2Q21 Financial Results

28 July 2021

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islandsbanki.is

Agenda

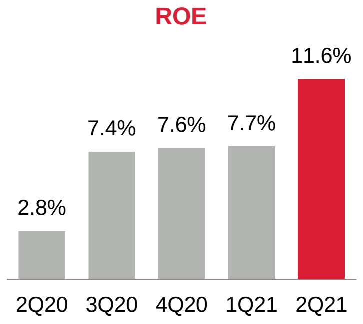
1. Financial and operational highlights

2Q21 Financial highlights

ROE above financial targets supported by economic recovery and resilience of borrowers

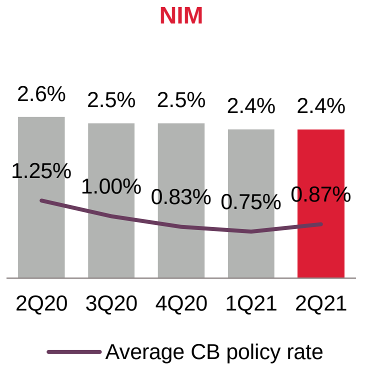
1. Positive impairments and reliable underlying operations bring ROE above financial targets

- Universal relationship banking strategy delivered another strong quarter with robust loan and revenue growth – ROE of 12.6% when one-off IPO costs are excluded
- Annualised cost of risk was -42bps in the quarter compared with 103bps in 2Q20



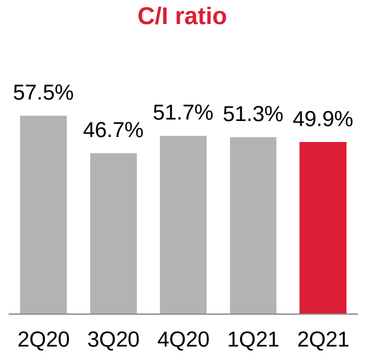
2. Continued **solid top line performance**

- Total operating income up 14% YoY, with solid growth in main line items
- The Bank has successfully increased lending margins to offset deposit margin erosion due to lower interest rate environment



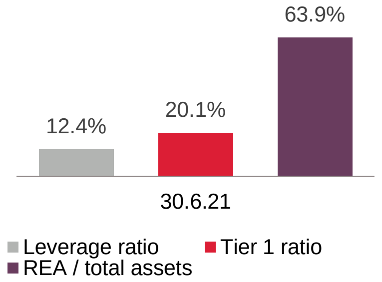
3. Competitive C/I ratio – continued digital uptake

- Substantial YoY reduction in C/I ratio due to revenue and cost improvements
- Strong track record of cost savings (incl. FTE and branch reductions) without impacting revenue growth



4. Strong, clean and diversified balance sheet largely funded with stable deposits

- Positive IFRS 9 stage migration, strong credit quality and conservative LTV distribution
- Robust liquidity and capital metrics, high REA density and low leverage versus Nordic peers



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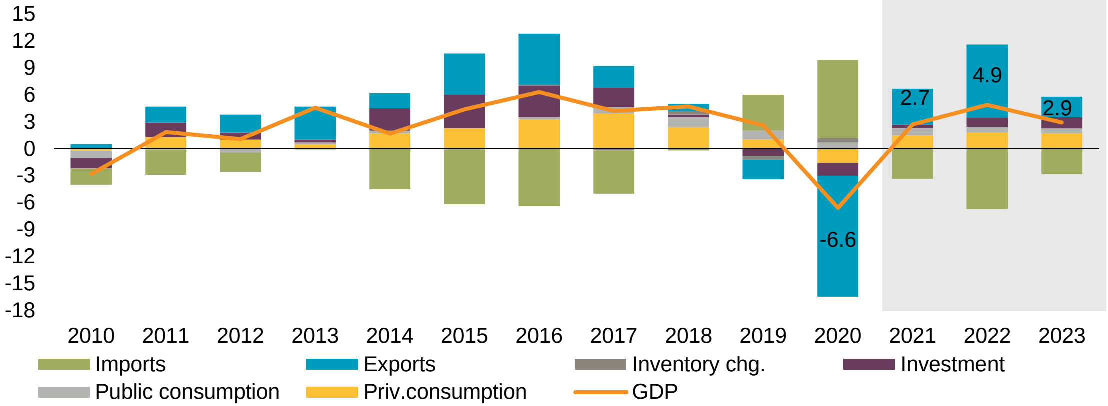
A return to solid growth in 2021 following COVID-19 recession

