meet the funding requirements of its customers in both ISK and FX



■ Loans to customers ■ Loans to credit institutions ■ Cash and balances with Central Bank ■ Financial instruments ■ Intangible assets ■ Other assets

<sup>1</sup>Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets

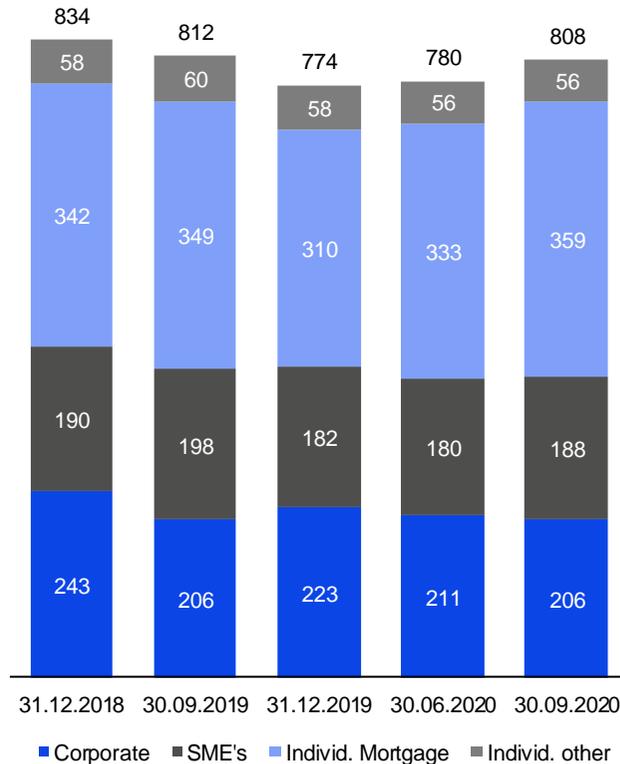


# Loans to customers

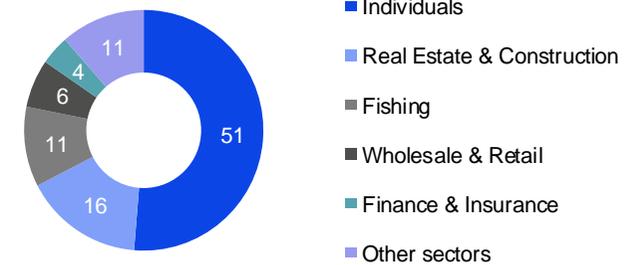
New mortgage lending and refinancing ISK 68 billion in Q3 and ISK 151 billion YTD

- The loan book continues to be well balanced between individuals and corporates
- Loans to individuals increased by 6.6% during the quarter mainly due to strong mortgage lending which increased by 7.7%
  - NIM in the front book is slightly lower than in the back book
- The corporate loan book is slightly reduced and partially held up by lower ISK
- Calculated cost of risk was 19 bps of loans to customers during the third quarter
  - 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 tourism exposure in credit risk
  - -0.4 bps. (-2% of net impairments) is due to other exposure in credit risk
- REA from loans to customers increased by 2.6% from YE 2019 while loans to customers increased 4.4%. Deviation partly due to regulatory changes regarding SME exposures

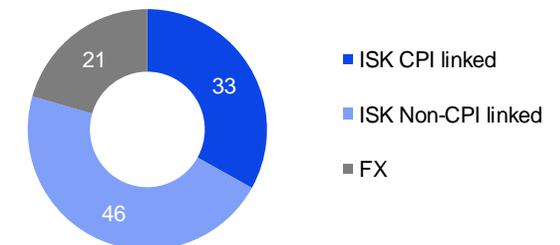
Loans to customers



Loans to customers by sector (%)



Loans to customers by currency (%)

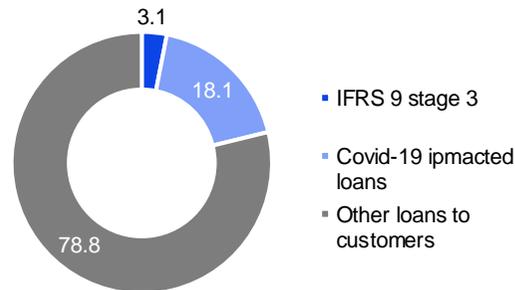


# Covid-19 impacts ISK 149 billion or 18% of the loan book

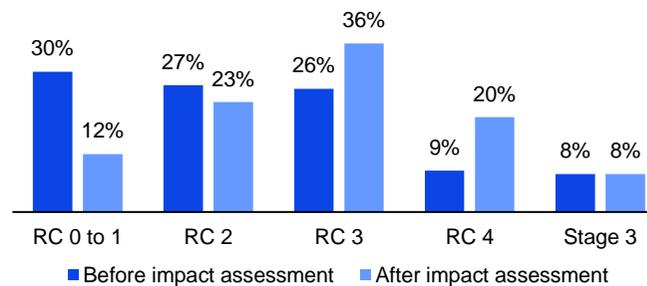
IFRS 9 impairments are forward looking but management overlay is necessary

- IFRS 9 models do not fully capture Covid-19 impact so management overlay on certain customers is necessary (Covid-19 impacted loans):
  - Tourism
  - Customers with payment moratoria in Q3
  - Recipients of loans through government sponsored loan schemes
- Gross carrying amount of Covid-19 impacted loans is ISK 149 billion or 18% of total loan book
  - Thereof ISK 118 billion secured by real estate
  - Tourism loans with carrying amount of ISK 75 billion
- Credit ratings of Covid-19 impacted loans was downgraded based on assessment into four impact groups
- Use of payment moratoria is decreasing

**Breakdown of loans to customers** (% of gross carrying amount)

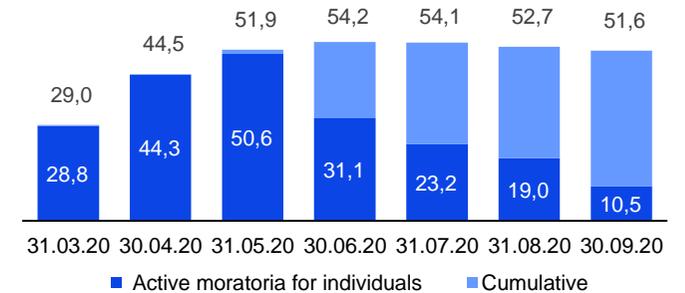


**Risk classes (credit ratings) in Covid-19 impacted loans were downgraded based on impact assessment** (% of gross carrying amount)

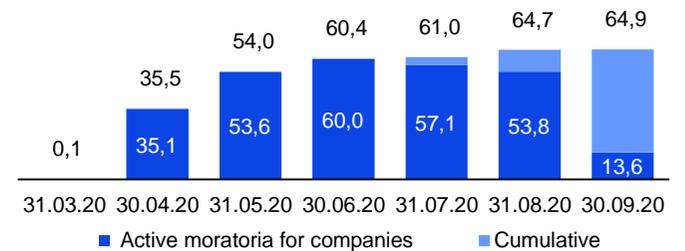


**Loans with Covid-19 related payment moratoria (ISK billion)**  
Cumulative includes those which are no longer active.

Individuals:



Corporates:

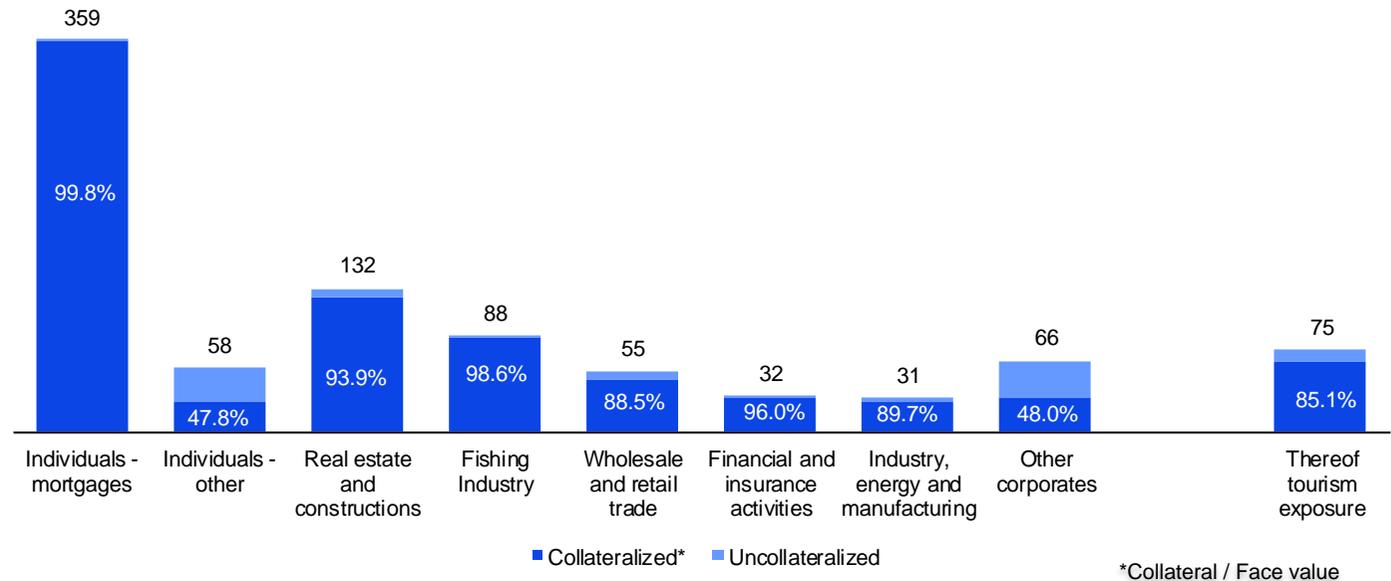


# Loans to customers – asset quality

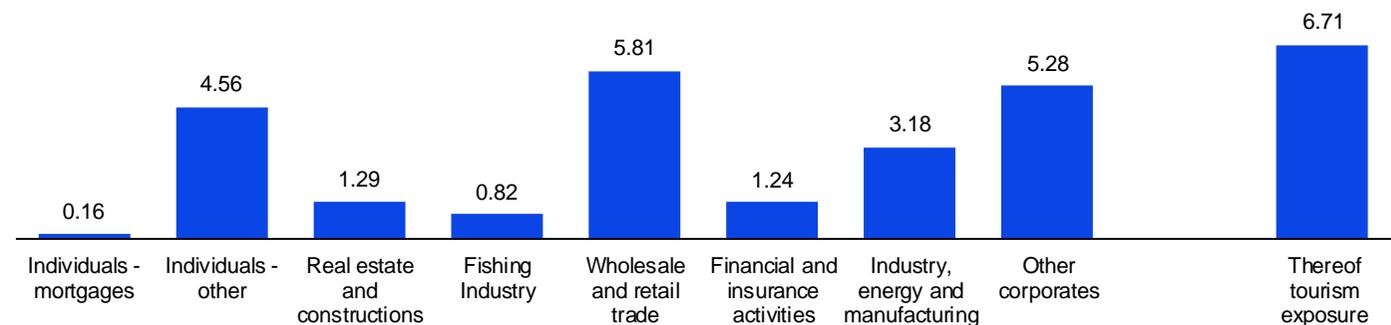
Very well collateralized loan portfolio supports asset quality - Coverage ratio of 31%, which is low due to high collateral rate in the loan portfolio

- Approximately 90% of loans to customers are secured by collateral, of which 78% are secured by real estate
- Mortgages to individuals are about 44% of the loan portfolio
- Due to Covid-19 pandemic, the Bank decided to transfer all tourism-related loans to Stage 2 in Q1. Increased loss allowance of tourism exposure amounted to approx. ISK 2.8 billion during 9M 2020

Loans to customers by sector (ISK billion)

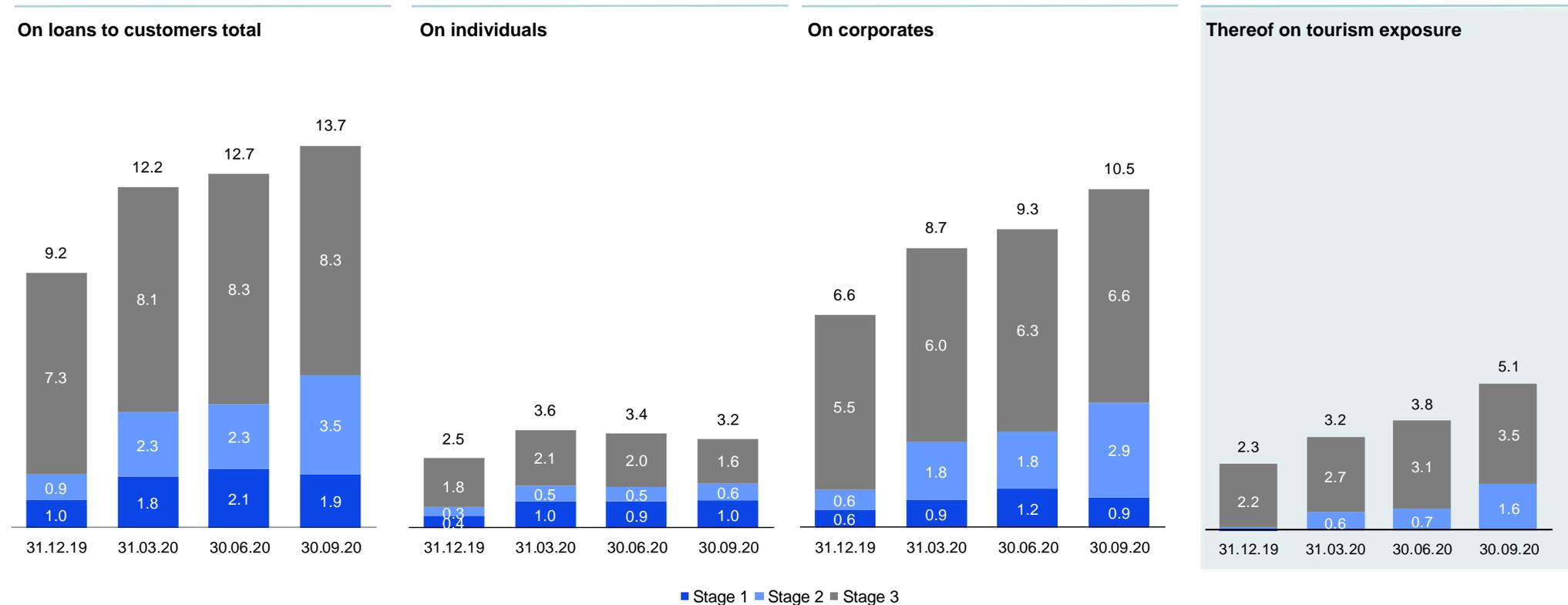


Loss allowance by sector (% of face value)



# Loss allowance on loans to customers by IFRS 9 stages

Covid-19 has so far had minor effects on loans to individuals which comprises 50% of the loan book



- Total loss allowance increase of ISK 4.6 billion or 49.7% during the first nine months
  - Thereof ISK 1.0 billion during Q3 or 8%
- Decrease in Q3 in loss allowance in loans to individuals, as mortgage refinancing have a positive effect

- Transfer of all tourism exposure from Stage 1 to Stage 2 in Q1 had a significant effect on total loss allowance on tourism exposure or ISK 0.9 billion or 40%
  - Further changes in assumptions from 31.03 have further negative effect, total of ISK 2.9 billion or 58%



