13 February 2019

2018 Financial Results

islandsbanki.is

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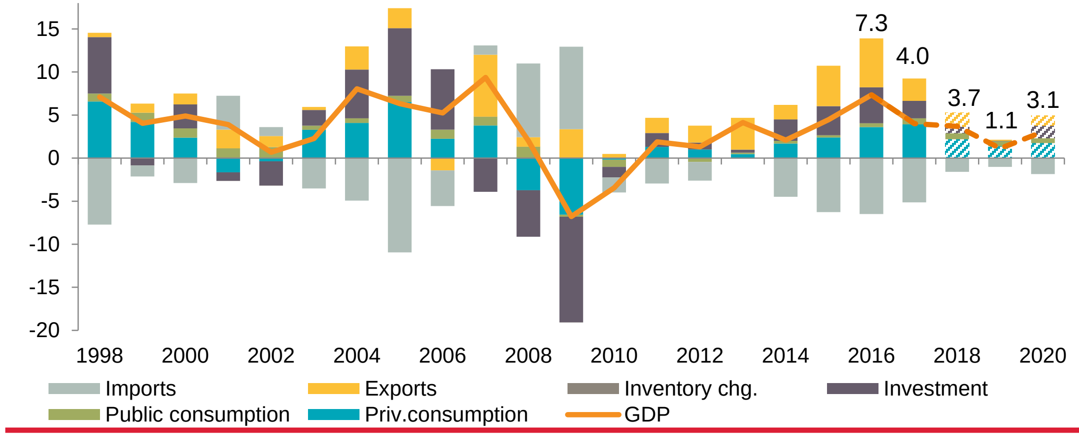
1. 2018 highlights

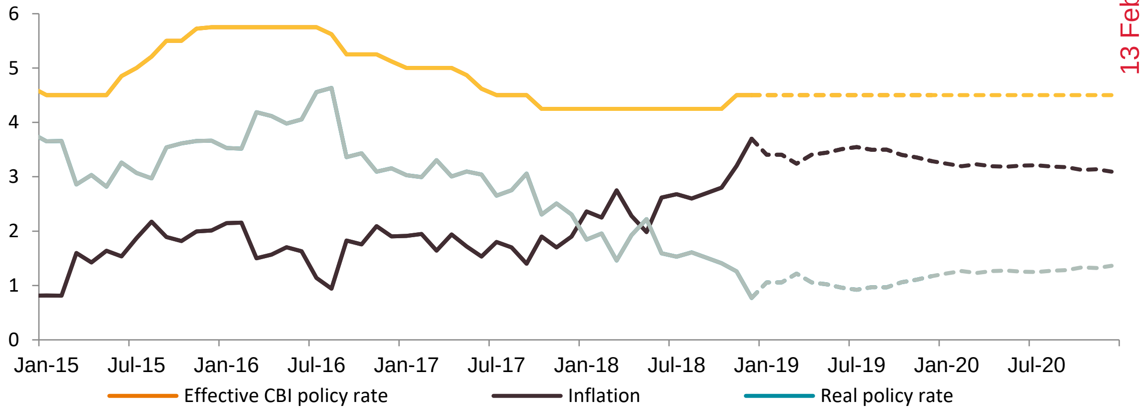
Economic highlights

Economy cooling as tourist sector matures

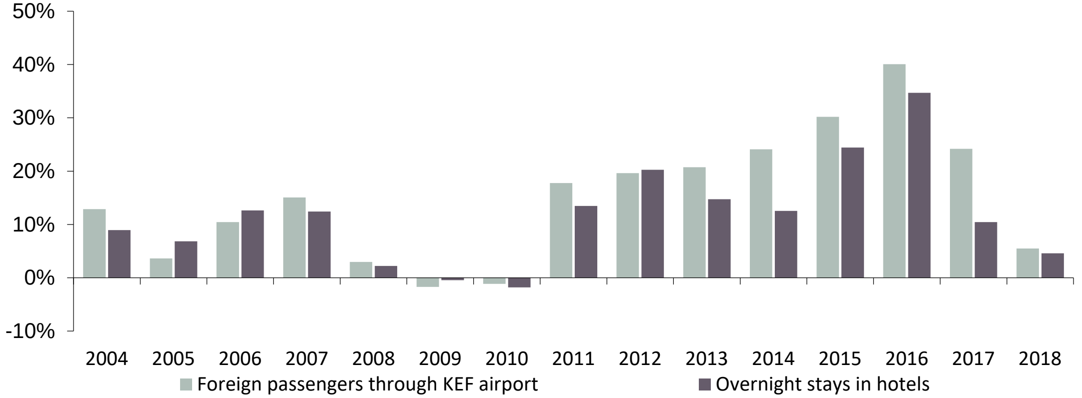
Slower GDP growth in 2019 due to less increase in domestic demand...



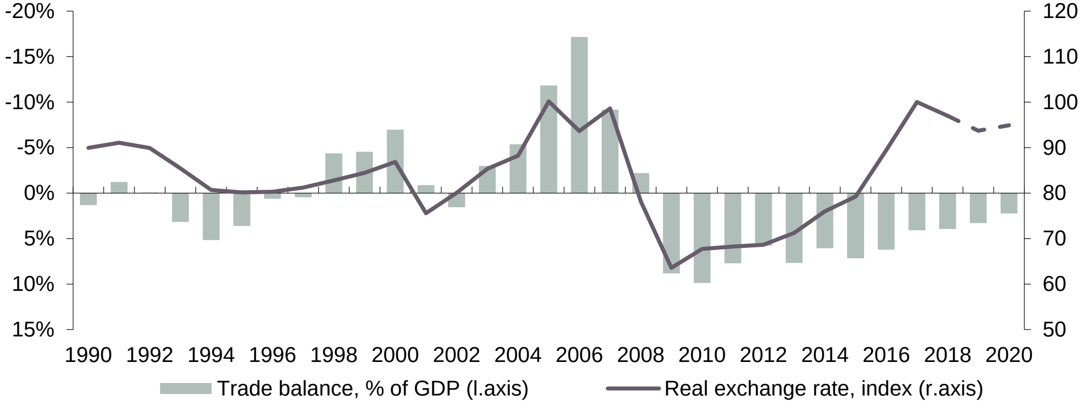
...inflation is likely to subside gradually as ISK depreciation impact fades...



...and a halt in the YoY growth of the tourism sector…



...as a lower real exchange rate translates into an improved trade outlook



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

Financial highlights

Key figures & ratios

		2018	2017	2016	2015	2014
PROFITABILITY	ROE 16% CET1 (regular operations)[1]	**8.0%**	9.9%	10.3%	11.9%	11.4%
	ROE (after tax)	**6.1%**	7.5%	10.2%	10.8%	12.8%
	Net interest margin (of total assets)	**2.9%**	2.9%	3.1%	2.9%	3.0%
	Cost to income ratio[2]	**66.3%**	62.5%	56.9%	56.2%	57.7%
	After tax profit, ISK m	**10,645**	13,226	20,158	20,578	22,750
	Earnings from regular operations, ISK m[3]	**12,042**	13,848	15,138	16,198	14,846

		31.12.2018	31.12.2017	31.12.2016	31.12.2015	31.12.2014
CAPITAL	Total equity, ISK m	**176,313**	181,045	178,925	202,227	185,487
	Tier 1 capital ratio	**20.3%**	22.6%	24.9%	28.3%	26.5%
	Total capital ratio	**22.2%**	24.1%	25.2%	30.1%	29.6%
	Leverage ratio	**14.6%**	16.2%	16.0%	18.1%	19.5%
BALANCE SHEET	Total assets, ISK m	**1,130,403**	1,035,822	1,047,554	1,045,769	911,328
	Loans to customers, ISK m	**846,599**	755,175	687,840	665,711	634,799
	Deposits from Customers, ISK m	**578,959**	567,029	594,187	593,245	529,447
	Customer deposit / customer loan ratio	**68.4%**	75.1%	84.2%	84.6%	79.0%

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. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items)
3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs and income . As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations

This is Íslandsbanki

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

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 demonstrating corporate social responsibility.

Universal banking

ergo

ÍSLANDSSJÓÐIR

Awards

ÍSLENSKA ÁNÆGJUVOGIN 2013-2018

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

EUROMONEY AWARDS FOR EXCELLENCE 2013-2018

Credit rating

S&P Global Ratings

BBB+/A-2

Stable outlook

2018 Key figures for the Group

ROE (Regular operations)[1]	8.0%
Cost to income ratio[2]	66.3%
Total Capital Ratio	22.2%
Total Assets	ISK 1,130bn

Employees of the Bank

834 Number of **FTE's** for parent company at end of 2018

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

5 training courses a year per employee

Market share[3]

32% Individuals

37% SMEs

33% Large companies and investors

Ways to bank

54 ATMs

14 branches

81,500 APP users

112,000 online banking users

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. Calculated as (Administrative expenses + Contribution to the Depositors´ and Investors´ Guarantee Fund – One off items) / (Total operating income – one off items)
3. Based on Gallup survey regarding primary bank

Eventful 2018 for Íslandsbanki

Q1

January

Íslandsbanki issues a **EUR 300m bond at a 75 basis point spread over interbank rates in euros.** The bond has a six-year maturity but is callable in five years

February

Íslandssjóðir launches **development company 105 Miðborg**, which will collaborate with investors to build a new 42,000-m2 neighbourhood in Kirkjusandur in the next few years

The Bank launches **Georg and the clock app**, its third under the brand *Georg and friends*

March

The Bank's Annual General Meeting approves a **dividend payment of ISK 13bn**

The Depositors' and Investors' Guarantee Fund concludes an asset management agreement with Íslandsbanki

Q2

April

The Bank begins collaborating with innovation companies on the **development of fintech solutions for customers**

The Bank receives **renewed recognition for excellence in corporate governance** from the University of Iceland Institute of Business Administration's Centre for Corporate Governance

Íslandsbanki issues a **SEK 1,000m** senior bond

Íslandsbanki leads **the sale process for Jarðboranir**

May

Ground is broken on the new mixed commercial-residential neighbourhood at Kirkjusandur in Reykjavík

The Bank's **Selfoss branch reopens** after extensive renovations

June

Íslandsbanki acts as arranger for **EUR 190m syndicated loan taken by HB Grandi**

Q3

July

International financial magazine **Euromoney names Íslandsbanki Iceland's best bank**

International credit rating agency S&P Global Ratings affirms **Íslandsbanki's credit rating at BBB+/A-2, with a stable outlook**

Íslandsbanki subsidises **international relief work** by the Red Cross

August

Over **ISK 157m is raised in pledges to charity** by participants in the Íslandsbanki Reykjavík Marathon. A **total of 14,000 people took part**, and participation in the 10km and 3km races was stronger than ever before

Íslandsbanki issues a **subordinated bond in the amount of SEK 500m.** The bond bears a 10-year maturity and is callable after five years

September

Íslandsbanki launches a new core deposits and payments system, one of the largest software projects ever undertaken in Iceland. The new system will enable the Bank to function more effectively in a changed competitive environment

Q4

October

Íslandsbanki opens a **secure, identifiable online chat** feature on its website

Íslandsbanki holds an open meeting at Hótel Nordica on **finances at retirement, total of 310 guests attended**

November

Íslandsbanki announces a **new solution that will allow users to pay for goods and services** at all point-of-sale terminals using their mobile phones

Íslandsbanki **enters into cooperation** with the world's largest fintech centre

Íslandsbanki invests in **Meniga for ISK 410m**

Íslandssjóðir **launches a green bond fund** which invests in bonds intended to have a positive impact on our environment and society

Fitch Ratings affirms Íslandsbanki's **credit rating at BBB, with a stable outlook**

December

The Government issues its **White Paper on a Future Vision for the Financial System,** which recommends that the State sell Íslandsbanki

Íslandsbanki employees travel to Africa **to assist with an information technology project** for the Red Cross

Íslandsbanki's customers are **the most satisfied in the banking market,** according to the Icelandic Customer Satisfaction Index, for the sixth consecutive year

Íslandsbanki is a proud sponsor of the UN Sustainable Development Goals through various societal initiatives

Business

- Informational seminars for SMEs
- Responsible tourism

Education

- Educational grants
- Various financial literacy initatives

Environment

- Responsible lending
- Responsible investments
- Fixed loan book ratio for a affordable clean energy

- Green car fleet
- Employee allowance for limited car use to work

- Responsible purchasing / fair trade
- Paperless bank
- Recyclable bank

- Investment in Wetland fund
- First Icelandic green bond fund

- Incentive for less plastic consumption
- Responsible fisheries

Work place and equality

- Equal gender ratios
- Mentor training for employees
- Annual equal rights meetings
- Certification for equal pay
- Sponsor Associaton of women business leaders in Iceland (FKA)

Community

- Employee participation in Helping hand
- Debt deferral programme
- Holiday celebration for refugees

- Helping hand in Africa
- Cantine cooperation with local food kitchen (Samhjálp)

- Íslandsbanki Reykjavík marathon
- Month of Masters

- Startup Tourism
- Enterpreneur fund
- Cooperation with Lattice 80
- Fintech centre

From then to now – Íslandsbanki´s digital journey

In 2018 we saw a major shift to digital solutions by the Personal Banking customer

New digital onboarding solution recently launched - will dramatically speed up and facilitate process for onboarding new customers

Bills paid via the ISB app increased by 60% YOY.

Mobile payments via Kort app introduced in Nov 2018 and payments via wearables in Dec 2018

1 of 3 customers is 30 day active in ISB app and over 81,000 have installed the app

70% of all accepted overdrafts are done via the ISB app, 6,500 customers use the solution each month.

PIN was collected around 60,000 times in the Kort app and cards "frozen" over 10,000 times in 2018

Visits to branches decreased by 10% between 2017 and 2018

Transactions via the ISB app have increased by 31% YOY

45% of all split payments are done via the Kort app

Over 5,000 sales initiatives are conducted via the CRM system monthly

95% of credit valuations are done online and more than 55% applications for pension savings.