Strong foundations facilitate a robust recovery as world-wide pandemic impact fades

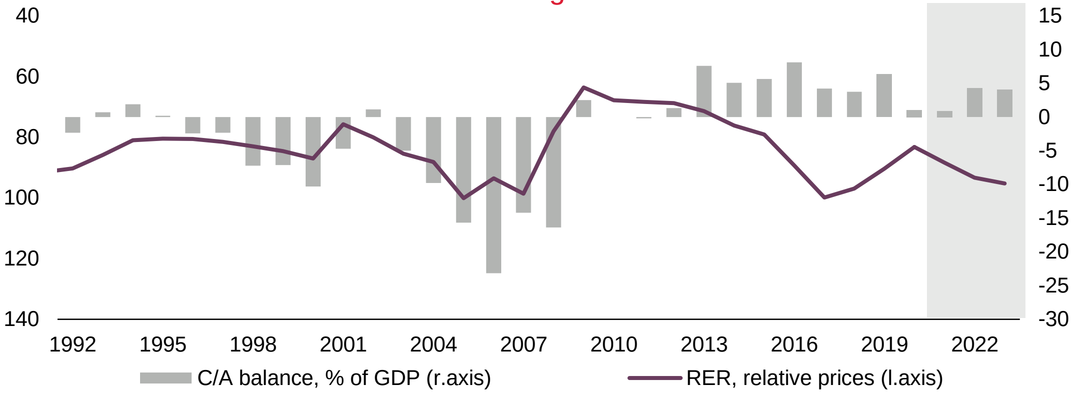
Following a recession in 2020, the economy is likely to return to growth..

Real GDP and main subitems, YoY change



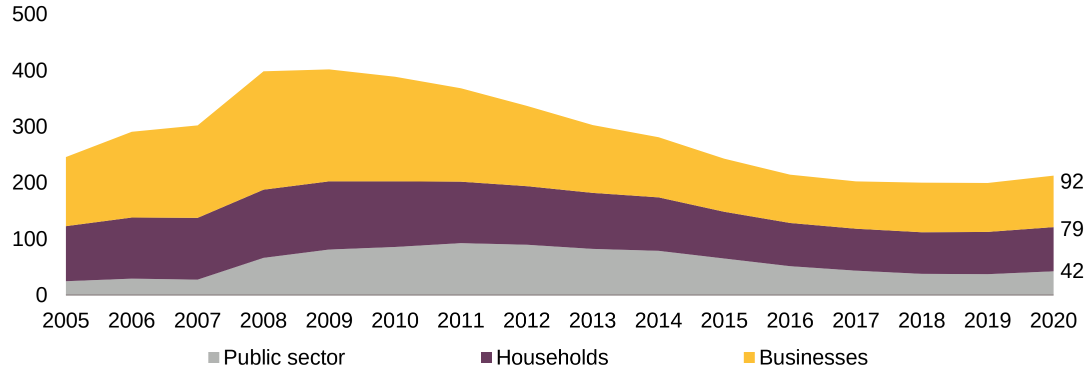
...supported by a lower real exchange rate and strong external balance

Current account balance and real exchange rate



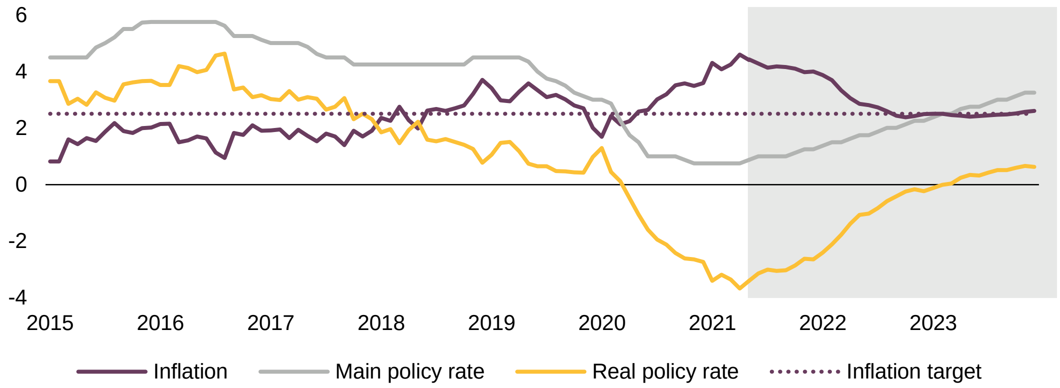
Moderate leverage throughout the economy increases resilience to shock..