# Balance sheet – Liabilities and equity

Deposits are increasing in the funding mix in line with strategy

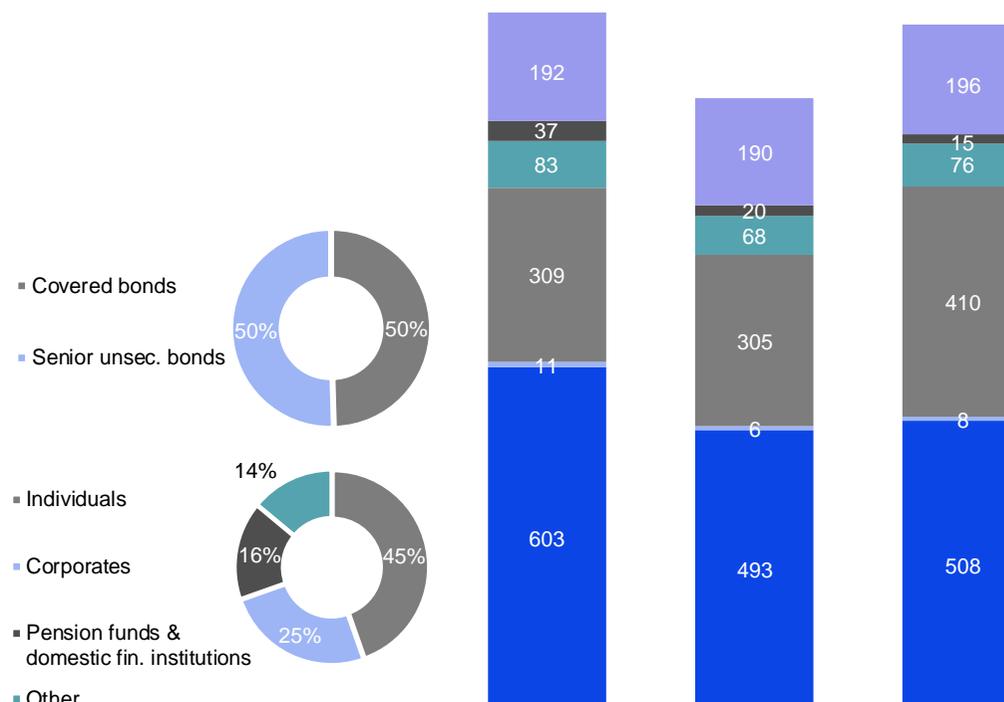
- Strong equity position and a very high leverage ratio
- The Bank is a frequent issuer of covered bonds in the domestic market and a regular issuer of senior unsecured in the international market.
  - Borrowings is held up by the weaker ISK as the Bank did not issue any new wholesale funding during 9M 2020
- Deposits increased by 22.3% from YE 2019 and 8.5% during the quarter
  - Core deposits are up 11.1% from YE 2019 and 2.9% during Q3
- The funding mix is well balanced between deposits, covered bonds and senior unsecured bonds
- The Bank issued its first AT1 instrument during Q1 (USD 100 million or ISK 13 billion) and has previously issued a number of Tier 2 subordinated bonds in line with its capital strategy

**Equity**  
 CET1 ratio 22.5%  
 CAD ratio 27.6%  
 Leverage ratio 14.3%

**Borrowings (in ISK)**  
 ISK 153 billion  
 EUR 130 billion  
 Other currencies 26 billion

**Deposits**  
 On demand 72%  
 Up to 3M 11%  
 More than 3M 17%  
 11.0% increase from 30.09.2019

30.09.2020 ISK 1,236 billion    31.12.2019 ISK 1,082 billion    30.09.2019 ISK 1,213 billion



▪ Deposits ▪ Due to credit institutions and Central Bank ▪ Borrowings ▪ Other ▪ Subordinated liabilities ▪ Equity

<sup>1</sup> Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities

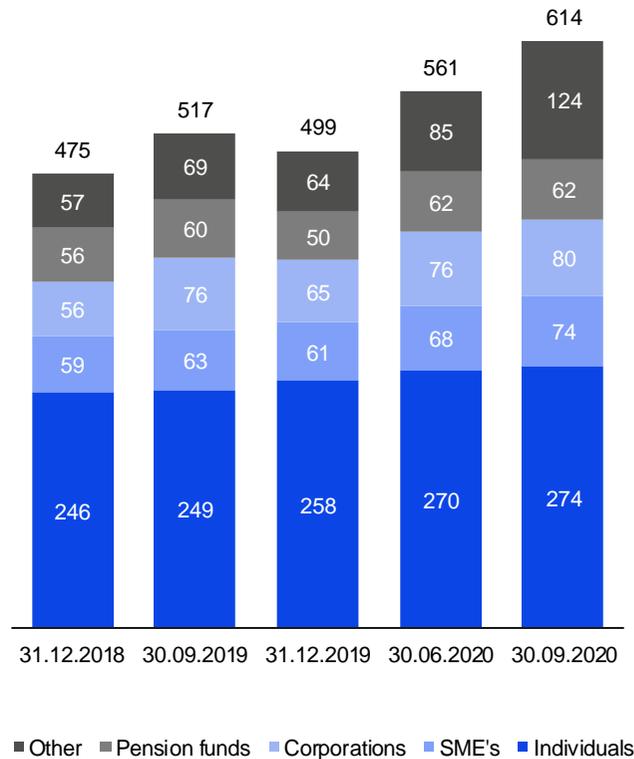


# Deposits

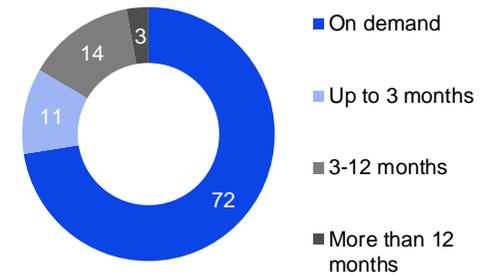
Strong growth of 11.1% in core deposits from YE 2019

- Deposits represent 58% of the Bank's total liabilities
- Core deposits are from individuals, SME's and corporates
- Very strong growth in other deposits that tend to be less sticky
- As a part of its ESG strategy the Bank launched a new deposit product, Green Deposits in Q3
- Special emphasis on corporate deposits
  - 33% growth from YE 2018 and 22% growth from YE 2019
- FX deposits represent 14% of total deposits, unchanged from year-end 2019, mainly due to depreciation of the ISK
- The Bank will continue focusing on deposits from individuals and corporates as they provide long term stable funding

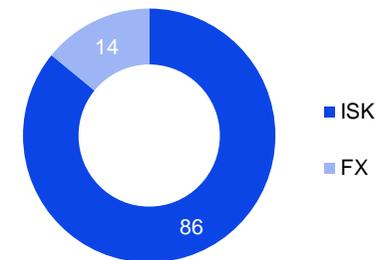
Deposits and due to credit institutions and Central Bank



Maturity of deposits (%)



Deposits by currency (%)

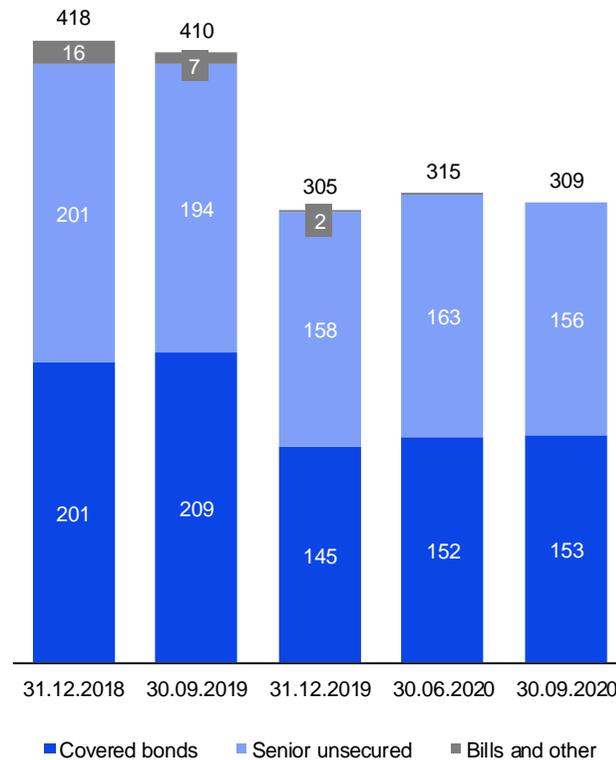


# Borrowings

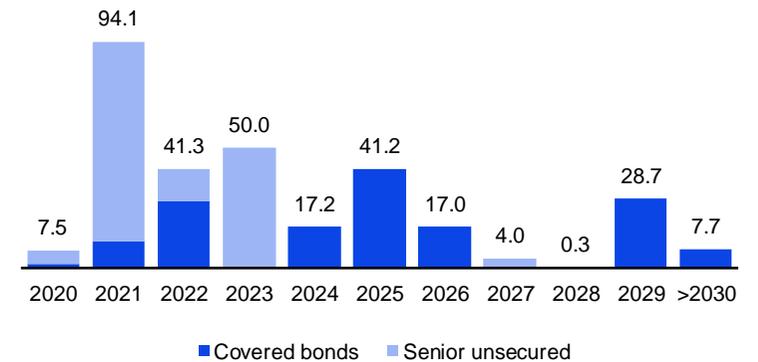
Limited activity in the wholesale funding markets due to the strong liquidity position