50% of all credit limits changes take place in the Kort app

2. Income statement

Income statement

Continued positive net impairments in 2018 despite slowdown in the economy

ISK m	2018	2017	Δ	4Q18	4Q17	Δ
Net interest income	**31,937**	29,999	1,938	**8,294**	7,338	956
Net fee and commission income	**12,227**	13,750	(1,524)	**3,478**	3,632	(154)
Net financial income	**(962)**	(715)	(247)	**(637)**	260	(897)
Net foreign exchange gain	**1**	527	(526)	**76**	81	(5)
Other operating income	**1,784**	628	1,156	**120**	122	(2)
Total operating income	**44,987**	44,189	798	**11,331**	11,433	(102)
Salaries and related expenses	**(15,500)**	(15,233)	(267)	**(4,047)**	(4,297)	250
Other operating expenses	**(12,150)**	(11,735)	(415)	**(3,418)**	(3,358)	(60)
Administrative expenses	**(27,650)**	(26,968)	(682)	**(7,465)**	(7,655)	190
Depositors' and Investors' Guarantee Fund	**(1,173)**	(1,083)	(90)	**(299)**	(288)	(11)
Bank tax	**(3,281)**	(2,892)	(389)	**(740)**	(614)	(126)
Total operating expenses	**(32,104)**	(30,943)	(1,161)	**(8,504)**	(8,557)	53
Profit before net impairment on financial assets	**12,883**	13,246	(363)	**2,827**	2,876	(49)
Net impairment on financial assets	**1,584**	1,556	28	**(297)**	969	(1,266)
Profit before tax	**14,467**	14,802	(335)	**2,530**	3,845	(1,315)
Income tax expense	**(4,734)**	(4,151)	(583)	**(1,118)**	(816)	(302)
Profit for the period from continuing operations	**9,733**	10,651	(918)	**1,412**	3,029	(1,617)
Profit from discontinued operations net of income tax	**912**	2,575	(1,663)	**(8)**	83	(91)
Profit for the period	**10,645**	13,226	(2,581)	**1,404**	3,112	(1,708)

Highlights

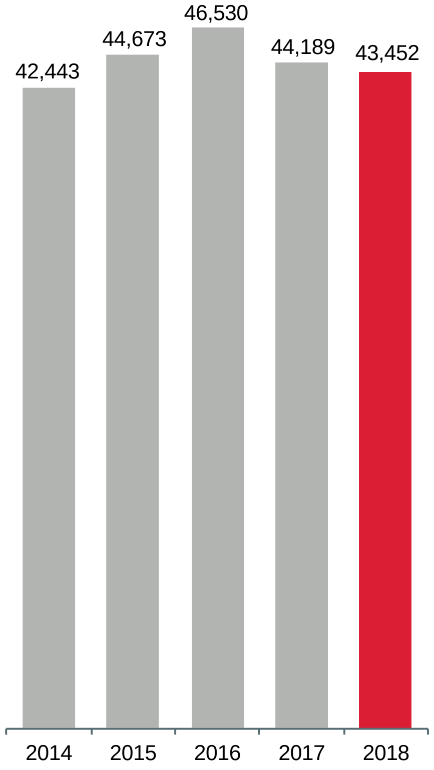
- Total income amounted to ISK 45bn in 2018, an increase of 1.8% between years as a result of strong interest income and sale of properties
- Positive changes in the CPI index and strong loan growth contribute to higher net interest income
- Overall net fee income showed a 11.1% decline year on year, principally due to lower activity levels from two of the Bank's fee generating subsidiaries
- Total salaries were ISK 15.5bn in 2018, a 1.8% increase between years
- Net impairment on financial assets generated a gain of ISK 1.6bn in 2018. Mostly deriving from the lifting of the Bank's prior commitments in relation to foreign currency-based loans

Operating income

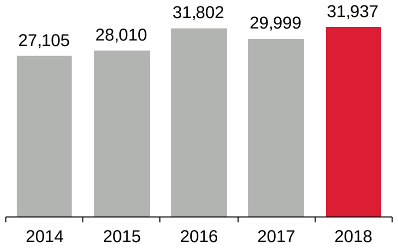
Net fee and commission down by 11% for Group - up by 6% for Bank and core subsidiary Íslandssjóðir

Income trends

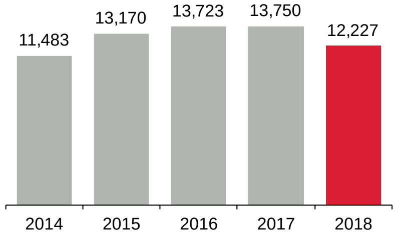
Total operating income
Excluding one-off income
ISKm



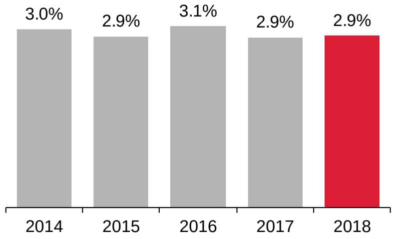
Net interest income (NII)
ISKm



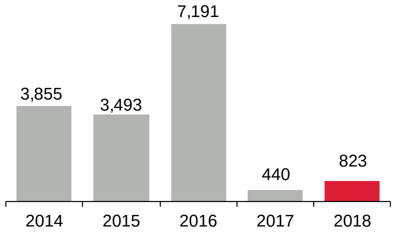
Net fee and commission income
ISKm



Net interest margin (NIM)



Other income
ISKm



Highlights

- Net interest income was ISK 31.9bn (2017: ISK 30bn), an increase of 6.5% between years and the net interest margin was 2.9%, same as in 2017
- Net fee & commission income for the Bank and Íslandssjóðir was ISK 10.3bn (2017: ISK 9.7bn), an increase of 6% between years

NII and NFCI by segments

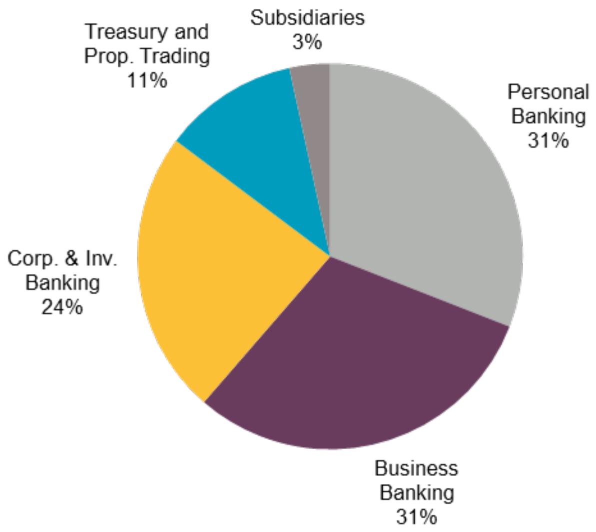
Statements now include breakdown by segments which follows from May 2017 organisational change

Highlights

- Net interest income evenly distributed between the three business divisions
- Personal Banking division main contributor to net fee and commission income

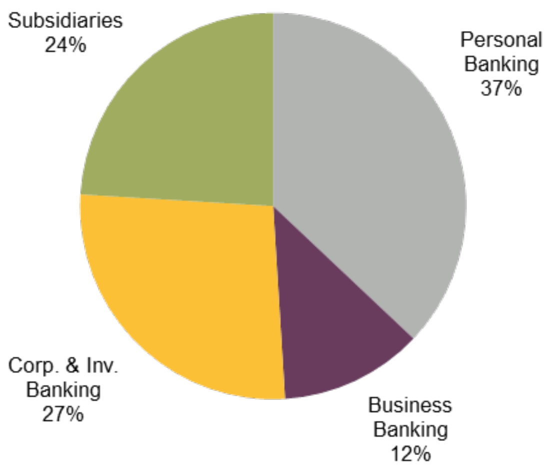
Net interest income (NII)

%



Net fee and commission income (NFCI)

%



Earnings from regular operations

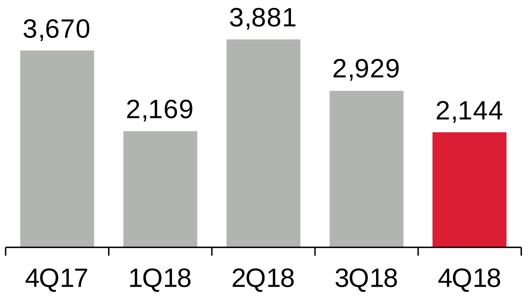
Excludes one-off items and ROE calculation is adjusted to normalised CET1 of 16%

Resilient ROE from regular operations

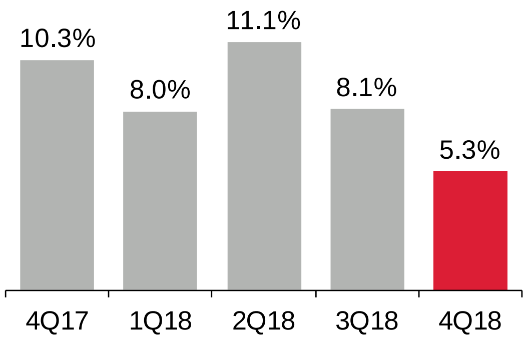
ISKm	2018	2017	Δ	4Q18	4Q17	Δ
Reported after tax profit	**10,645**	13,226	(2,580)	**1,404**	3,112	(1,708)
One-off revenue	**(2,546)**	0	(2,546)	**0**	0	0
One-off costs¹	**0**	413	(413)	**0**	36	(36)
Bank tax	**3,281**	2,892	389	**740**	614	126
Profit (loss) from discontinued ops	**0**	(2,575)	2,575	**0**	(83)	83
Tax impact of adjustments	**662**	(107)	769	**0**	(9)	9
Earnings from regular operations²	**12,042**	13,848	(1,806)	**2,144**	3,670	(1,526)
ROE 16% CET1 (regular operations)³	**8.0%**	9.9%		**5.3%**	10.3%	
ROA from regular operations (after tax)	**1.1%**	1.3%		**0.7%**	1.4%	
Net interest margin adj. 16% CET1	**2.7%**	2.6%		**2.7%**	2.6%	
Cost / income ratio adj. 16% CET1	**66.4%**	66.2%		**70.7%**	72.5%	

Earnings from regular operations

ISK m



ROE reg. operations CET1 16%



Earnings from regular 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%). This has been applied to all historical results

One off items 2018

— ISK 1.5bn in income from the sale of property in April 2018 deemed one-off income as is ISK 1.0bn income as the statute of limitation for some disputed foreign currency-linked loan contracts passed

Earnings from regular operations

— Regular earnings decreases, as a result of underperformance from fee generating subsidiaries and negative impact of net financial income

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. As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations
3. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capita.

Administrative expenses

The Bank's C/I ratio of 60.4% is lower than for the Group but still higher than 55% long term target

Highlights

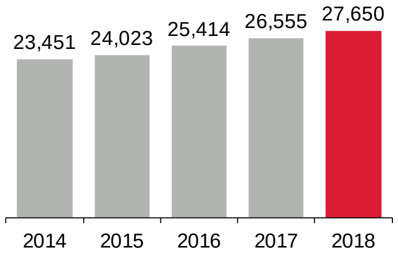
- Lower capitalisation related to the implementation of new core system and collective wage agreements main reasons for higher costs
- Bank is determined to lower its administrative costs going forward and expects to reach its C/I ratio target of 55% within a few years

Efficiency – Cost to income (C/I) ratio[1]

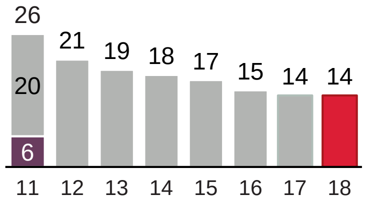
The Group[2]

Cost structure

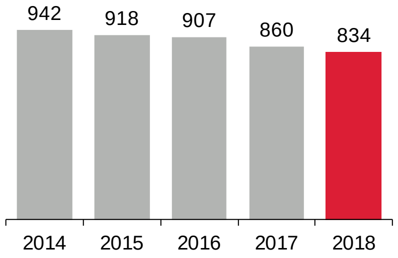
Administrative expenses[3]
ISK m



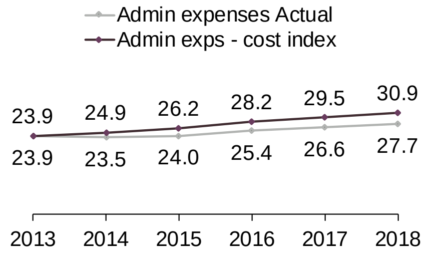
Branch network
#, Byr branches due to merger in dark grey



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 summer 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 9.1% up from year-end 2017

Highlights

Liquid assets
- The Bank lowered its liquidity levels with the Central Bank by ISK 54bn from year-end 2017, partly due to March 2018 ISK 13bn dividend pay-out
- Three line items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 246bn

Bonds and debt instruments
- Have grown by ISK 42bn since year end 2017, primarily from trading bonds issued by the Government

Loans to credit institutions
- Have increased by ISK 15bn from year end 2017, ISK 5.7bn in money market loans and ISK 9.3bn from deposits due from credit institutions

Loans to customers
- New lending amounted to ISK 239bn since year-end 2017
- Loans to customers grew by 12% since year-end

Asset encumbrance
- The Bank's asset encumbrance ratio was 18.0% at end of year, compared to 15.2% at end of 2017

Assets, ISK m	31.12.2018	31.12.2017	Δ
Cash and balances with CB	135,056	189,045	(53,989)
Bonds and debt instruments	69,415	27,090	42,325
Shares and equity instruments	13,074	10,177	2,897
Derivatives	4,550	2,896	1,654
Loans to credit institutions	41,577	26,617	14,960
Loans to customers	846,599	755,175	91,424
Investment in associates	682	704	(22)
Property and equipment	5,271	7,128	(1,857)
Intangible assets	5,002	4,231	771
Other assets	7,947	9,993	(2,046)
Non-current assets held for sale	1,230	2,766	(1,536)
Total assets	1,130,403	1,035,822	94,581

Development of loans to customers

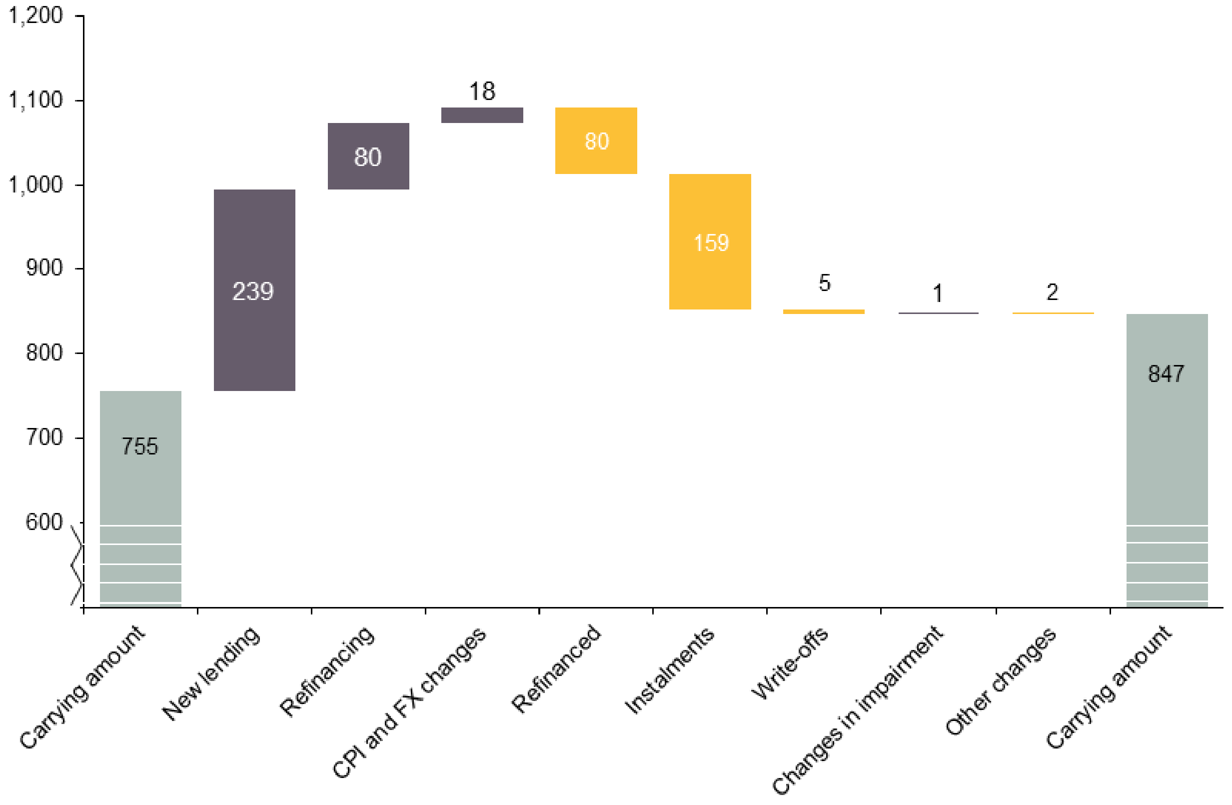
New lending in 2018 amounted to ISK 239 billion

Highlights

- New lending amounted to ISK 239bn in 2018
- In addition to new lending, loans amounting to ISK 80bn were refinanced during the year
- Outstanding loans that are refinanced within the Bank are shown both as an increase and a decrease in the net carrying amount
- Contractual instalments, pre-payments and loans that are fully repaid are shown as instalments in this chart
- The effect of facilities that do not have a fixed repayment schedule, such as overdrafts and credit cards, is included in Other changes