Gross debt as % of GDP



...and counter-cyclical economic policy supports households and businesses

Inflation and policy rate, %



Shaded areas indicate ISB Research forecasts.
Source: Statistics Iceland, the Central Bank of Iceland and ISB Research.

2Q21 Operational highlights

Íslandsbanki welcomed to Nasdaq Iceland Main Market

- Íslandsbanki was listed on Nasdaq Iceland Main Market on 22 June after the successful completion of the Bank's IPO which, the largest IPO in Iceland to date. The Bank's flotation saw record participation from investors with a huge oversubscription resulting in the largest shareholder base of any listed company in Iceland
- Business activity was lively across all units. The loan book grew by 6% in 2Q21 (8% in 1H21) – the majority coming from mortgages although there was also a strong growth in the corporate loan book, including the refinancing of Míla, and an ISK 6.5bn green long-term loan extended to a listed real estate company
- June saw the largest month in new car financing to individuals since Ergo, the leasing arm of the Bank, was founded
- A strong quarter in the investment banking sector. Assets under management at Iceland Funds grew by 8% during 1H21 due to strong inflows into equity funds, balanced funds and asset portfolios
- The "funds in app" solution was introduced – enabling all retail clients to trade any of IS funds as well as viewing fund details and performance in the app
- 9 strategic projects have been defined and started for the later part of the year, to ensure further implementation of the Bank´s strategy and to reinforce the path to the Bank´s ROE target

Attractive and achievable financial targets

Clear path to ROE expansion, attractive capital return and optimisation

	Financial targets	2Q21	1Q21	2020	Guidance
Return on equity[1]	8-10% by 2023 >10% long-term	11.6% ✓	7.7%	3.7%	— Based on average expected risk-free rates through the business cycle — The Bank has a clearly identified path to ROE improvements, supported by a clear action plan and economic recovery — **The Bank assumes the loan book will grow in line with nominal GDP on average through the business cycle**
Cost-to-income ratio[2]	<45% by 2023	49.9% ✓	51.3% ✓	54.3% ✓	— The Bank continues to invest in IT infrastructure and process efficiency to improve the C/I ratio in the medium to long-term — Costs to remain broadly flat over the next 3 years
CET1 capital ratio	>16%	20.1% ✓	19.2% ✓	20.1% ✓	— Based on current regulatory requirements and management buffer of 50-200bps, the CET1 target range is currently 13.2-14.7% — Assuming that the countercyclical buffer increases from 0% to 2% — **The Bank will start paying out a part of its excess capital in parallel with its ordinary dividend payable for the FY 2021 – the amount to be decided at that time**
Total capital ratio	18.3-19.8%	22.9% ✓	21.9% ✓	23.0% ✓	— Based on current regulatory requirements and management buffer of 50-200bps — Long term target range is 19.5-21.0%, assuming that the countercyclical buffer increases from 0% to 2% and the COVID-19 effects on the Pillar 2-R requirements is reversed — **The Bank will issue an AT1 instrument over the course of next 6-18 months, given favourable market conditions (including tax deductibility of such instruments)**
Dividend payout ratio	c. 50%			50% ✓	— Target for annual regular dividend — Excess capital to support further dividend payments, buybacks, and/or ROE enhancing growth — Additional capital return to approach capital targets over the medium term

1. ROE excluding one-off cost is 12.6% for 2Q21, one-off cost for 2Q21 is 627m. 2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). IPO costs in 1Q21 were not adjusted for in the 1Q21 results presentation.

2. Income statement

Significant increase in total operating income YoY

Economic recovery yields positive net impairment on financial assets

Highlights

- Strong quarter delivering ROE at 11.6% following a 7.7% ROE in 1Q21. ROE excluding one-off cost is 12.6% in 2Q21 and 10.2% in 1H21
- NIM remains stable at 2.4%
- The Bank focuses on core banking operations with NII and NFCI accounting for around 93% of income in 2Q21
- 14% increase in total operating income YoY
- Cost-to-income improves from 1Q21 and is 49.9% in 2Q21
- One-off IPO cost of ISK 588m in 2Q21 and 663m in 1H21. Excluding one-off cost admin expenses were level with 2Q20
- Annualised cost of risk was -0.42% in 2Q21 and -0.12% in 1H21, compared to 0.91% for the full year 2020. The average cost of risk in 2019 and 2020 excluding the effect of COVID-19 was 0.35%
- The positive net impairment in 2Q21 is mostly due to the brightening outlook for the tourism industry
- Lower effective tax rate due to tax treatment of equity forwards