- Liquidity Coverage Ratio of 206%, far above the regulatory minimum of 100%
- Emphasis on the reduction of funding cost both through prepayments and liability management
- No issuance of Covered bonds in Q3
- Maturities of international bonds not refinanced in the market due to strong liquidity position
  - NOK 800 million in July
  - SEK 250 million in September
- The Bank is preparing the refinancing of the EUR 500 million, December 2021 maturity

## Borrowings by type



## Maturities of borrowings



## Ratings - S&P (April 2020)

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

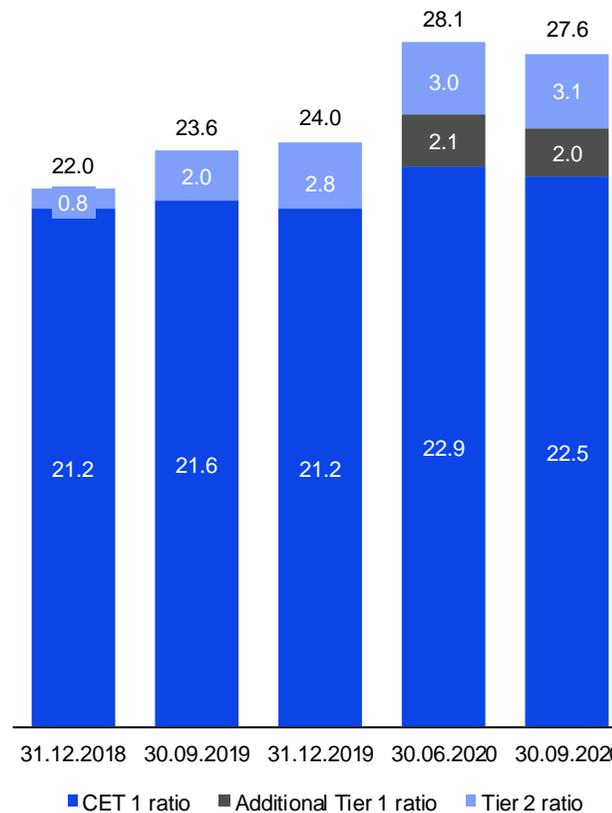


# Own funds

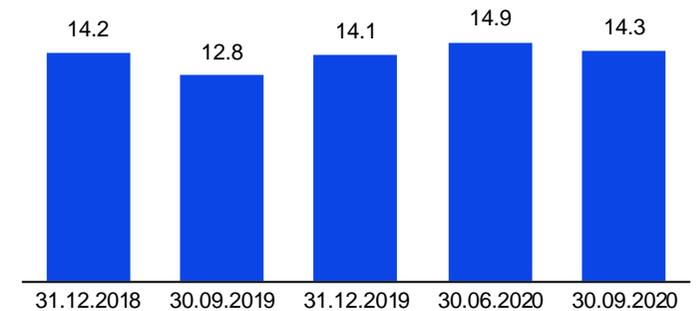
The Bank is deducting 50% of net earnings from its capital according to its dividend policy

- The CET1 ratio is further enhanced to 22.5% from the end of 2019 through earnings, management of REA and IFRS 9 related regulatory changes
- REA is relatively stable despite a 14.3% increase in balance sheet from YE 2019
- Arion Bank filled the Tier 2 bucket with issuance in 2018 and 2019
- The AT1 bucket was filled with issuance in February 2020
- Both instruments strengthen the Bank's own funds and are a milestone towards bringing the Bank's CET1 ratio down to the 17% medium-term targets
- Leverage ratio remains very strong in all respects

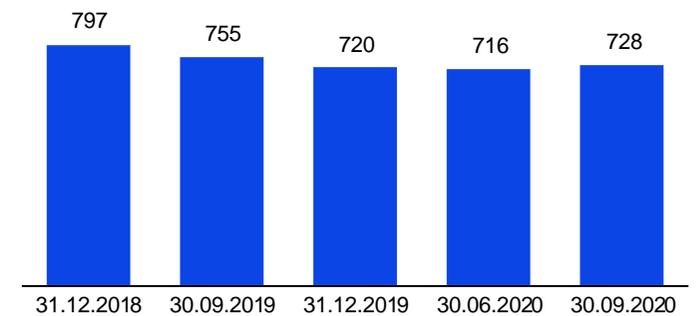
**Capital ratio (%)**



**Leverage ratio (%)**



**Risk-weighted exposure amount**

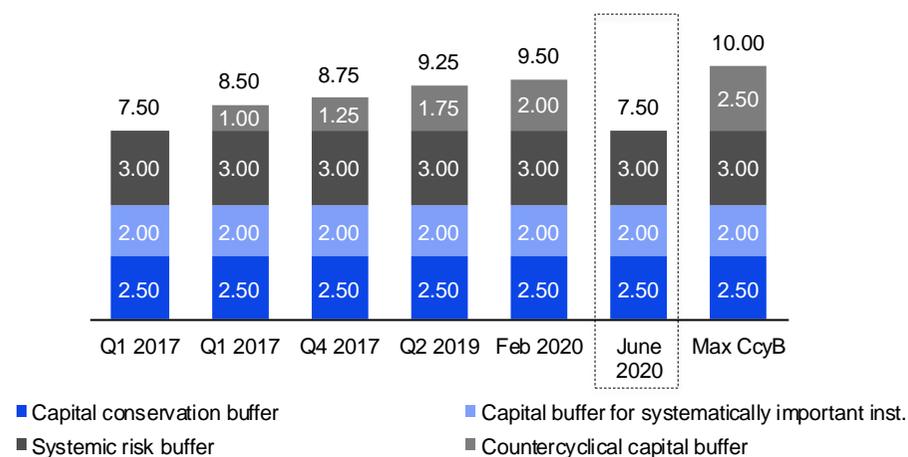


# Capital adequacy

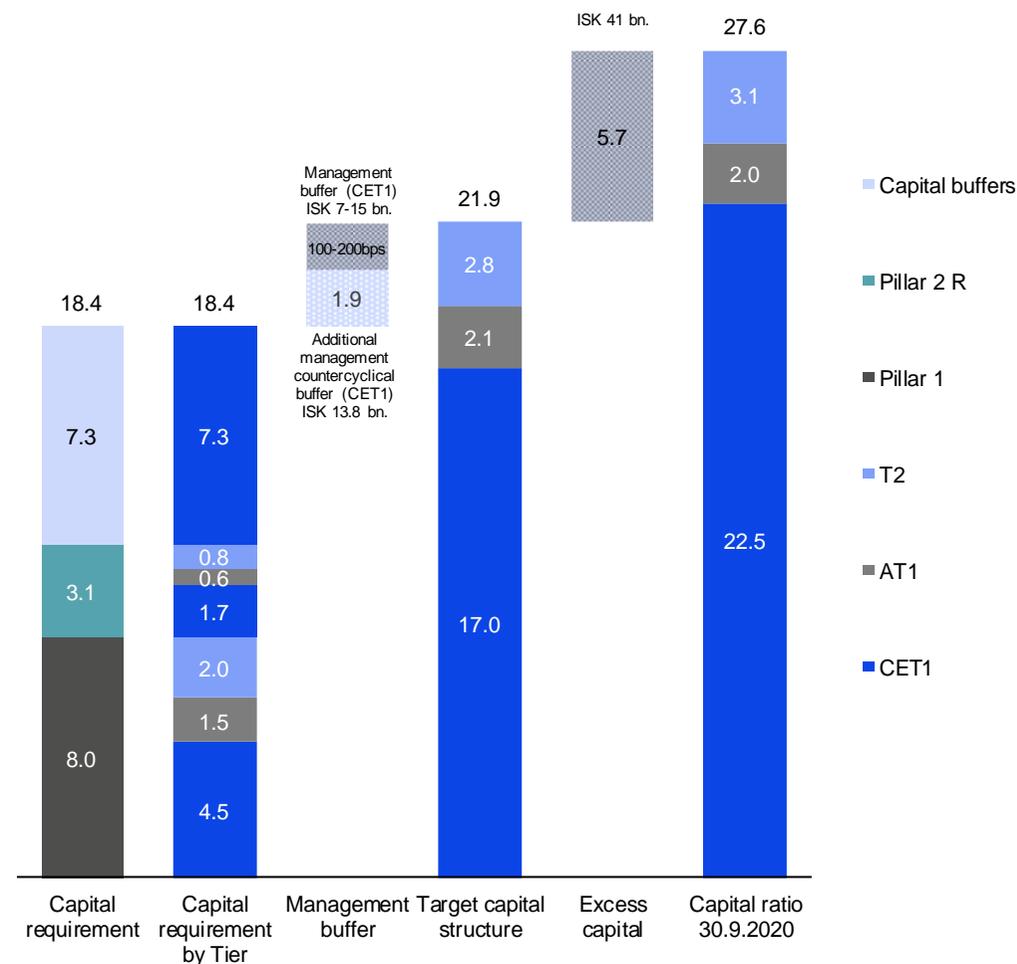
## Exceptionally strong capital position