Main sources of changes in net carrying amount

ISK bn, Consolidated



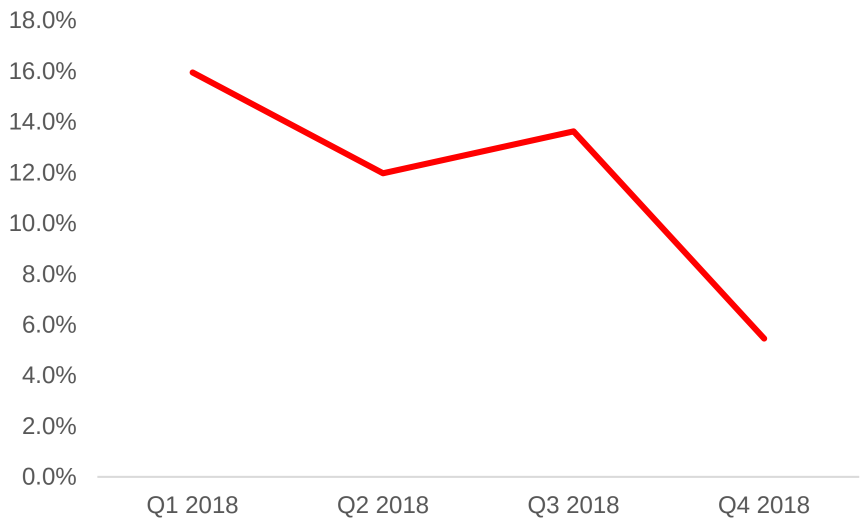
Loan portfolio

High growth in first three quarters of the year which slowed down in the fourth quarter

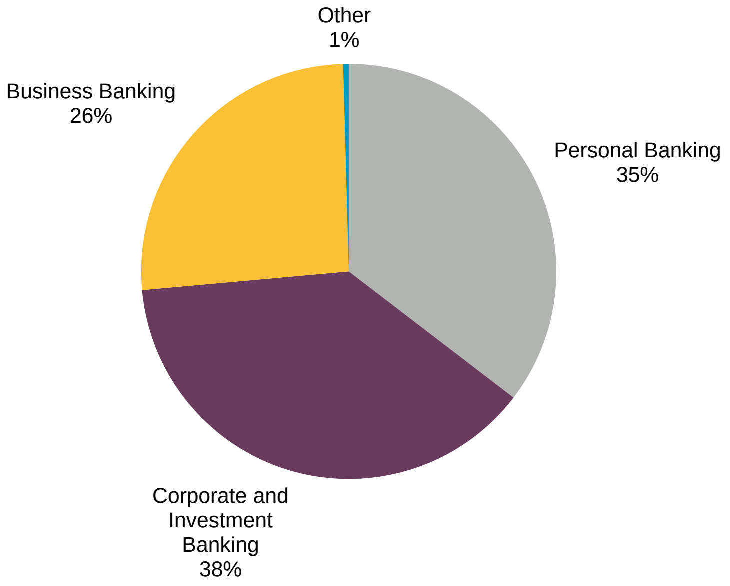
Highlights

- High growth in loan portfolio in first three quarters but slowed down in fourth quarter
- Loan portfolio evenly spread out by the three business divisions although CIB is the largest

Annualised growth in loan portfolio per quarter
Consolidated



Loan portfolio broken down by business divisions
Consolidated



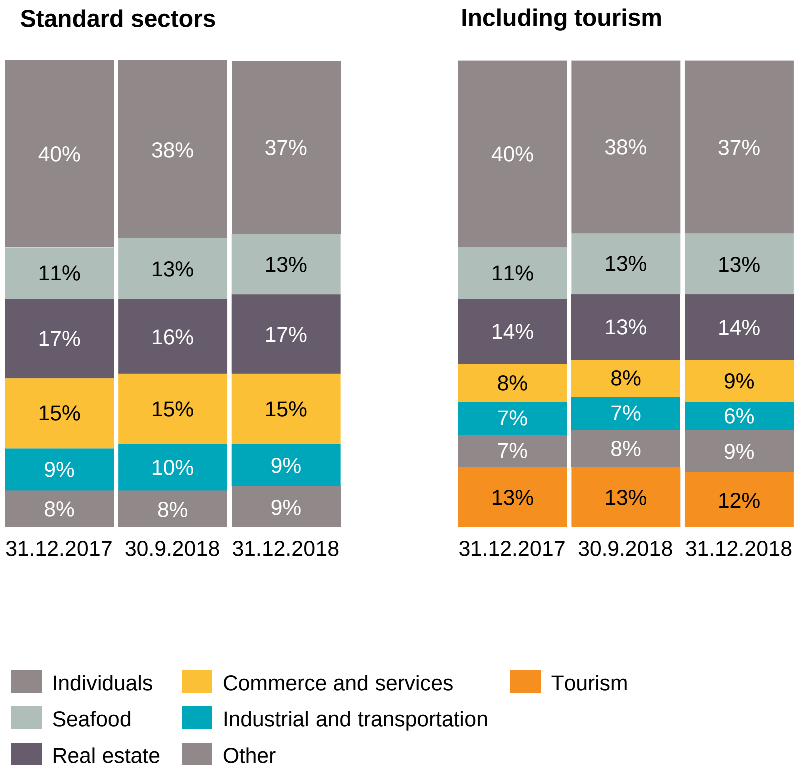
Diversified loan portfolio

Loans to customers grew by 12% in 2018

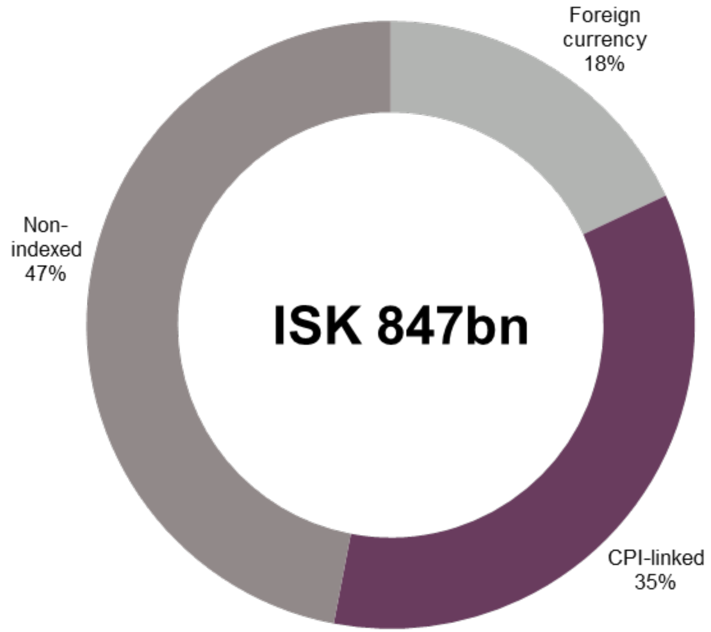
Highlights

- Strong demand for loans across all sectors in 2018
- The mortgage portfolio increased by 10.4% since year-end 2017. Mortgages comprised 29.4% of loans to customers at year-end 2018, compared to 29.8% the year before
- Exposure to tourism is now 12% of loans to customers compared to 13% last year
- Relative growth in corporate loans is partly due to ISK depreciation and subsequent increase in FX denominated loans but mostly due to new lending
- Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials and transportation are the largest underlying sectors in tourism

Loans to customers
By sector, Consolidated



Loans to customers
By currency type, Consolidated



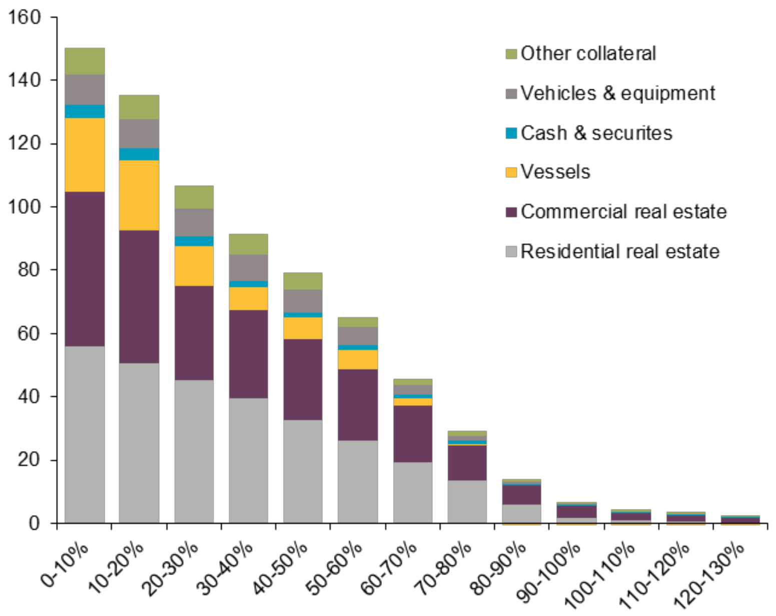
LTV distribution of loan portfolio

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

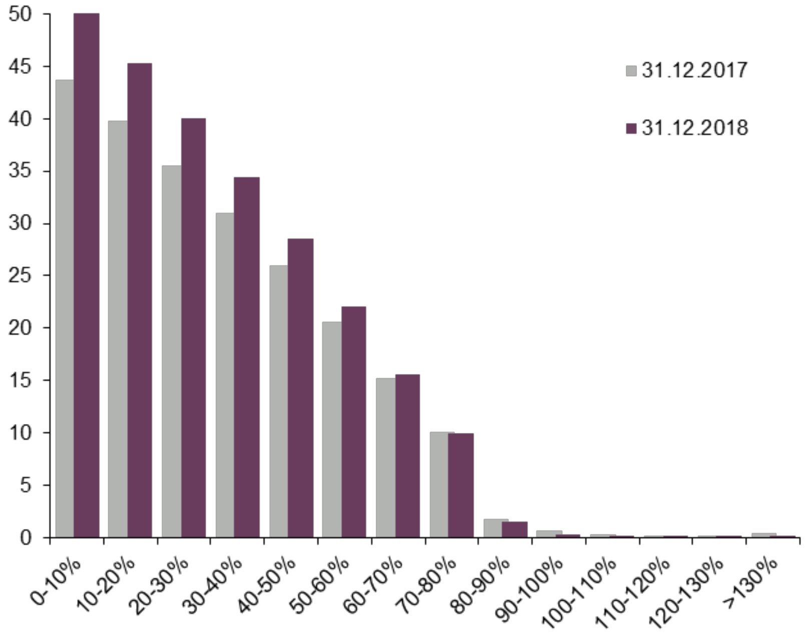
Highlights

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

LTV distribution by underlying asset class
ISK bn, by type of underlying asset, as of 31.12.2018



LTV distribution of mortgages to individuals
ISK bn, as of 31.12.2018 – avg LTV 61% (63% 31.12.2017)[1]



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

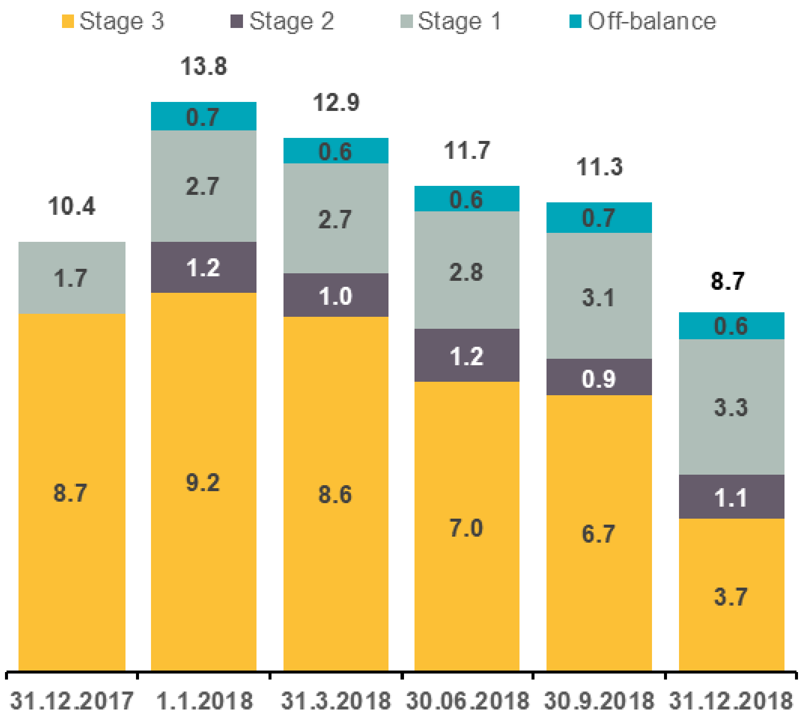
Asset quality

Asset quality improving with NPL ratios continuing downward trend

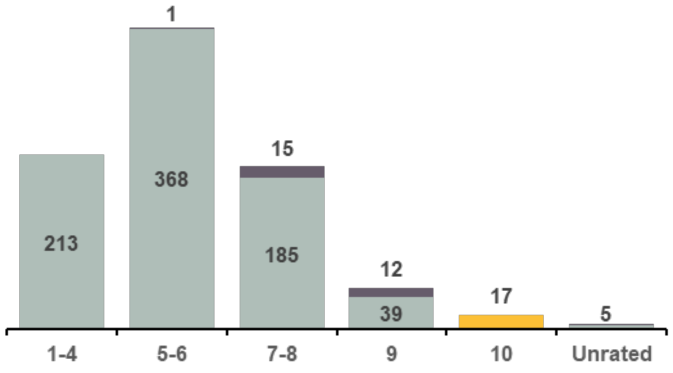
Highlights

- 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 year 2018 the impairment allowance has decreased, mainly due to write-offs of facilities in Stage 3
- At the end of 2018, gross carrying amount of loans in Stage 3 as a proportion of the total gross carrying amount of loans to customers was 2.0%, compared to 2.9% at end of 1H18, primarily caused by write-offs of legacy loans that did not affect the net carrying amount
- Using the European Banking Authority's definition of NPL, which does not only include loans to customers but also loans and advances to central banks and credit institutions, the Bank's NPL ratio was 1.7% at the end of 2018, compared to 3.4% average for European banks[2]

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, 31.12.2018



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

	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISK bn)	(% of portfolio)	(ISK bn)	(Imp. %)	(ISK bn)	(% of portfolio)
Stage 1	808	94.6%	3.3	0.4%	805	95.1%
Stage 2	29	3.4%	1.1	3.8%	28	3.3%
Stage 3	17	2.0%	3.7	21.3%	14	1.6%
Total	**855**	**100%**	**8.0**	**0.9%**	**847**	**100%**

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, data as of Q3 2018

Liabilities

Diversified funding strategy

Liabilities & equity, ISK m	31.12.2018	31.12.2017	Δ
Deposits from CB and credit inst.	15,619	11,189	4,430
Deposits from customers	578,959	567,029	11,930
Derivatives and short positions	5,521	5,492	29
Debt issued and other borrowed funds	300,976	217,748	83,228
Subordinated loans	16,216	9,505	6,711
Tax liabilities	7,150	7,787	(637)
Other liabilities	29,643	35,947	(6,304)
Non-current liabilities held for sale	6	80	(74)
Total liabilities	954,089	854,777	99,312
Total equity	176,313	181,045	(4,732)
Total liabilities and equity	1,130,403	1,035,822	94,581

Highlights

Deposits

- Customer deposits are up by 2.1% to ISK 579bn at end December 2018
  - The increase was due mainly to a rise from retail customers
  - The customer deposit to customer loan ratio was 68.4% at year end

Debt issued and other borrowings

- Includes covered bonds, commercial papers and bonds in foreign currency
- Market access for covered bonds remains solid, with issuance of ISK 23.9bn in 2018, reinforcing the Bank's position as Iceland's largest covered bond issuer