Income statement, ISKm	2Q21	2Q20	Δ	Δ%	1H21	1H20	Δ	Δ%	2020
Net interest income	**8,417**	8,228	189	2.3%	**16,607**	16,808	(201)	(1.2%)	33,371
Net fee and commission income	**2,907**	2,307	600	26.0%	**5,769**	4,798	971	20.2%	10,525
Net financial income (expense)	**619**	(181)	800	-	**912**	(1,919)	2,831	-	(1,391)
Net foreign exchange gain	**95**	208	(113)	(54.3%)	**225**	263	(38)	(14.4%)	451
Other operating income	**82**	71	11	15.5%	**204**	90	114	126.7%	197
Total operating income	**12,120**	10,633	1,487	14.0%	**23,717**	20,040	3,677	18.3%	43,153
Salaries and related expenses	**(3,594)**	(3,447)	(147)	4.3%	**(7,168)**	(6,694)	(474)	7.1%	(12,917)
Other operating expenses	**(2,894)**	(2,424)	(470)	19.4%	**(5,172)**	(4,869)	(303)	6.2%	(9,829)
Administrative expenses	**(6,488)**	(5,871)	(617)	10.5%	**(12,340)**	(11,563)	(777)	6.7%	(22,746)
Contribution to the Depositor's and Investors' Guarantee Fund	**(162)**	(247)	85	(34.4%)	**(344)**	(475)	131	(27.6%)	(679)
Bank tax	**(451)**	(399)	(52)	13.0%	**(861)**	(758)	(103)	13.6%	(1,588)
Total operating expenses	**(7,101)**	(6,517)	(584)	9.0%	**(13,545)**	(12,796)	(749)	5.9%	(25,013)
Profit before net impairment on financial assets	**5,019**	4,116	903	21.9%	**10,172**	7,244	2,928	40.4%	18,140
Net impairment on financial assets	**1,140**	(2,439)	3,579	-	**622**	(5,929)	6,551	-	(8,816)
Profit before tax	**6,159**	1,677	4,482	267.3%	**10,794**	1,315	9,479	720.8%	9,324
Income tax expense	**(769)**	(119)	(650)	546.2%	**(1,805)**	(888)	(917)	103.3%	(2,472)
Profit for the period from continuing operations	**5,390**	1,558	3,832	246.0%	**8,989**	427	8,562	2,005.2%	6,852
Discontinued operations held for sale, net of income tax	**41**	(313)	354	-	**57**	(558)	615	-	(97)
Profit (loss) for the period	**5,431**	**1,245**	**4,186**	**336.2%**	**9,046**	**(131)**	**9,177**	**-**	**6,755**

Key ratios

	2Q21	2Q20	1H21	1H20	2020
Net Interest Margin (NIM)	**2.4%**	2.6%	**2.4%**	2.7%	2.6%
Cost-to-income ratio (C/I)[1]	**49.9%**	57.5%	**50.6%**	60.1%	54.3%
Return on Equity (ROE)	**11.6%**	2.8%	**9.7%**	(0.1%)	3.7%
Cost of risk (COR)	**(0.42%)**	1.03%	**(0.12%)**	1.28%	0.91%

1. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).