- Own funds decreased by ISK 0.2 billion in Q3 2020 mainly due to inclusion of foreseeable dividend
  - ISK 2.0 billion added back to the CET1 capital through the IFRS9 transitional arrangement which was ratified into Icelandic law on 4 May 2020
- Target CET1 ratio remains unchanged at 17%
  - Additional 1.9% management buffer (ISK 13.8 billion) that corresponds to the previous Countercyclical capital buffer which was vacated entirely in Q1 2020. The traditional 100-200bps management buffer amounts to ISK 7.3-14.6 bn.
  - CET1 capital of ISK 40 billion and CAD capital of ISK 41 billion is in excess of target capital structure
- The Group's consolidated situation as stipulated in CRR is the Group's accounting consolidation excluding insurance subsidiaries.
  - The solvency ratio of Vördur tryggingar hf. was 171% at 30.6.2020

Development of capital buffers (%)



Own funds and capital requirements (%)

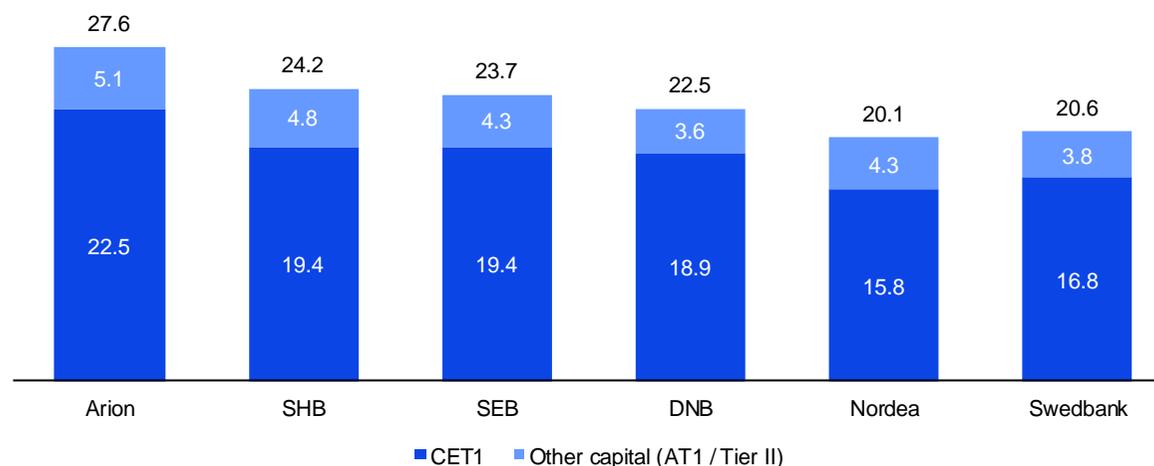


# Arion Bank's capital position in a Nordic context

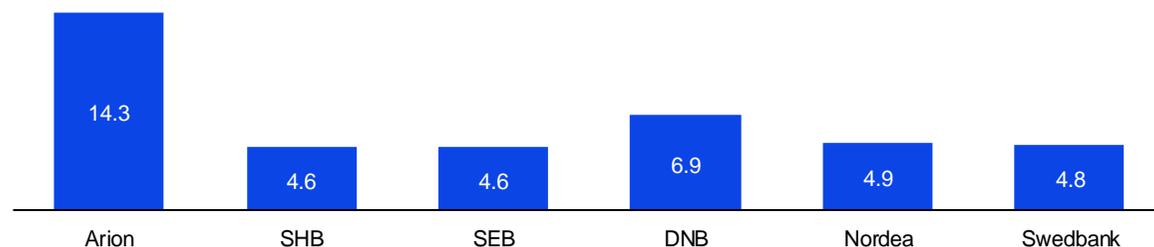
Leverage ratio is an unbiased measurement of financial strength

- Arion Bank is one of the best capitalized banks in the Nordic region
  - Total capital ratio of 27.6% is 340 bps above the second strongest bank
  - CET1 of 22.5% is 310 bps higher than the second strongest
- Capital ratios only show a limited version of capital strength as they can vary based on different treatment of Risk Exposure Amount (REA), which is the capital any bank is required to use to support the various elements of its business
  - The Nordic banks all use internal ratings based methods to determine capital needs
  - Arion Bank uses a standardized approach that calls for higher REA
- The leverage ratio excludes the effects of REA and is a more accurate measurement for comparing financial strength
  - Arion Bank's leverage ratio is more than twice as strong as the second-placed bank

Capital ratio (%) \*



Leverage ratio (%) \*



\* Based on Q3 2020 published Interim Financial Statements



## Going forward



Arion Bank is delivering on its strategy and will strive to build on the positive operational progress from the last quarters



Macro economic developments could have an effect on growth and performance but Arion Bank will support its customers as much as possible and has the financial strength to be an active participant in the rebound of the economy



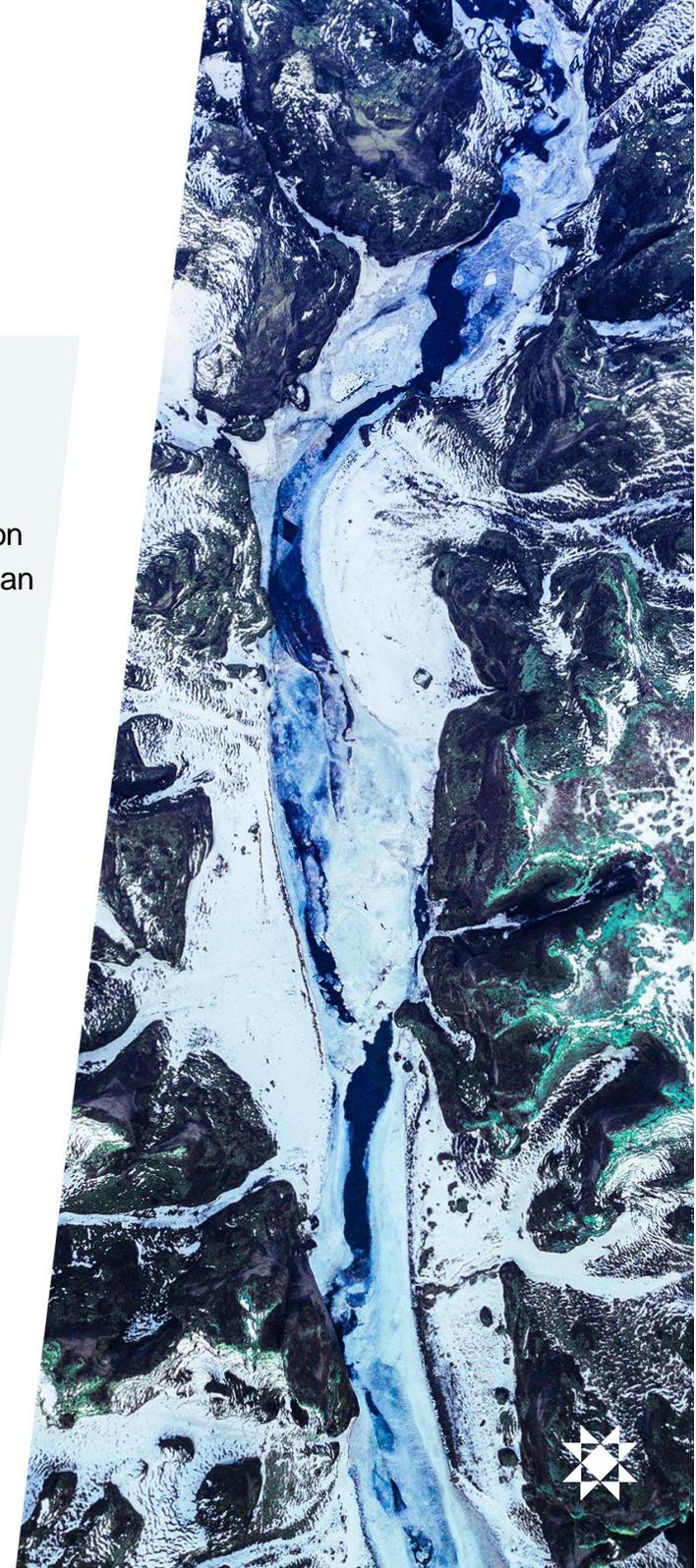
Economic uncertainty has declined and there is improved visibility on asset quality. Additional Covid-19 related impairments can however not be excluded in the coming quarters