Other liabilities

- 76% of other liabilities are attributable to credit card liabilities to retailers through the Bank's subsidiary Borgun

Equity

- The Board of Directors of Íslandsbanki proposes that ISK 5.3 billion will be paid in dividends to shareholders for the 2018 financial year. The dividend corresponds to about 50% of after tax profits for 2018, and is consistent with the Bank's dividend payout ratio target of 40-50%

Deposits remain the main source of funding

Core deposits continue to be stable

Highlights

Stable core deposit base

— Deposits remain the main funding source for the Bank and the deposit to loan ratio remains high

— At the end of the period, 72% of the deposits were in non-indexed ISK, 16% CPI linked and 12% in foreign currencies

Deposits concentration remains stable

— At the end of December 2018,14% of the Bank's deposits belonged to the 10 largest depositors depositors and 35% belonged to the 100 largest depositors. Compared to 15% and 39% respectively for year-end 2017

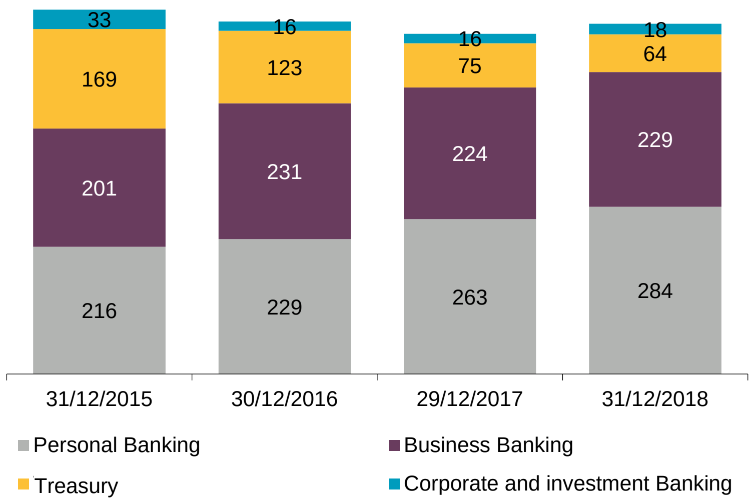
Customer deposits by LCR category

31.12.2018 compared with year end-2017, ISK bn, Consolidated

ISK bn	Less stable	Δ	Stable	Δ	Term deposits	Δ	Total deposits	Δ
Retail	**216**	30	**81**	4	**78**	(1)	**376**	33
Operational relationship	**3**	1	**-**	-	**-**	-	**3**	1
Corporations	**64**	0	**0**	-	**23**	(7)	**87**	(6)
Sovereigns, central-banks and public sector entities	**8**	0	**0**	(0)	**1**	(1)	**8**	(1)
Pension funds	**31**	(0)	**-**	-	**27**	(2)	**58**	(2)
Domestic financial entities	**27**	(7)	**-**	-	**25**	(3)	**52**	(10)
Foreign financial entities	**3**	(2)	**-**	-	**8**	3	**11**	2
Total deposits	**352**	**23**	**81**	**4**	**161**	**(10)**	**595**	**16**

Deposits breakdown by business divisions and Treasury

ISK bn, Consolidated



Borrowings

Successful international and domestic market transactions

Highlights

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

— Total covered bonds issuance in 2018 was ISK 24bn

Successful international funding in 2018

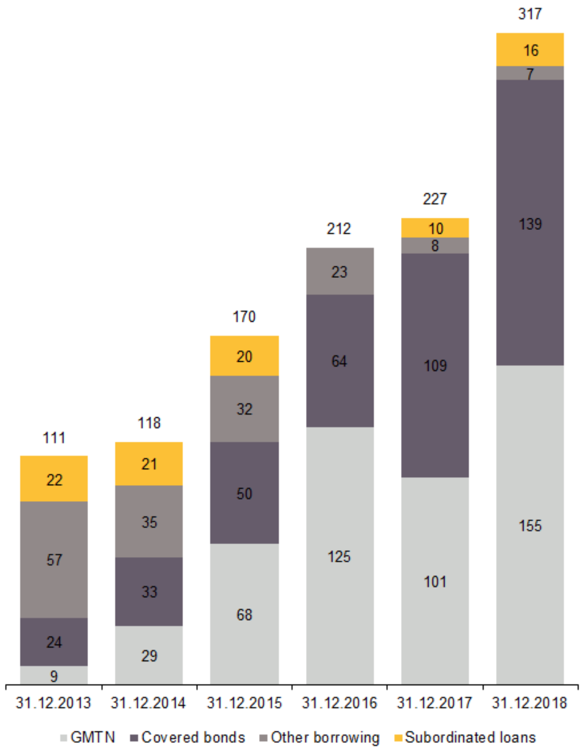
— EUR 300m issued in January

— SEK 500m Tier 2 issued in August

— In 2018 the Bank issued a number of private placements under its GMTN Programme totalling SEK 2.6bn

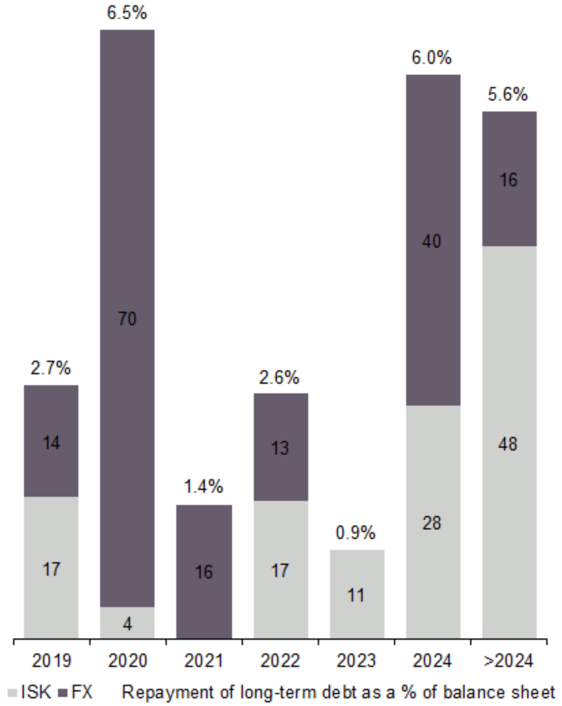
Borrowing sources

Book value, ISK bn



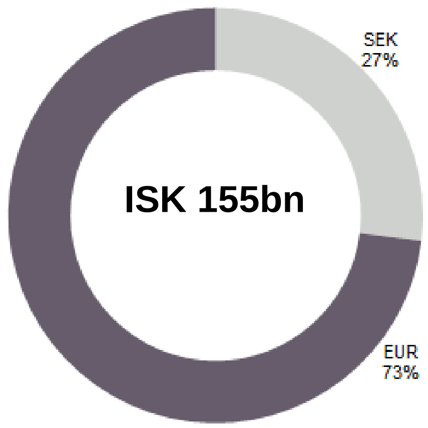
Maturity profile of long-term debt and repayment of long term debt as percentage of balance sheet[1]

Nominal value, ISK bn



Currency split of GMTN borrowing sources

31.12.2018, Nominal value, ISK bn



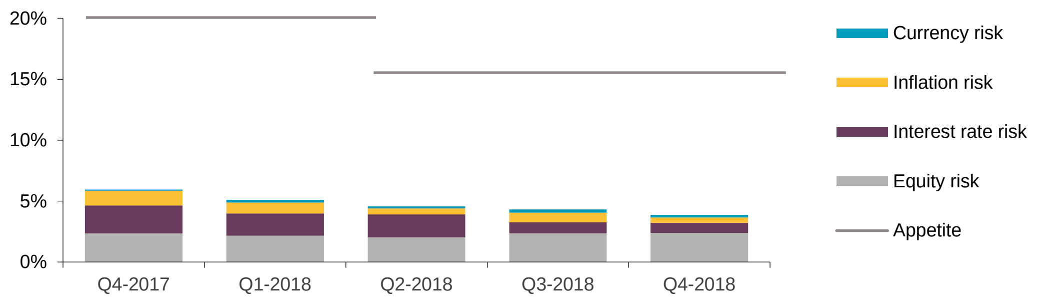
1. Final maturity assumed for callable bonds

Market risk developments

The Bank has a modest market risk profile

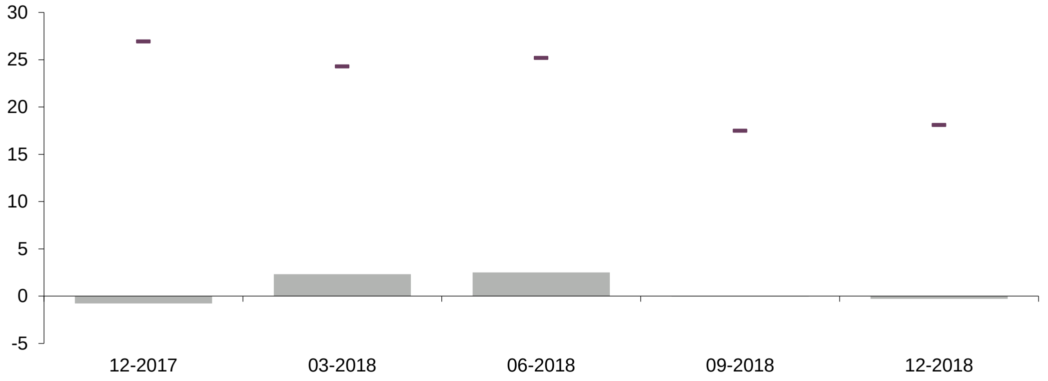
MARKET RISK EXPOSURE AND MARKET RISK APPETITE

Average positions as percentage of total capital base, Consolidated



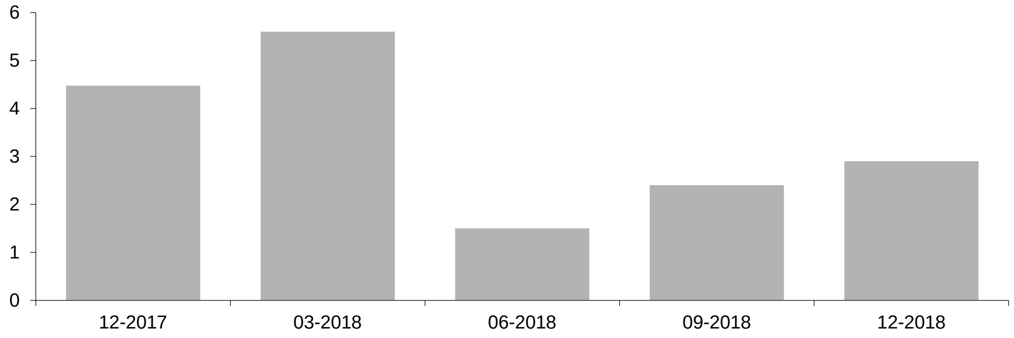
DEVELOPMENT OF THE CURRENCY IMBALANCE

ISK bn, Consolidated



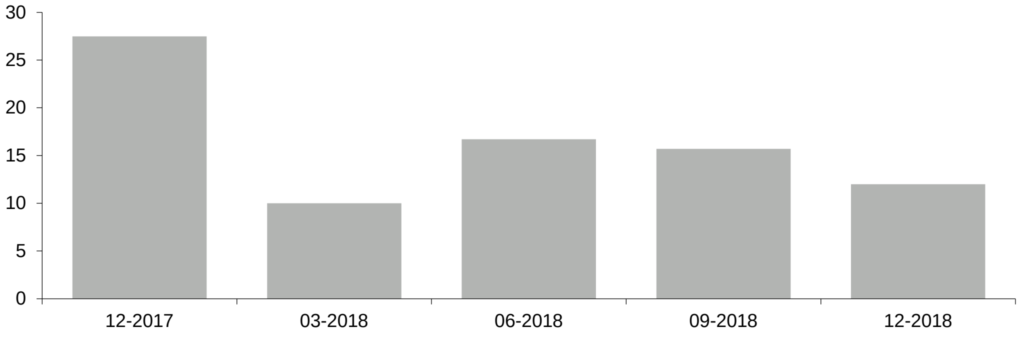
DEVELOPMENT OF INTEREST RATE RISK IN THE BANKING BOOK

Weighted average BPV, ISK m, Consolidated



DEVELOPMENT OF THE BANKING BOOK INFLATION IMBALANCE

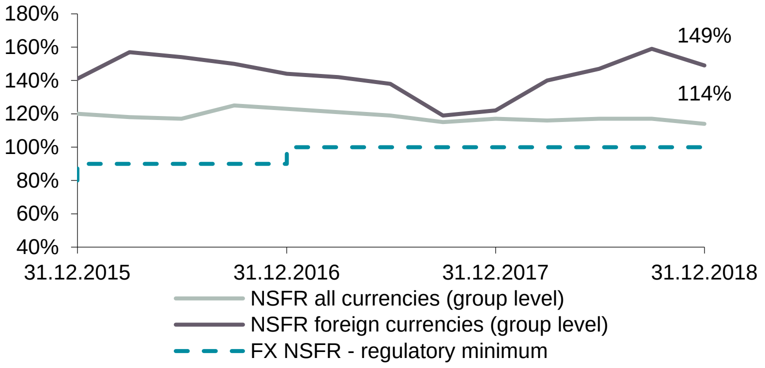
ISK bn, Consolidated



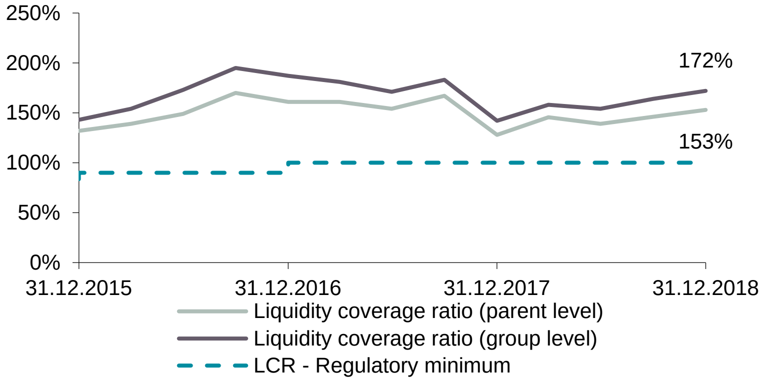
Sound management of liquidity

Liquid assets of ISK 209 billion are prudently managed

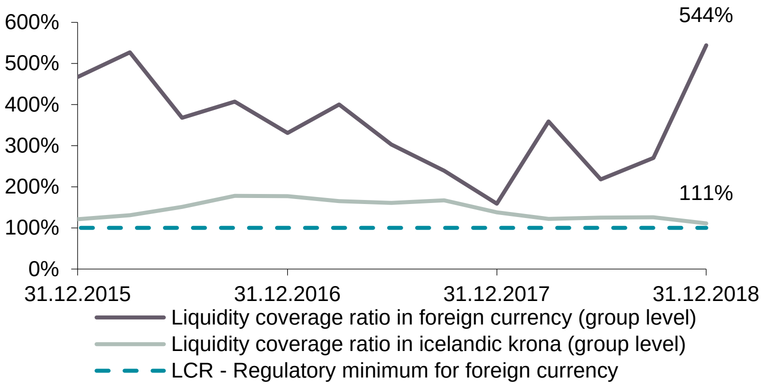
Net stable funding ratio (NSFR)



Liquidity coverage ratio – all currencies



Liquidity coverage ratio – foreign currencies and Icelandic krona



Highlights

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

Sound capital position

The capital ratio in line with target and leverage is low

Highlights

Capital ratios

— The Capital base was ISK 188bn and the CET1 capital was ISK 172bn at 31 December 2018, compared to ISK 187bn and 176 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