Increase in net profit YoY

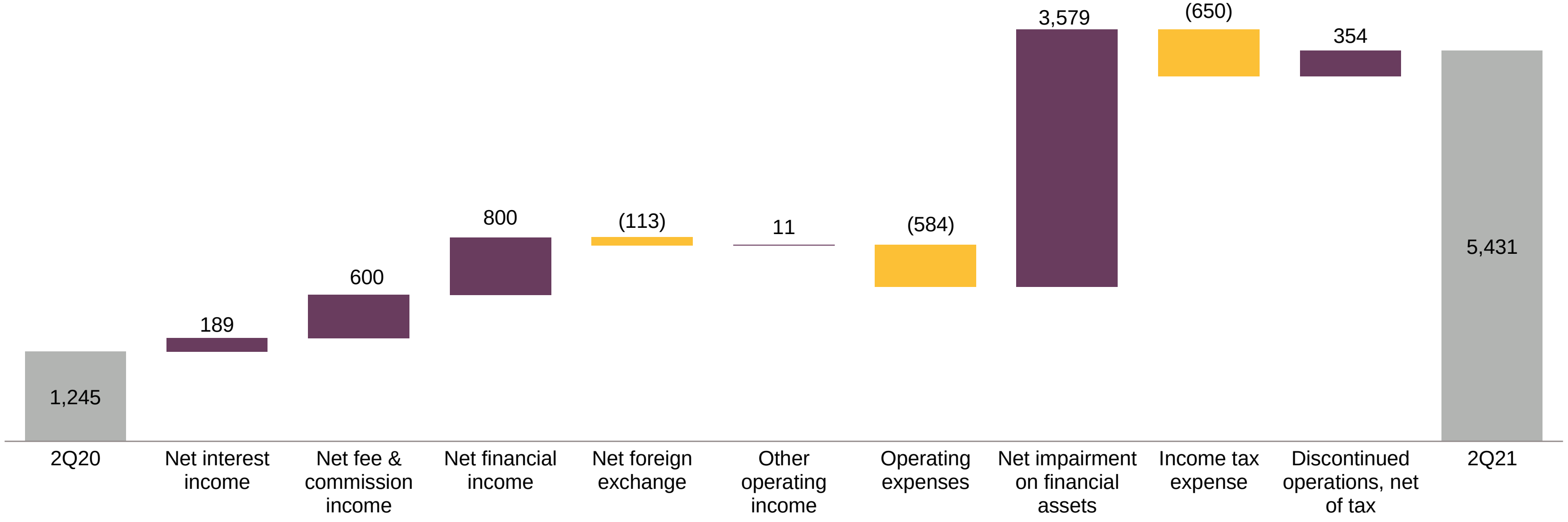
Positive impairments and net financial income have positive impact on 2Q21 net profit

Highlights

- Net fee and commission income increases YoY for all business segments and subsidiaries
- Net financial income shifting from loss of ISK 181m in 2Q20 to income of ISK 619m in 2Q21 as domestic equity market is showing strong performance
- Increase in operating expenses is mainly explained by one-off costs (ISK 588m) related to the Bank´s IPO
- Positive net impairments on financial assets is mostly due to more favourable outlook in the tourism industry

Net profit development 2Q20 vs. 2Q21

ISKm



NII and NIM have shown resilience despite lower base rate

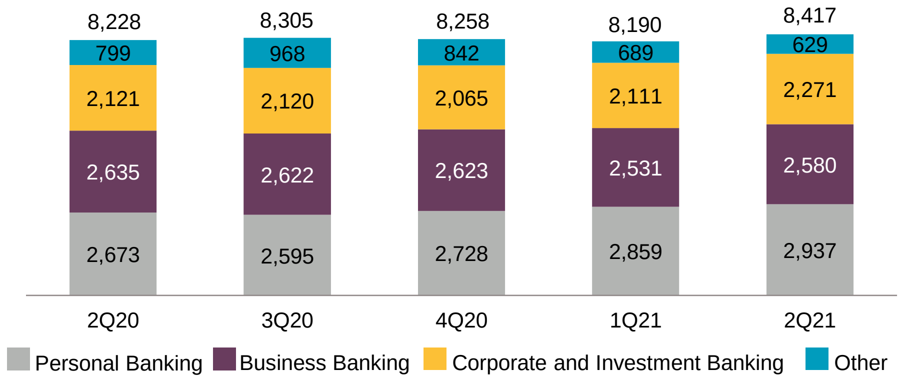
Lending volume offsetting pressure on deposit NIM

Highlights

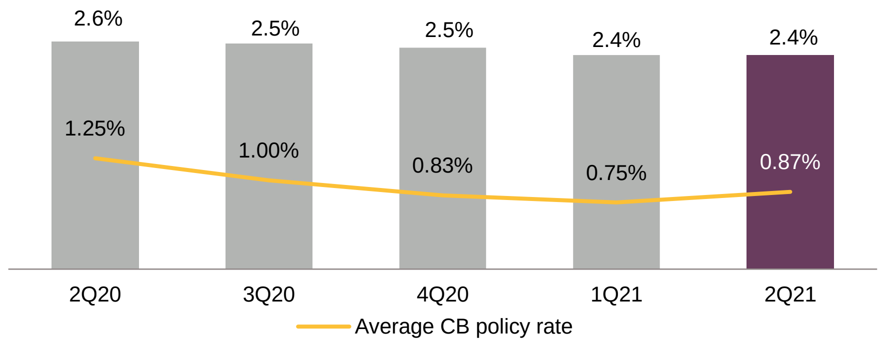
- Net interest margin on total assets was relatively stable at 2.4% in 2Q21 despite lower interest rate environment
- Net interest margin on loans remained 2.2% in 2Q21 as net interest margin for deposits decreased to 1.1% in 2Q21
- Average CB policy rate is 0.87% compared to 1.25 in 2Q20
- NII grew 2.3% YoY, the NII trend demonstrates the resilience of the loan book
- NII grew YoY in Personal Banking due to strong growth in the mortgage loan book, offsetting the pressure on NIM