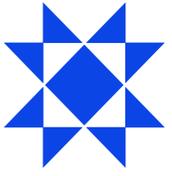


The Bank does not rule out the possibility that the current economic environment, coupled with the Bank's very strong capital and liquidity position, might open up opportunities to efficiently use some of these resources for either internal or external growth



The Bank is committed to its dividend policy and closely follows the discussions which are currently taking place in Europe and the US on bank dividends knowing how important dividends are to investors and our equity story



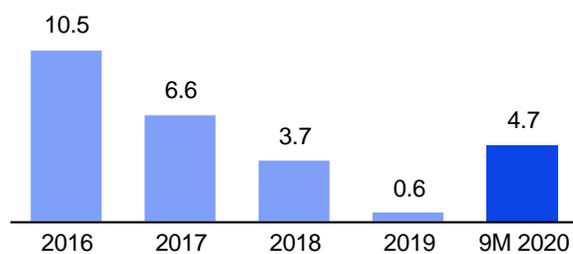


# Appendix

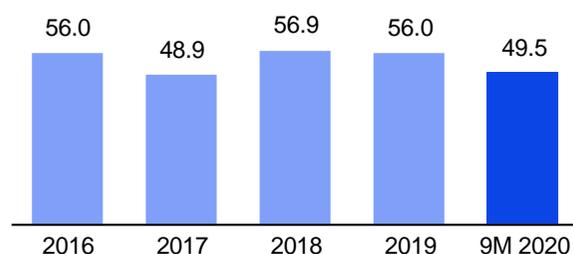


# Key financial indicators - annual

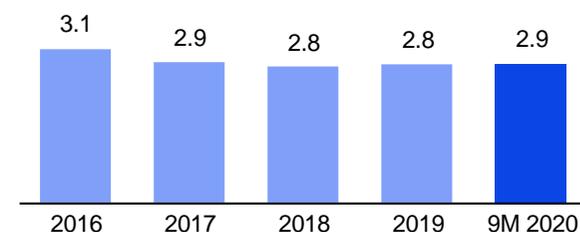
Return on equity (%)



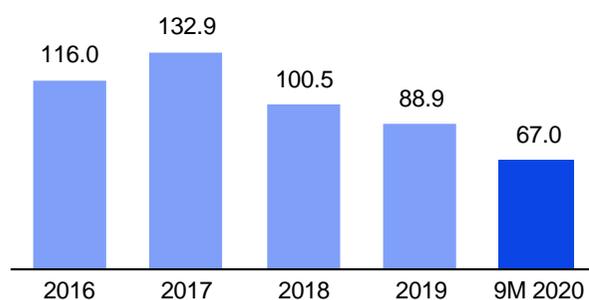
Cost-to-income ratio (%)



Net interest margin (%)



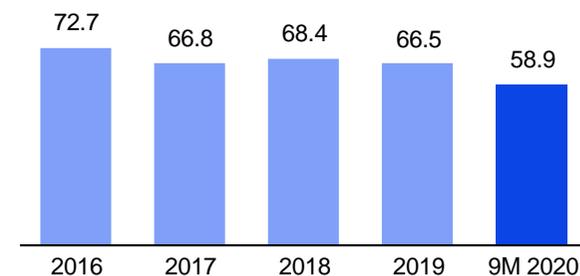
CPI imbalance (ISK billion)



Operating income / REA (%)

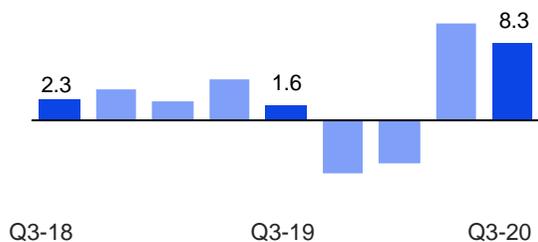


Risk weighted assets / Total assets (%)

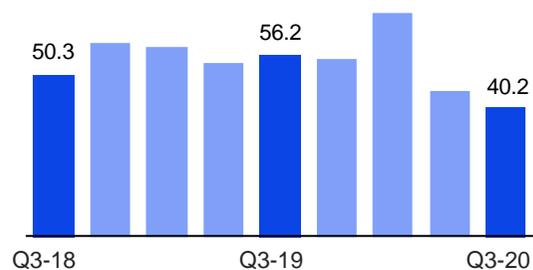


# Key financial indicators - quarterly

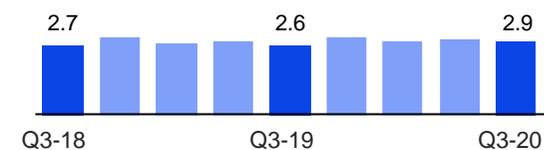
Return on equity (%)



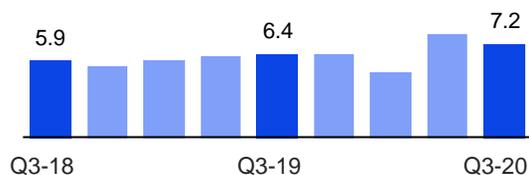
Cost-to-income ratio (%)



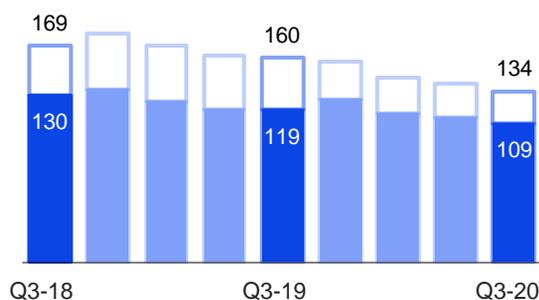
Net interest margin (%)



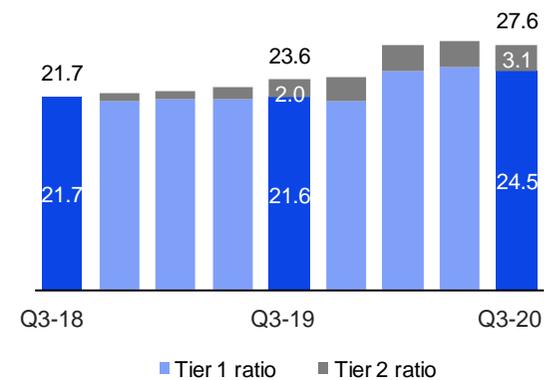
Operating income / REA (%)



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



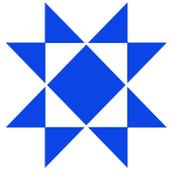
Capital ratio (%)