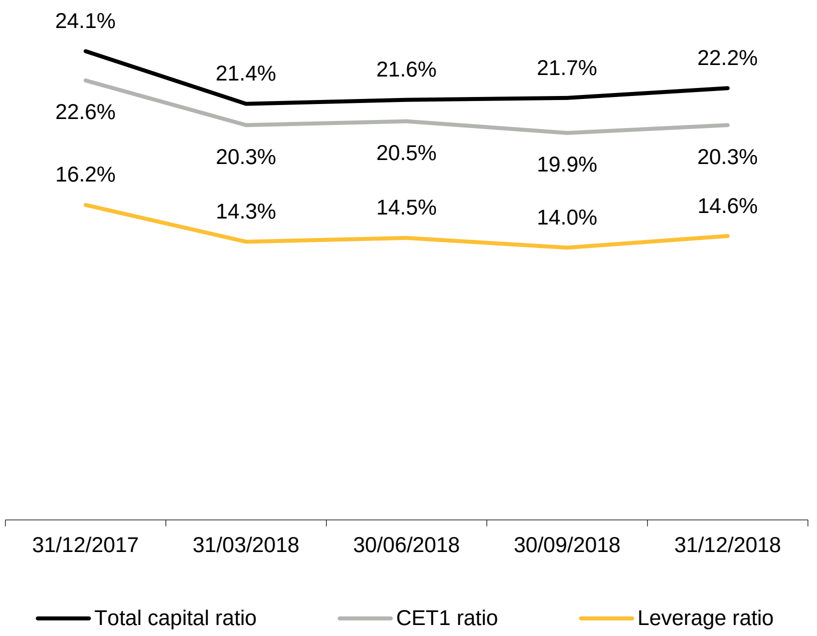
— The issuance of Tier 2 subordinated debt amounting to SEK 500 million in August contributed to an increase in the capital base, offsetting further the dividend payment, leaving the capital base at a level comparable to year end figures

Risk exposure amount (REA)

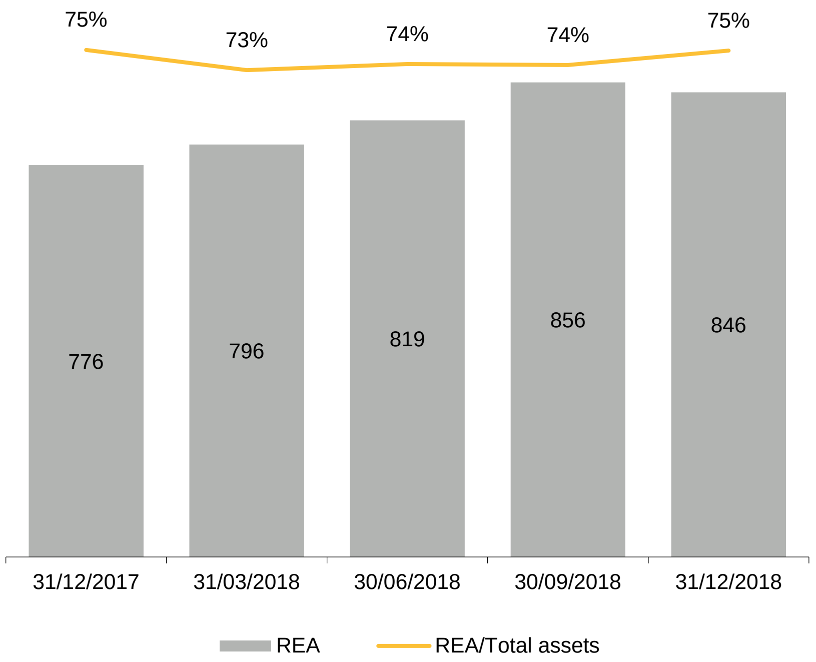
— The REA growth is mainly due to increase in loans to customers during the year

— The ratio of REA of total assets remains fairly stable at 75%

Capital and leverage ratios



Risk exposure amount (REA)
ISK bn



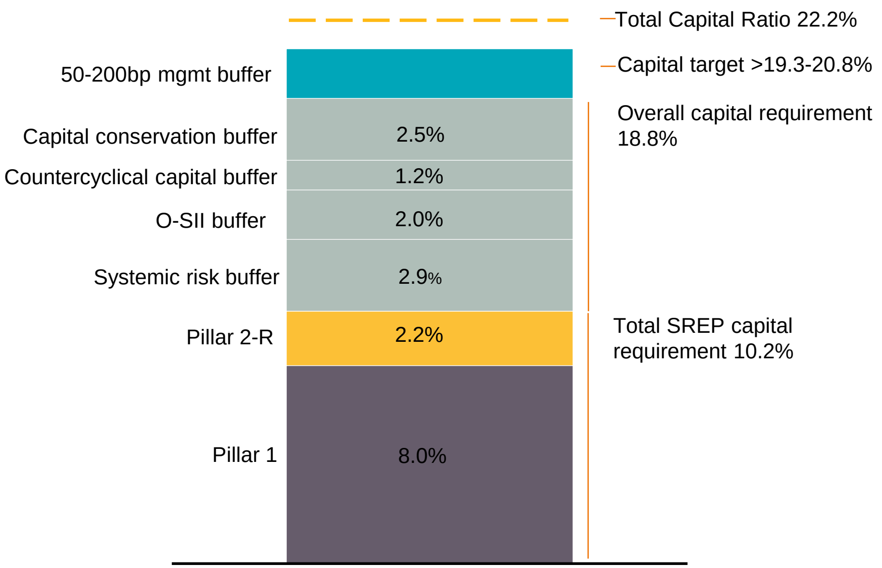
Íslandsbanki's capital target

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

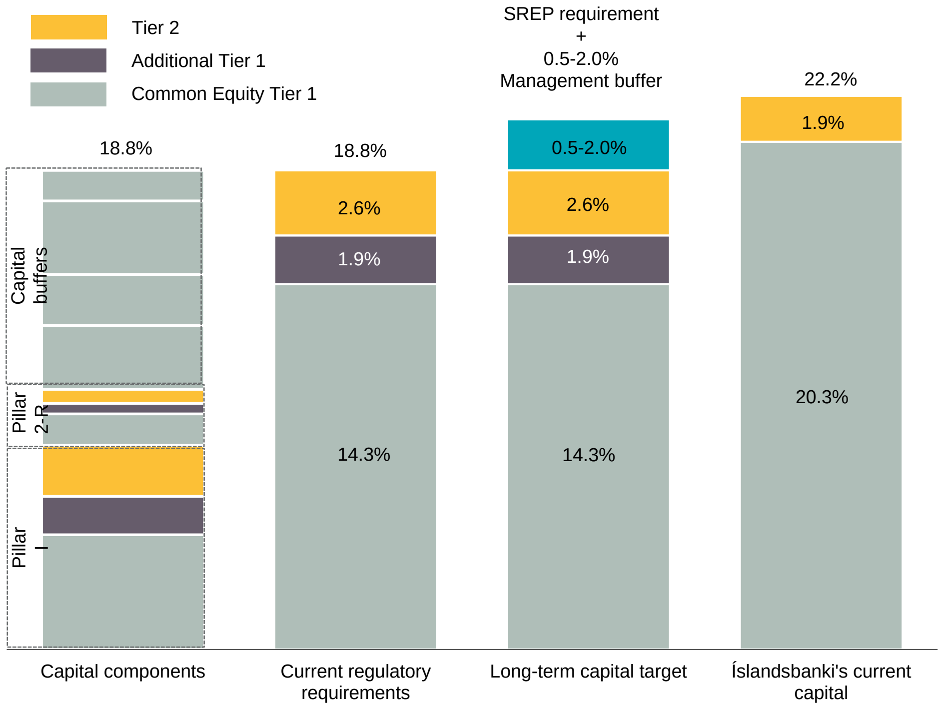
Highlights

- 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, publisher 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% and to 2.0%, effective from May 2019 and February 2020 respectively.
- 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's capital target



Capital requirement composition



Íslandsbanki credit ratings

Ratings affirmed from S&P in 2018. Íslandsbanki announced the termination of Fitch credit rating agreement in January 2019

Íslandsbanki

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

Icelandic sovereign

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

S&P

BBB+/A-2 Stable Outlook

Press Release 17 July 2018

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

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

S&P also comments 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

Press Release 30 January 2019

Íslandsbanki informed that following expiration and by agreement of parties, **the credit rating service contract** between Fitch Ratings and Íslandsbanki **was to terminate**.

The decision by Íslandsbanki was driven primarily from **a cost perspective** and the Bank will **continue to work closely with S&P** and is committed to comply with its obligations to provide the relevant information in an open and transparent way, in support of the rating agency's actions in relation to the Bank.

Previously, in November 2018, Fitch had **affirmed** Íslandsbanki's ratings of **BBB/F3** with a **stable outlook**

4. Financial targets and next steps

Financial targets

Medium and long term strategies structured around achieving key financial targets

	Target	2018	2017	2016	Guidance
ROE regular operations[1]	8-10%	✔ 8.0%	✔ 9.9%	✔ 10.3%	— 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 substantive liquid assets, interest rate levels in Iceland can have a substantial impact on ROE — The bank tax, excluded from target returns, will have an impact on profitability if kept at current high levels — ROE target will be challenging to reach in the near term in a slowing economy and before a full realisation of the Bank's planned efficiency gains
Cost/ Income ratio[2]	<55%	66.3%	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	✔ 20.3%	✔ 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%	✔ 22.2%	✔ 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%	✔ 50%	✔ 100%	✔ 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 5.3 billion in dividend for the 2018 financial year which is in line with the Bank's dividend payout target

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. As the future level of bank tax is unclear, it is regarded as a one-off item in these calculations
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 targeting stable returns, lower costs and maintaining asset quality for the Bank in an increasingly competitive environment

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

Focus on stable returns, asset quality and core business in a “cooling off” economy

- 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
- The Bank put its subsidiary Borgun up for sale in January 2019

Continued focus on digital development

- 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 while
- Open banking platform will foster new ideas from fintechs
- Automatisation and simpler process from new digital solutions will lead to efficiency gains going forward

Further optimisation of 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 completed, ongoing or underway for multiple international regulation, including IFRS 9, MIFID II, PSD II, GDPR, BRRD and MREL
- The Bank received an Equal Pay Certification according to the ÍST 85:2012 standard on gender equality, incorporated into Icelandic law in June 2017

More about Íslandsbanki

Financials

Íslandsbanki publishes financial information quarterly. Below you can read Íslandsbanki's results presentations and other relevant information about its accounts.

2017 2016 2015 2014 2013 2012 2011 2010 2009 2008

	Report	Press Release	Presentation	Fact Sheet	Fact book
1Q					
2Q					
3Q					
FY					
Annual Report					
Pillar 3 Report					

Investor material

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

Please visit the Icelandic IR site for material in Icelandic:

https://www.islandsbanki.is/is/flokkur/bankinn/fjarfestatengsl

For further information, please contact

Gunnar S. Magnússon, Head of Investor Relations

Email: ir@islandsbanki.is

Telephone: +354-440 4665

Annex – Icelandic economy update

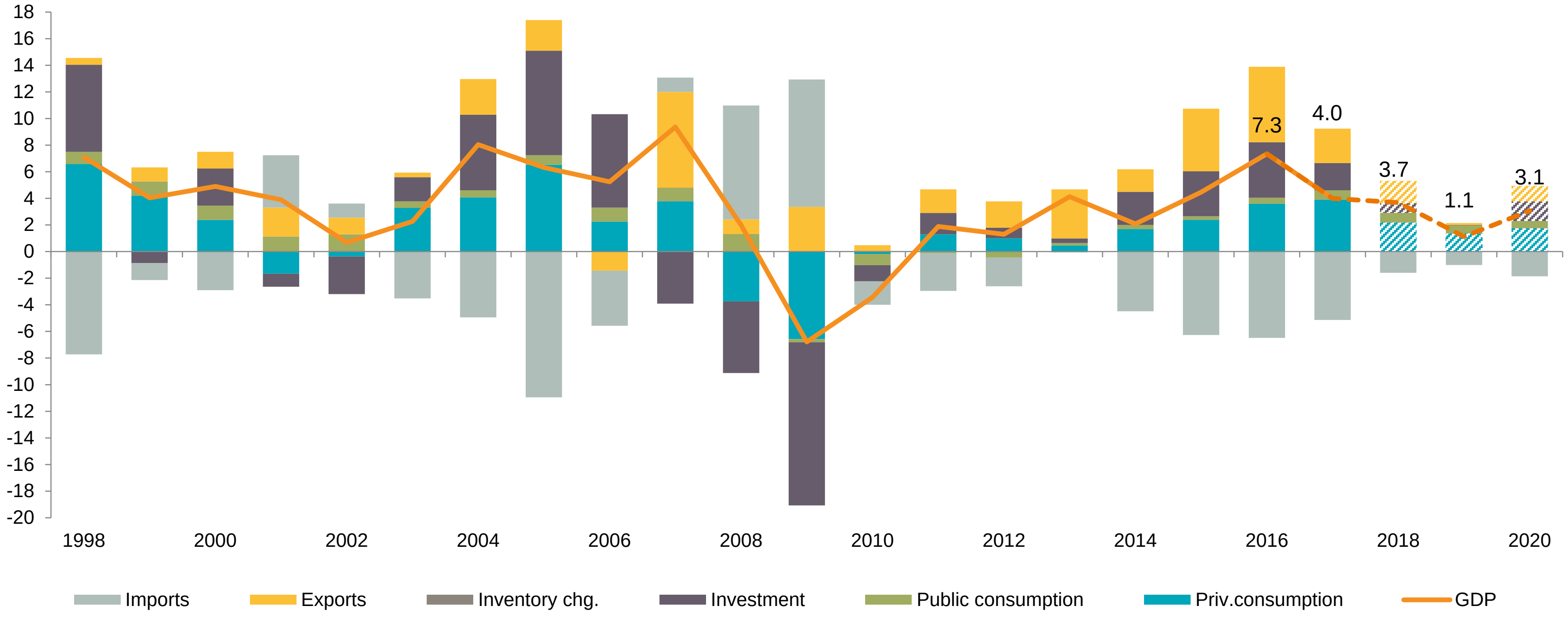
A temporary slowdown in GDP growth in 2019

Investment, private consumption and service exports will all be on sabbatical this year

- The current business cycle has proven more resilient than many expected. GDP growth averaged 4.4% per year in 2013-2017
- Output growth measured 5.0% in the first 9 months of 2018 owing in particular to swift private consumption growth and a favourable contribution from net trade
- There are a number of signs of a marked slowdown in Q4. Íslandsbanki Research therefore projects output growth for 2018 as a whole at 3.7%
- The outlook is for 1.1% GDP growth in 2019. The drivers of the recent growth spurt will all be on sabbatical this year
- Private consumption growth will be slow and services export growth muted, and business investment will contract year-on-year
- The outlook is for growth to pick up again in 2020, soaring to 3.1%, buoyed up by livelier private consumption growth, a resumption of growth in business investment, and continued growth in other investment and in goods and services exports

GDP and the contribution of major subitems [1]

YoY change (%)



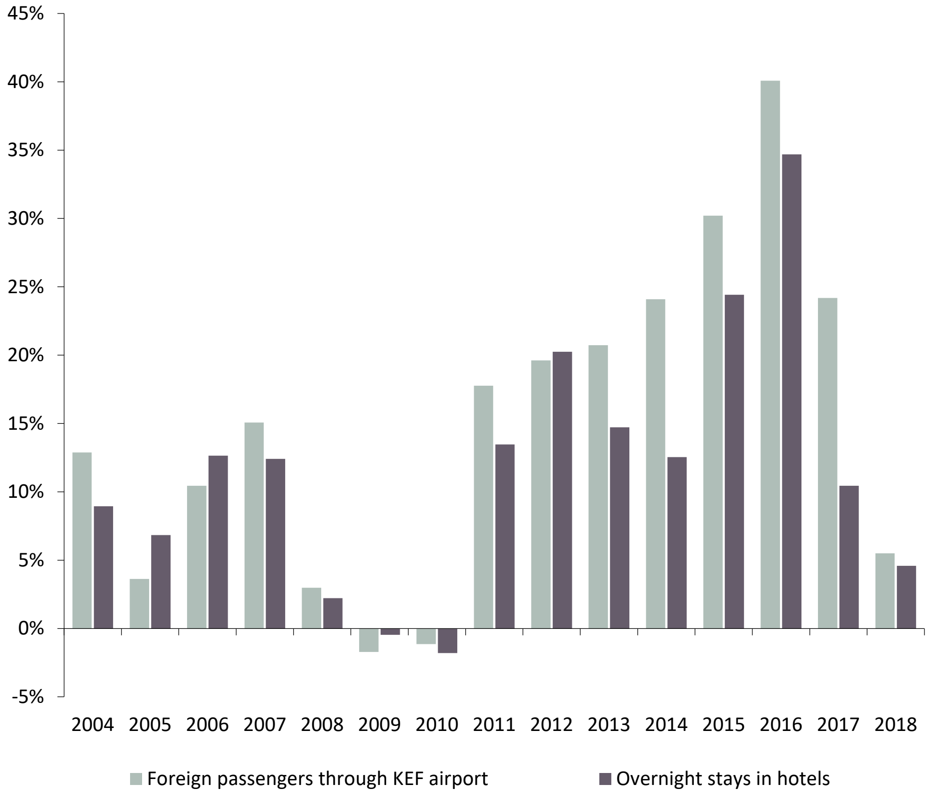
1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Tourism sector entering a phase of maturity

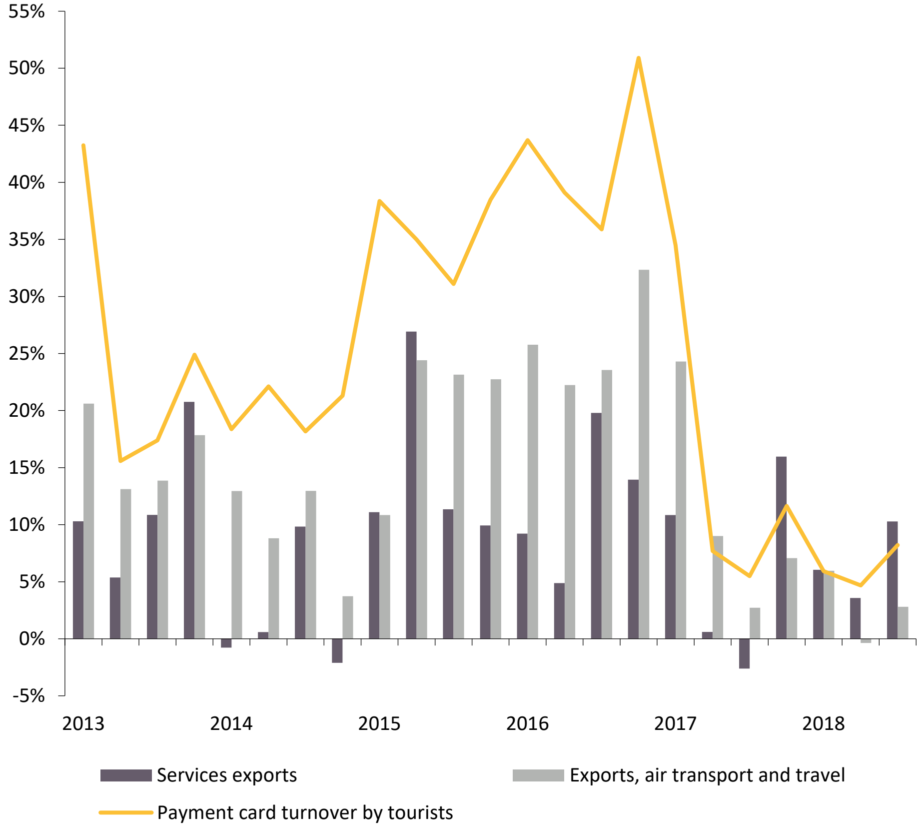
Largest export sector likely to grow very moderately in 2019

- The tourism industry is still growing, although the pace has eased considerably from the 2015-2016 peak, when growth in tourist arrivals measured 39% year-on-year
- Last year was the first without an appreciation of the ISK since the tourism boom started
- In 2018, the number of foreign tourists increased by 5.5% 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
- Tourism is likely to keep growing in the coming term, albeit quite a bit more slowly than it has to date

Foreign visitors and overnight hotel stays
YoY change



Services exports and foreign card turnover
YoY change



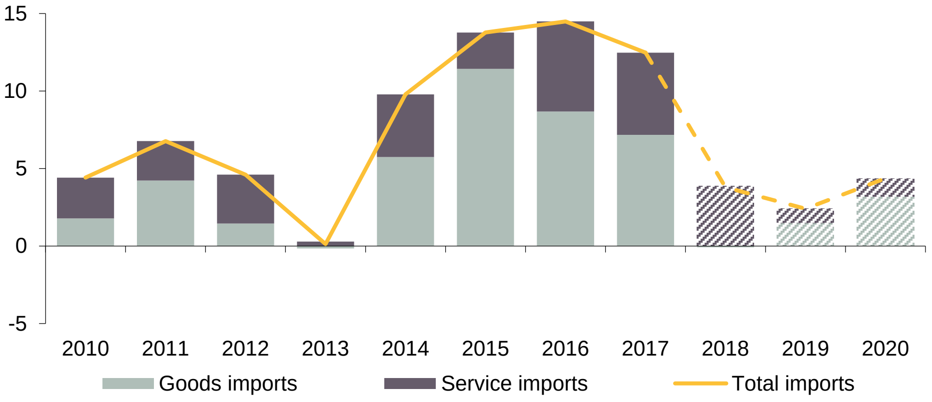
Source: Statistics Iceland, Centre for Retail Studies and Icelandic Tourist Board

Current account surplus throughout decade

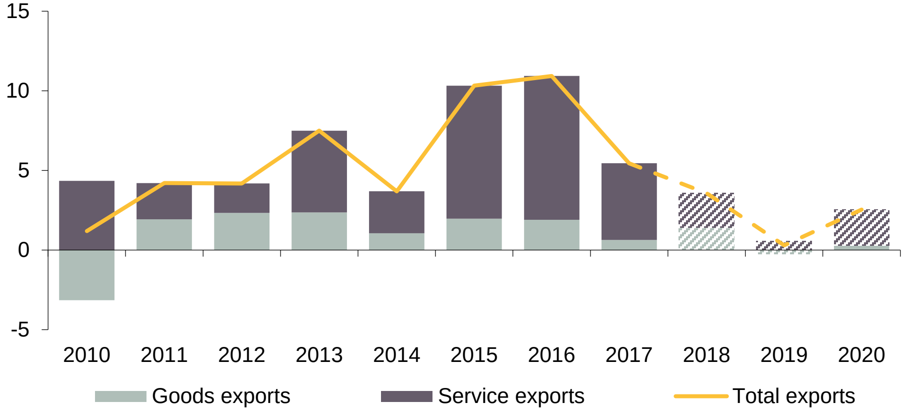
Net external position to continue improving

- Growth in both imports and exports is expected to be weaker in 2019-2020 than it has been in recent years
- Export growth at 0.3% and import growth at 2.4% this year, followed by 2.5% and 4.4%, respectively, in 2019 and 3.9% and 2.0%, respectively, in 2020
- Services exports — tourism in particular — will continue to be the mainstay of export growth, in our opinion. For imports, however, the reverse applies, as goods imports will weigh heaviest, particularly once domestic demand kicks in again
- Iceland's current account balance has never been as favourable in the history of the Republic as in recent years. The 2020 will likely 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, all else being equal. As of end-September 2018, external assets exceeded external liabilities by over 13% of GDP

Imports, YoY change (%)

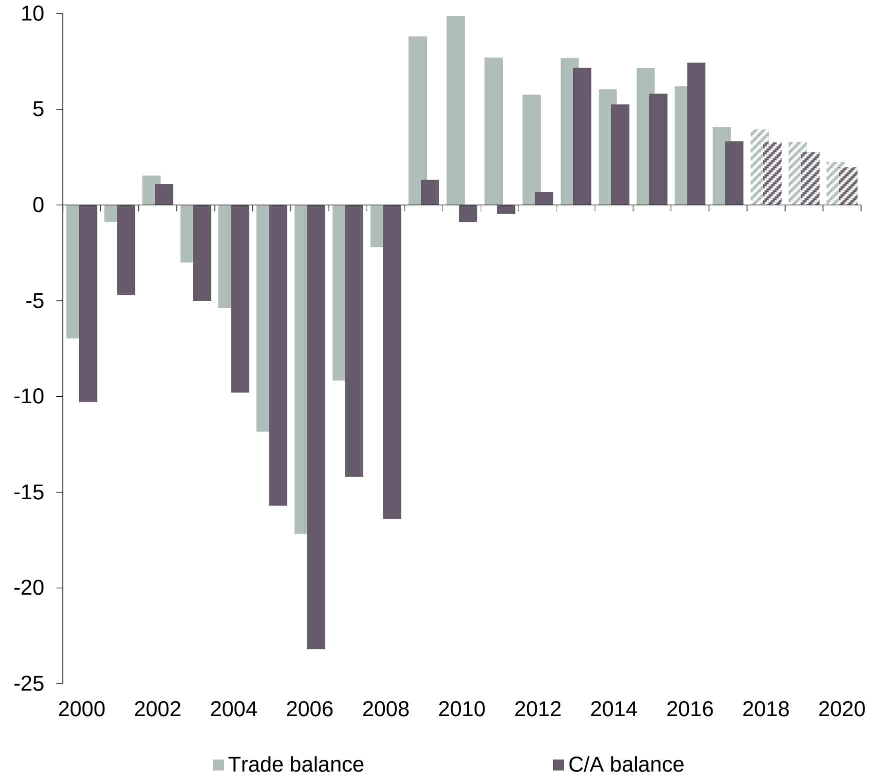


Exports, YoY change (%)