# Key figures

<b>Operations</b>	<b>9M 2020</b>	<b>9M 2019</b>	<b>9M 2018</b>	<b>9M 2017</b>	<b>9M 2016</b>	<b>Q3 2020</b>	<b>Q2 2020</b>	<b>Q1 2020</b>	<b>Q4 2019</b>	<b>Q3 2019</b>
Net interest income	23,099	22,624	21,350	21,857	22,058	7,989	7,857	7,253	7,693	7,382
Net commission income	8,526	7,335	7,603	7,087	10,213	2,762	2,688	3,076	2,615	2,639
Operating income	36,051	36,272	35,219	34,717	40,361	13,012	14,063	8,976	11,726	12,344
Operating expenses	17,834	20,420	19,679	16,450	22,330	5,232	6,395	6,207	6,443	6,940
Net earnings (loss)	6,708	3,875	6,162	10,353	17,264	3,966	4,913	(2,171)	(2,775)	761
Return on equity	4.7%	2.6%	3.9%	6.3%	11.2%	8.3%	10.5%	(4.6%)	(5.8%)	1.6%
Net interest margin	2.9%	2.7%	2.7%	2.9%	3.1%	2.9%	2.9%	2.8%	3.0%	2.6%
Return on assets	0.8%	0.4%	0.7%	1.2%	2.2%	1.3%	1.7%	(0.8%)	(1.0%)	0.2%
Cost-to-income ratio	49.5%	56.3%	55.9%	47.4%	55.3%	40.2%	45.5%	69.2%	54.9%	56.2%
Cost-to-total assets	2.0%	2.3%	2.2%	2.0%	2.9%	1.7%	2.2%	2.2%	2.2%	2.3%
<b>Balance Sheet</b>										
Total assets	1,236,217	1,213,155	1,219,529	1,144,853	1,038,479	1,236,217	1,182,250	1,187,820	1,081,854	1,213,155
Loans to customers	807,866	812,481	819,965	750,947	715,907	807,866	779,902	778,823	773,955	812,481
Mortgages	387,271	372,938	359,960	318,403	190,008	387,271	356,312	340,235	333,406	372,938
Share of stage 3 loans, gross	3.2%	2.5%	3.0%	-	-	3.2%	3.4%	2.9%	2.7%	2.5%
REA/ Total assets	58.9%	62.2%	66.2%	68.4%	73.2%	58.9%	60.6%	60.0%	66.5%	62.2%
CET 1 ratio	22.5%	21.6%	21.6%	26.6%	25.5%	22.5%	22.9%	22.5%	21.2%	21.6%
Leverage ratio	14.3%	12.8%	13.8%	0.0%	0.0%	14.3%	14.9%	14.5%	14.1%	12.8%
Liquidity coverage ratio	212.6%	246.4%	169.1%	228.6%	194.1%	212.6%	206.3%	224.2%	188.3%	246.4%
Loans to deposits ratio	134.0%	159.9%	169.2%	168.4%	165.7%	134.0%	140.3%	144.4%	157.0%	159.9%





# Macroeconomic environment

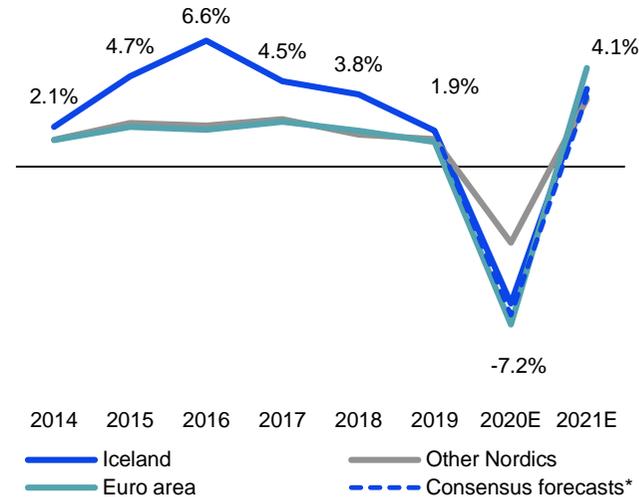


# Sharp contraction followed by growth next year

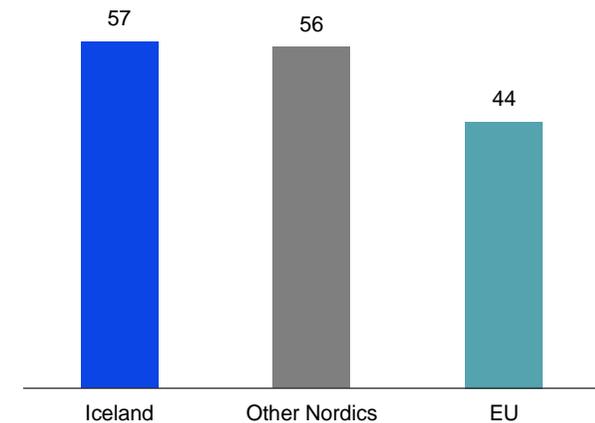
With prolonged travel restrictions more likely than ever the economic outlook for next year has deteriorated.

- The coronavirus crisis has heavily impacted the Icelandic economy due to its dependency on foreign trade, especially tourism
- According to IMF's October forecast Iceland's GDP could shrink by 7.2% in 2020, followed by a rebound in 2021. Domestic analysts are slightly more pessimistic, with the consensus at 7.8% contraction followed by a softer and more fragile recovery
- Iceland has recently observed a resurgence in new Covid-19 cases. The reactions have been swift and are expected to be effective
- With the pandemic on the rise globally prolonged travel restrictions of some sort coupled with obligatory quarantine and social distancing have thus become more likely, dampening economic recovery.

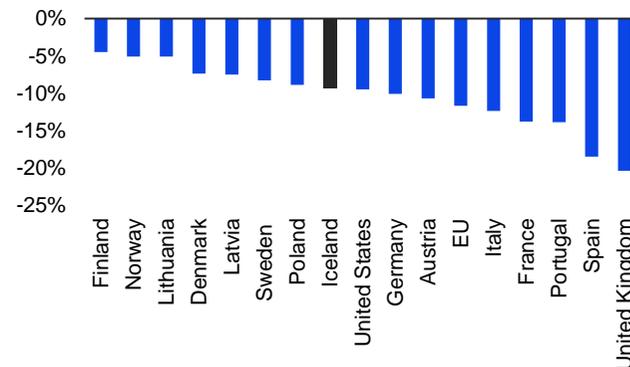
**GDP growth**



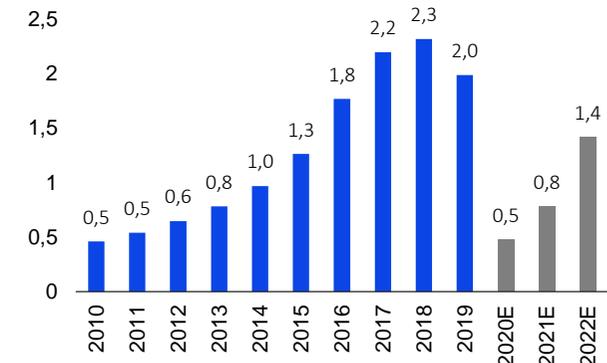
**GDP per capita in 2020 (US dollars, thous. IMF's estimates)**