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

Current account balance
% of GDP

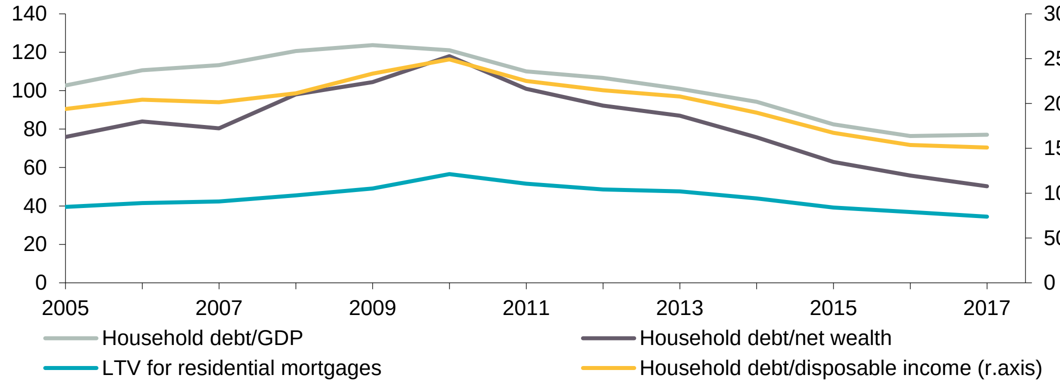


* 2009-2015: C/A balance excl. old banks

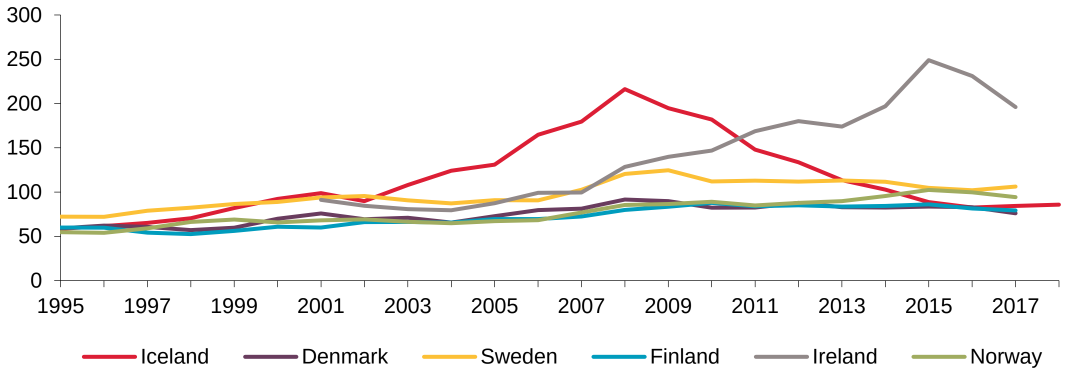
Domestic balance sheets remain robust

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

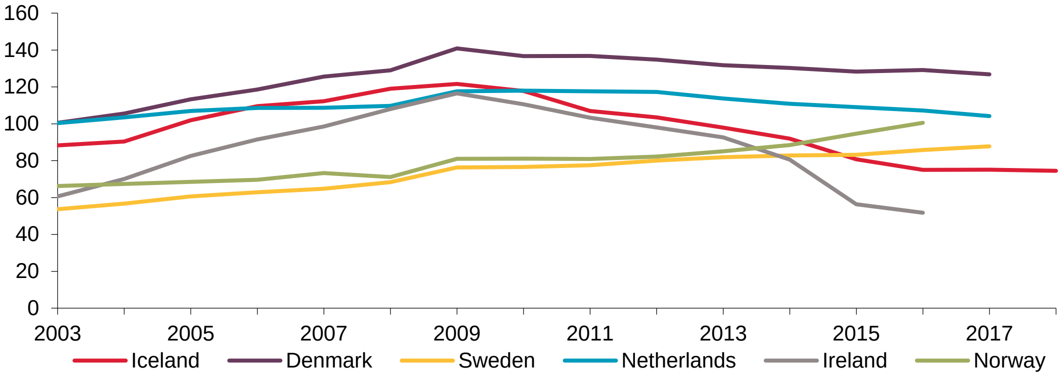
Household debt
%



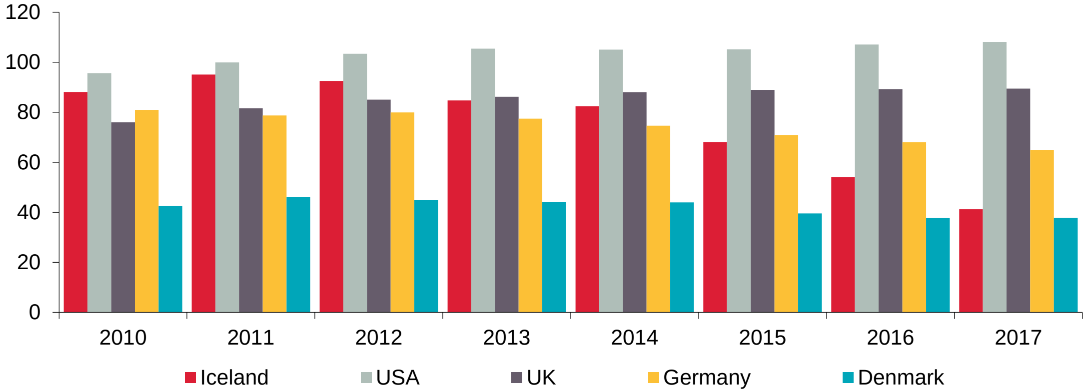
Corporate debt
% of GDP



Household debt
% of GDP



Central government gross debt
% of GDP



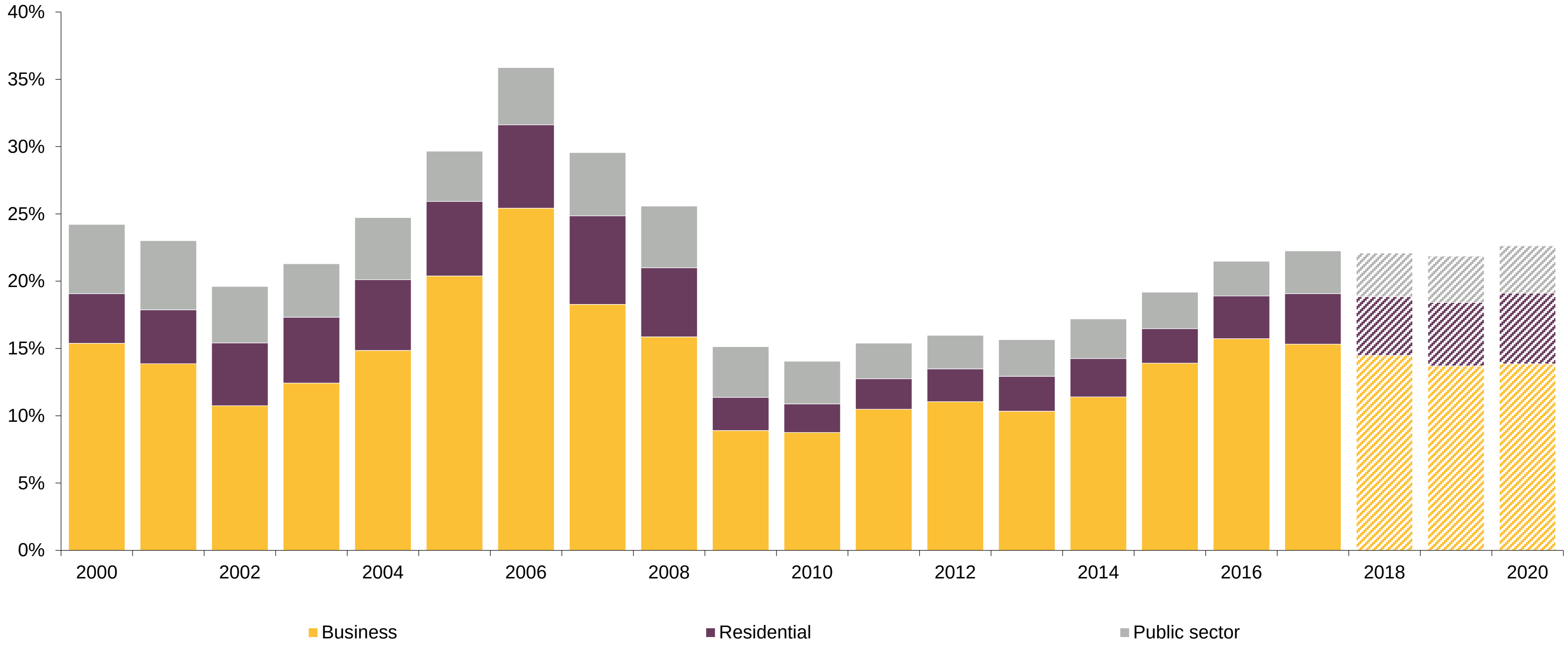
Source: Central bank of Iceland, Statistics Iceland

Outlook for a healthy investment level in coming years

Growth has shifted from business investment to residential investment and public sector investment

- Iceland's investment level rose substantially around the middle of the decade, after a period of limited investment in 2009-2013
- This surge was driven to a large degree by business investment
- The investment-to-GDP ratio was 22% in 2017, after bottoming out at just over 14% in 2010
- Main source of investment growth has shifted to residential investment and public investment
- Following 3.4% growth in investment in 2018, the outlook is for a slight contraction in 2019 due to a decline in business investment
- In 2020, however, all categories of investment will increase, delivering 6.7% growth in total investment that year
- The investment level will be just over a fifth of GDP in each year of the spread, and investment as a whole will therefore be robust in spite of the downturn in business investment

Investment [1]
% of GDP



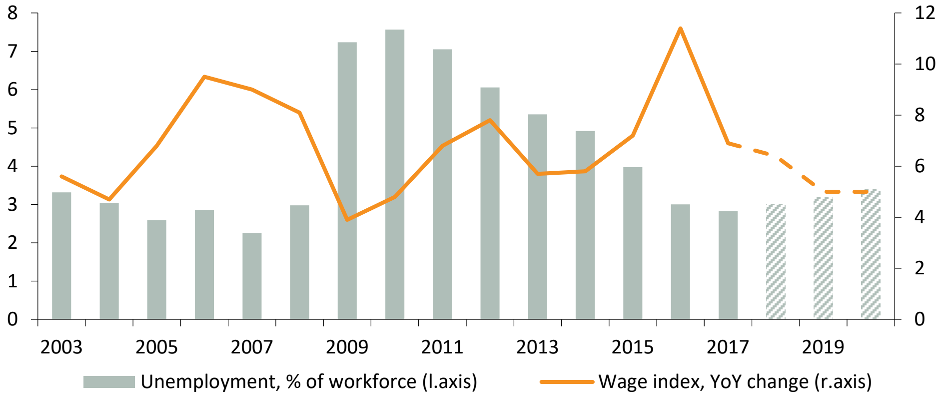
1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Household consumption growth eases

Labour market to remain relatively strong

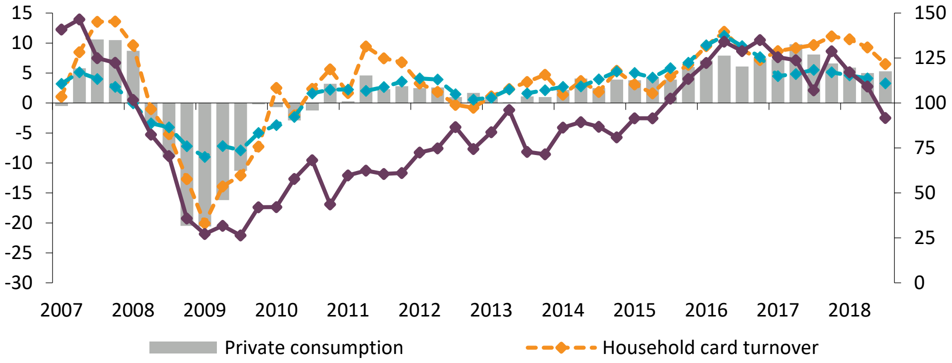
- In the recent past, private consumption growth has levelled off following rapid growth in 2015-2017
- Developments in key indicators suggest a further slowdown ahead. The Gallup Consumer Confidence Index has declined significantly, real wage growth has stalled, and payment card turnover in Q4/2018 was half that in Q1
- The Icelandic labour market has been lively in recent years, with rapid wage rises and steadily declining unemployment
- 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 is likely to inch upwards and real wage growth to ease in coming quarters
- Private consumption growth estimated at 4.4% in 2018, to be followed by 2.7% growth in 2019 and 3.4% in 2020 according to ISB Research's forecast

Unemployment and wage growth



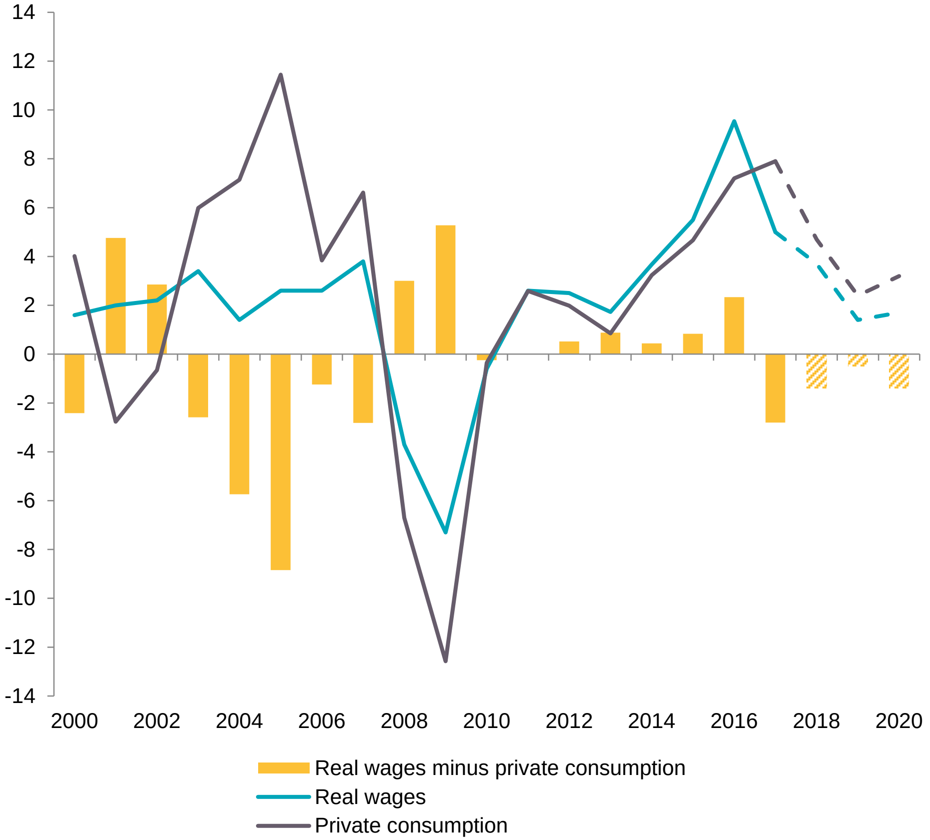
Private consumption and related indicators

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



Real wages and private consumption

YoY real change (%)

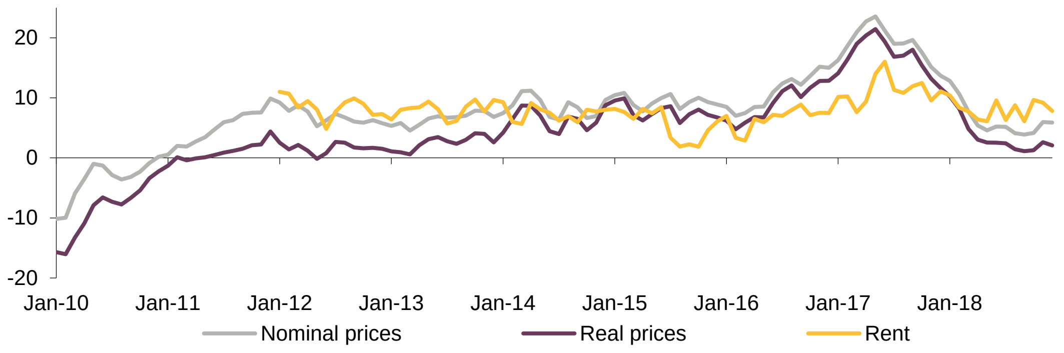


1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

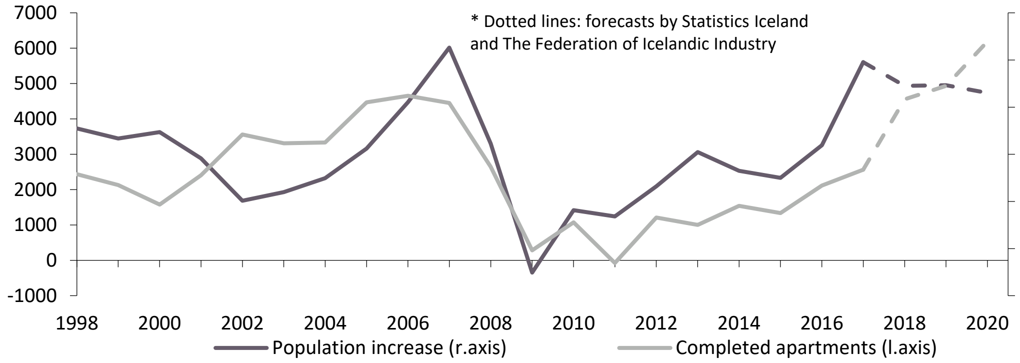
Real estate market normalising

Supply is increasing and the pace of price rises is moderating

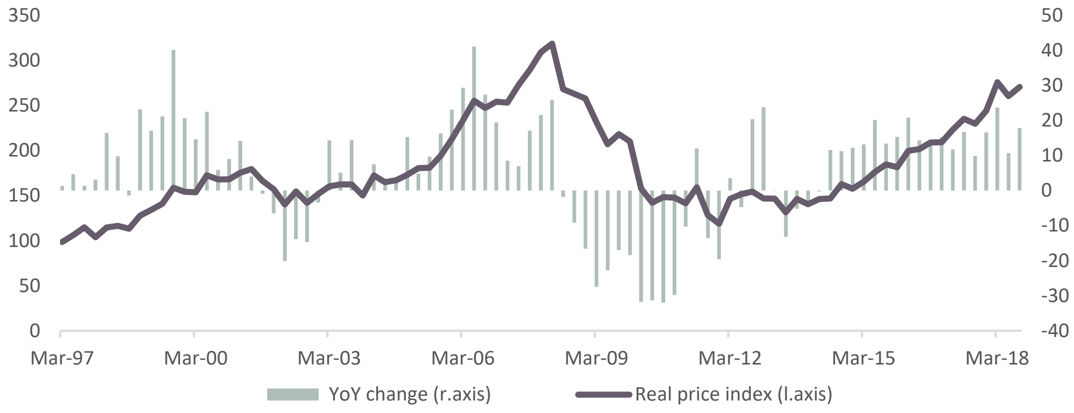
Residential capital region house prices and rent
YoY change, %



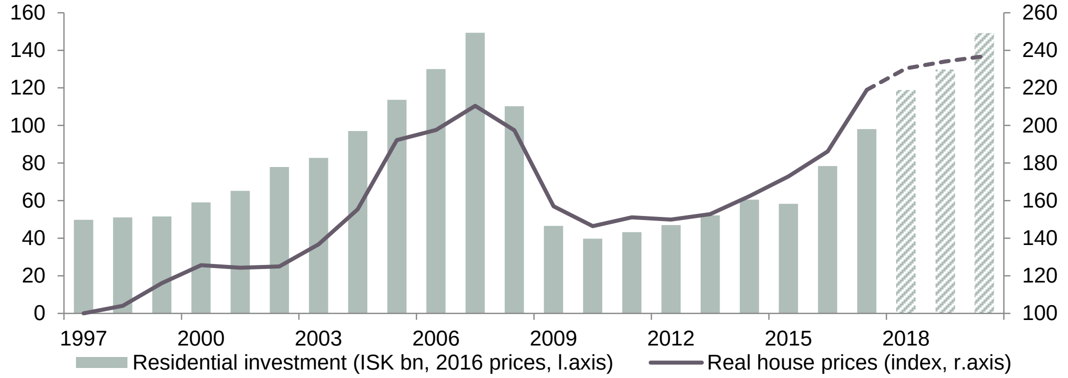
New apartments and population increase in the capital region [1]



Commercial real estate real price index



House prices and residential investment



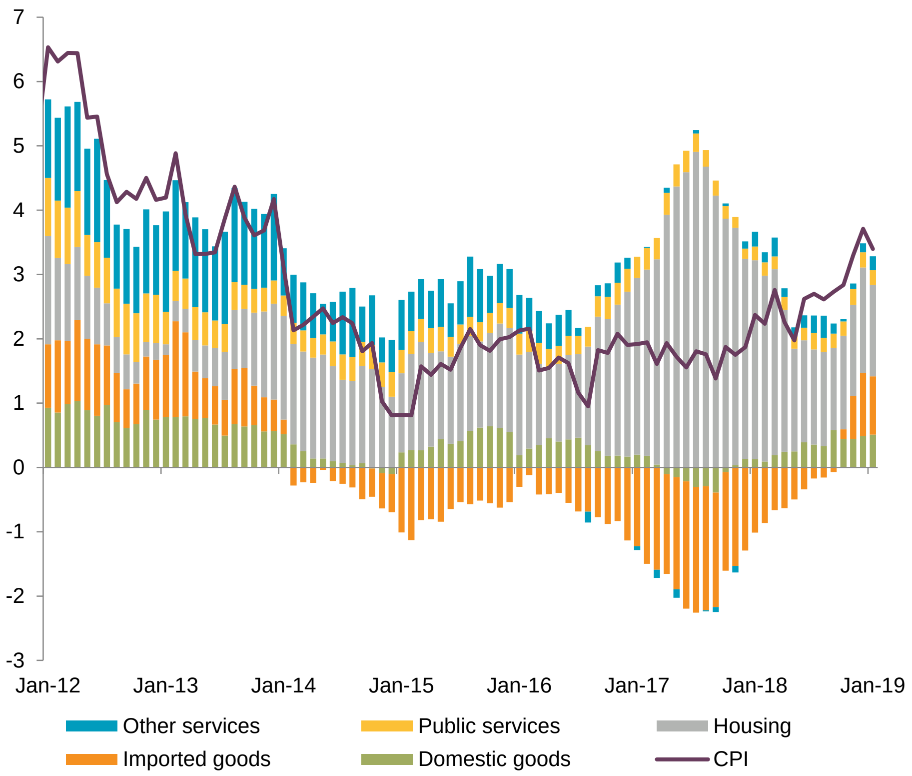
1. Shaded areas indicate ISB Research/ forecasts
Source: Statistic Iceland and ISB Research

Inflation relatively high in the coming term

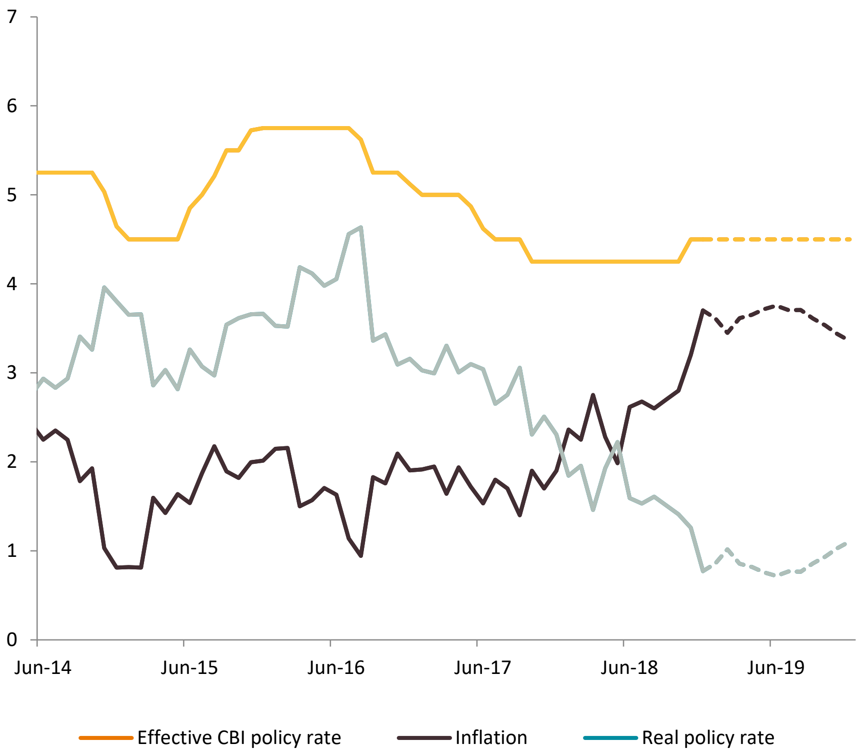
Policy rate could remain unchanged through the end of the decade

- Inflation has moved steadily closer to the upper tolerance limit of the CBI's inflation target in the recent term. Over 2018, it measured 3.7%
- The composition of inflation has changed: inflationary pressures from house prices have eased, and a larger share of the CPI increase stems from imported goods, whose prices are pushed upwards by the weakening of the ISK
- The outlook is for inflation to remain relatively high in 2019, peaking in Q3 at 3.8% and then tapering off steadily
- Inflation expected to measure 3.6% at the end of 2019 and to average 3.2% in 2020
- The Central Bank of Iceland's policy rate is currently 4.5%, following a 0.25% rate hike in November 2018
- Outlook for an unchanged policy rate as inflation peaks, inflation expectations stabilize and economy cools

Inflation and contribution of main subitems



Inflation, policy rate and real policy rate

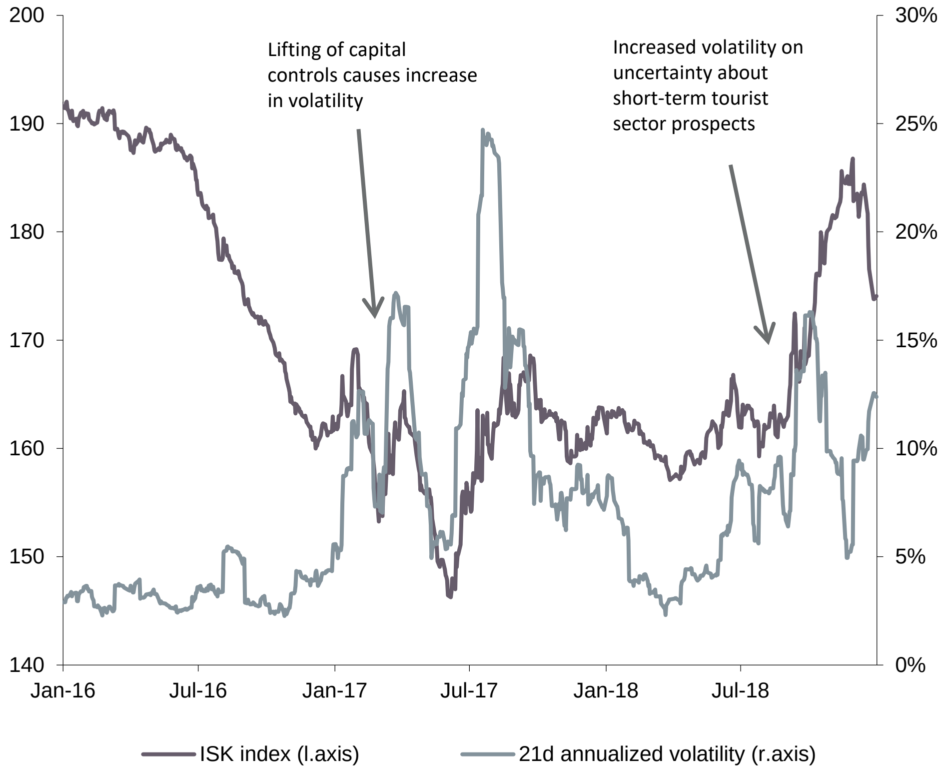


ISK on more solid ground following depreciation

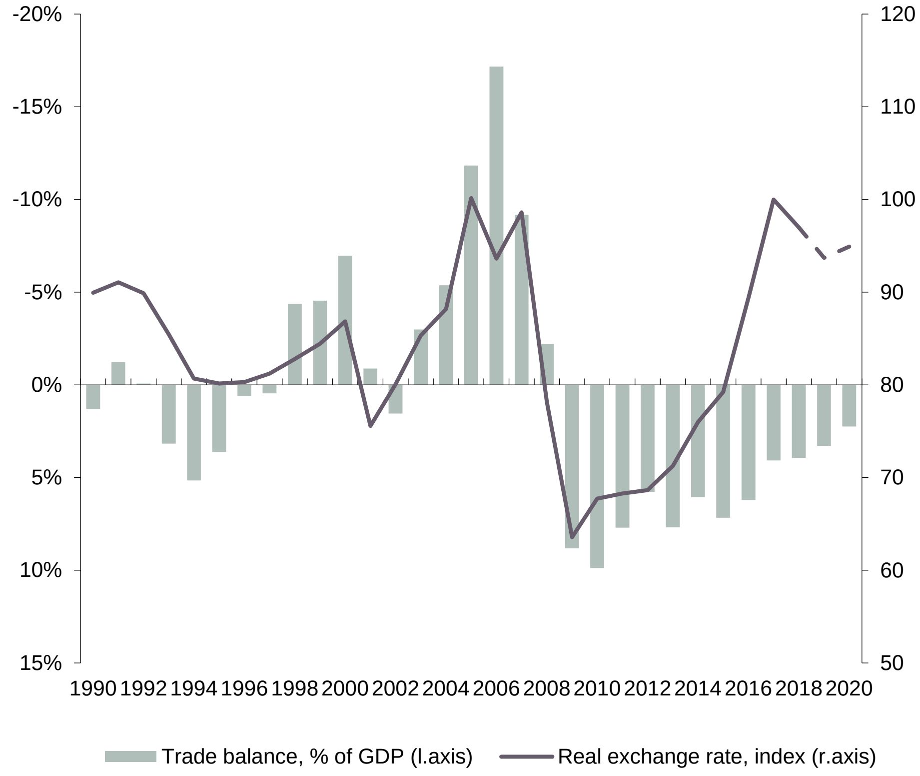
Real exchange rate likely to remain high through this decade

- The ISK depreciated by nearly 7% in H2of 2018, after a twelve-month period of relative stability
- This depreciation was broadly a positive development, conducive to reducing the risk of growing external imbalances in the short term.
- 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
- C/A surplus and inward investment should broadly suffice to offset FX outflows due to portfolio diversification by domestic investors
- Real exchange rate upward pressure due to large wage and price increases would likely lead to a corresponding depreciation pressure on the nominal ISK exchange rate

ISK exchange rate, daily values and volatility



Trade balance and real exchange rate

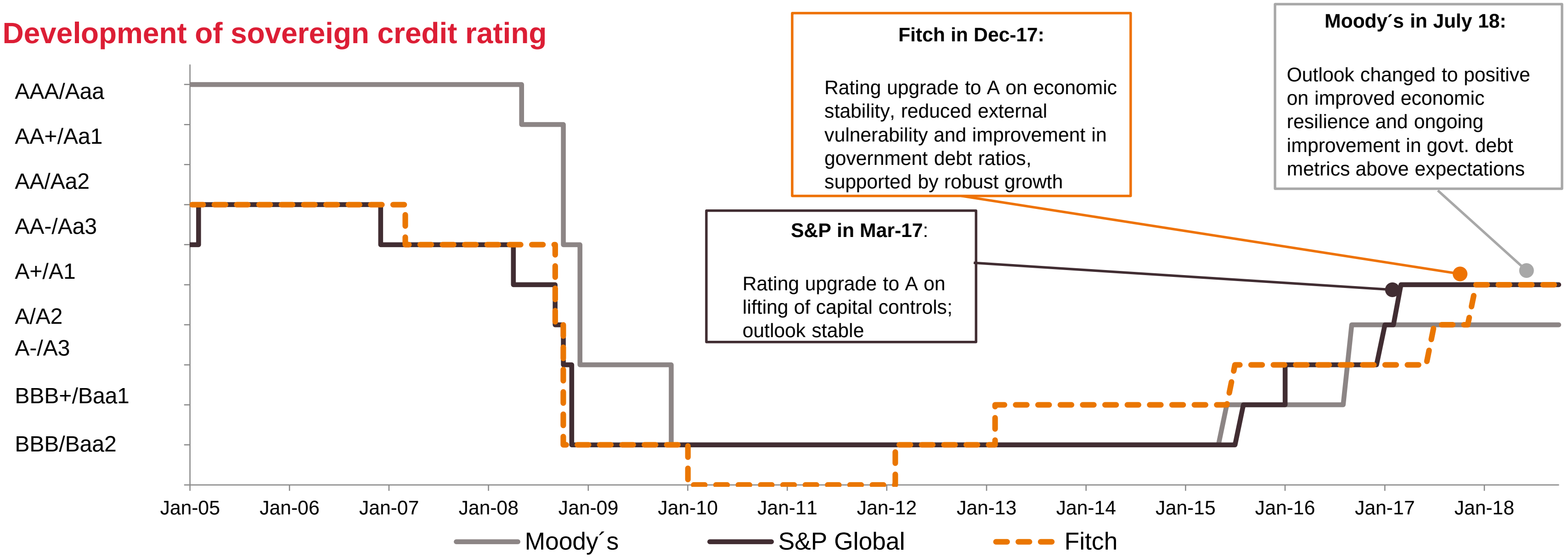


Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research

Iceland’s credit rating has improved markedly

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

Development of sovereign credit rating



MOODY’S IN JULY 2018

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

FITCH IN JUNE 2018

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

S&P IN JULY 2018

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

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

More about Íslandsbanki

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

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Investor material

Further investor information can be found at the Íslandsbanki IR website
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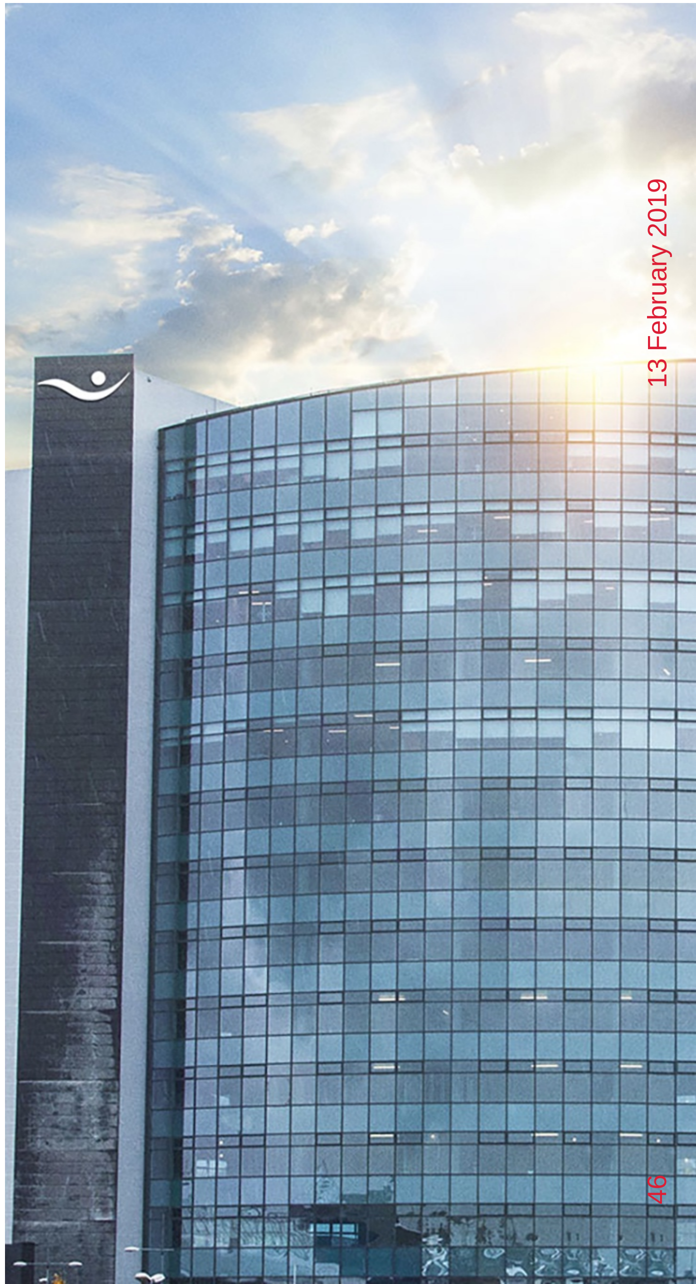

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