**GDP changes in Q2 (%-change, quarter on quarter)**



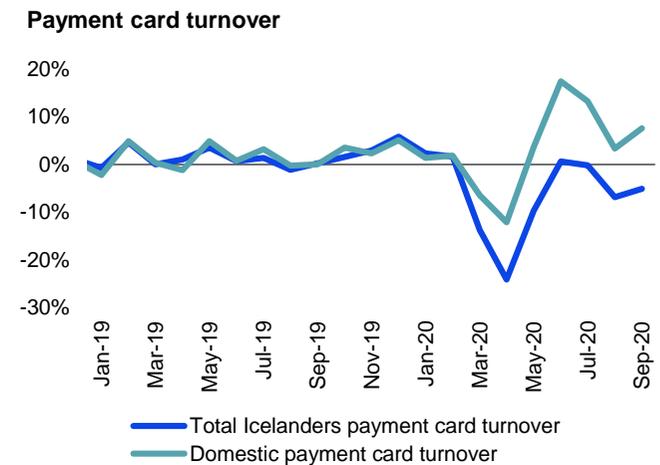
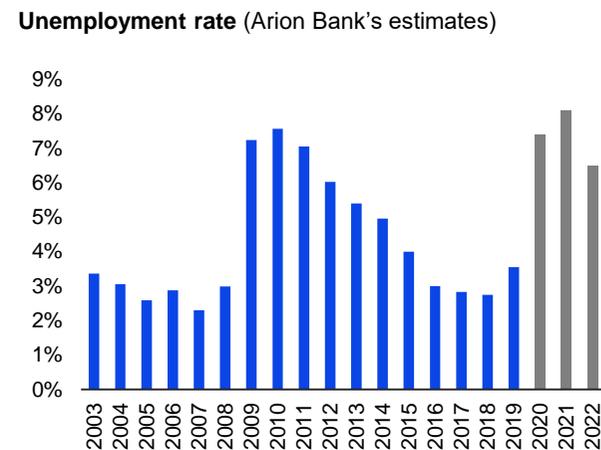
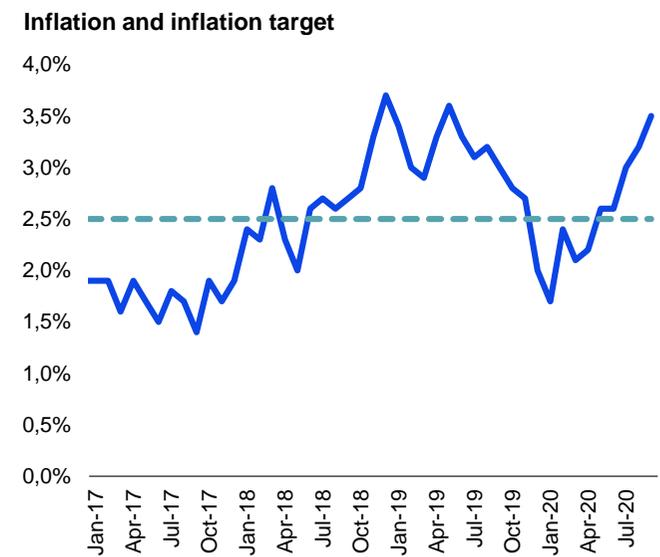
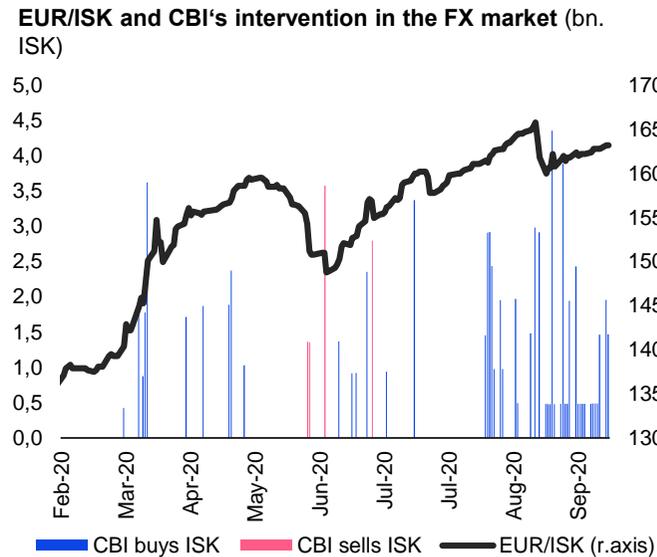
**Tourist arrivals via KEF airport (millions, Arion Bank's estimates)**



# The operating environment is challenging in the near term

While unemployment continues to climb, wages are on the rise. Nominal wage increases coupled with relatively low inflation have pushed real wages higher in the past couple of months.

- With some of the largest export sectors struggling, it's no surprise that the ISK has depreciated. The CBI has intervened in the FX market on the most volatile of days. In order to deepen the market the CBI has begun a regular program of foreign currency sales.
- Inflation has risen in the past months due to the pass-through from the ISK depreciation and climbing housing prices. The rapidness of the rise has come as a surprise, with most analysts now expecting inflation to inch towards upper tolerance level (4%).
- Domestic consumption has been remarkably strong, with domestic payment card turnover reaching unprecedented heights over the summer months.
- High unemployment rate was expected to curb consumption but other factors seem to currently hold greater weight, for example increasing purchasing power as measured by the wage index.
- Tighter public health measures and travel restrictions have dampened consumer confidence and sapped the tourism industry. Thus the winter is expected to be especially tough on the labor market, as reflected in Arion Bank's latest estimates.

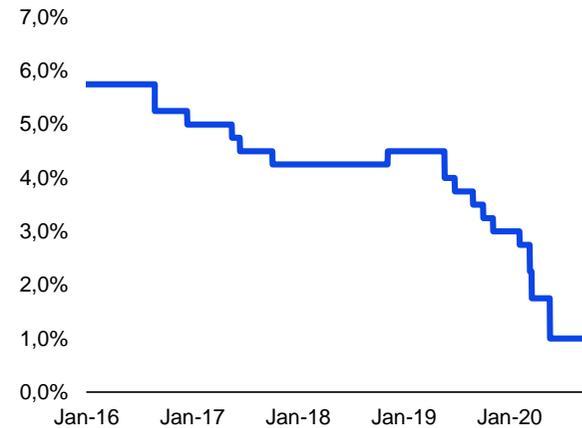


# Fiscal and monetary responses soften the adverse economic situation

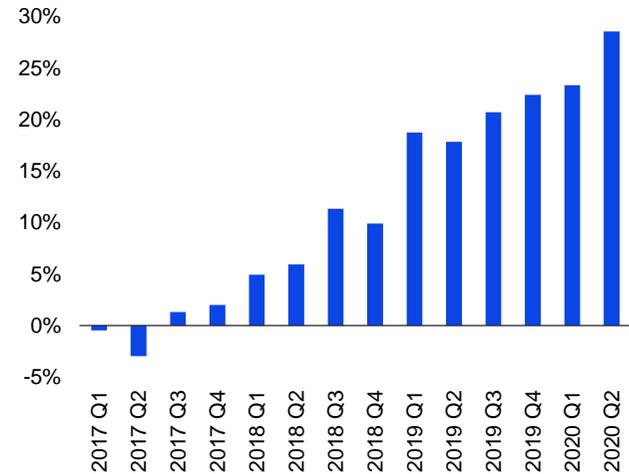
The government and the CBI have underlined that all necessary measures will be taken.

- Icelandic authorities have plenty of firepower at their disposal to support the economy. The CBI has cut interest rates by 2 percentage points, eased the countercyclical capital buffer and launched a QE program. In addition, the CBI has ample FX reserves at its disposal, supporting investors confidence.
- The CBI's FX reserves, well balanced external trade, despite everything, and the positive NIIP of the economy mean that balance of payments worries are limited.
- More importantly, both the public and private sectors used the last upswing to deleverage, pushing debt levels to historic lows.
- The Treasury bears the brunt when it comes to protecting the economy. So far numerous fiscal policy measures have been introduced, both aimed at mitigating the revenue shock suffered by households and companies and protecting jobs and companies.
- Following a budget deficit in 2020, taking debt/GDP up to approx. 50%, the government has pledged to continue to use fiscal policy to support the economy.

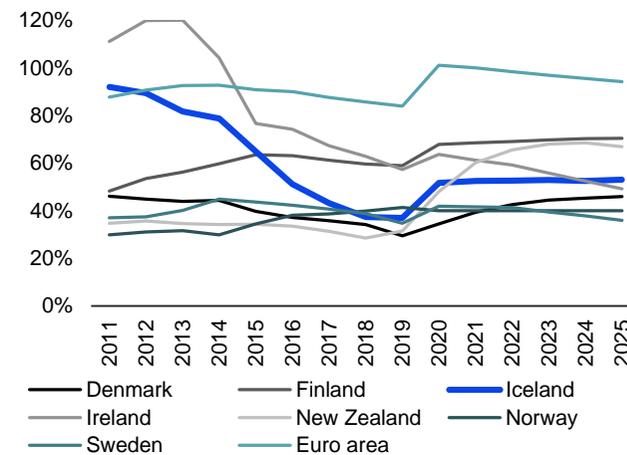
**Key interest rates** (seven-day term deposit rate)



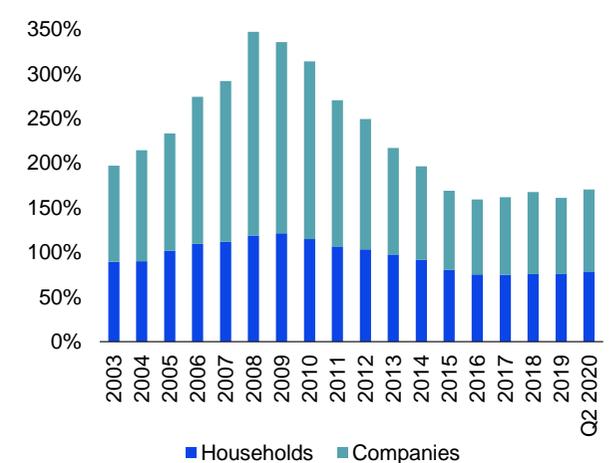
**Net international investment position** (% of GDP)



**General government gross debt** (% of GDP)



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



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