Net interest income

Business segments, ISKm

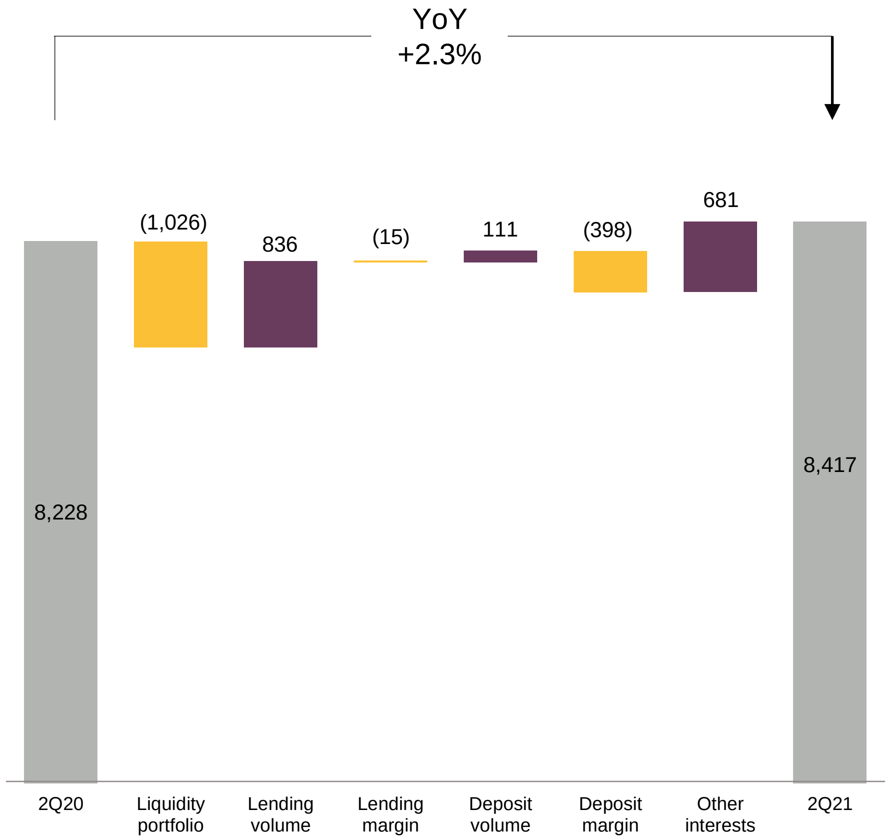


Net interest margin



NII – Comparison 2Q YoY

ISKm



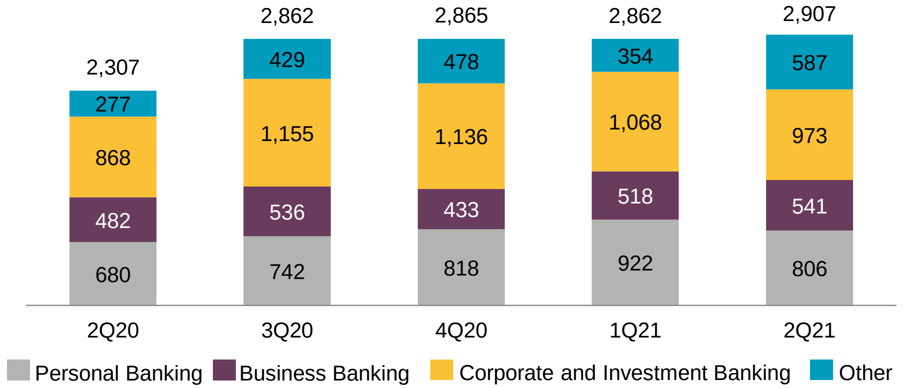
Diversified sources of NFCI

26% increase YoY distributed across business segments

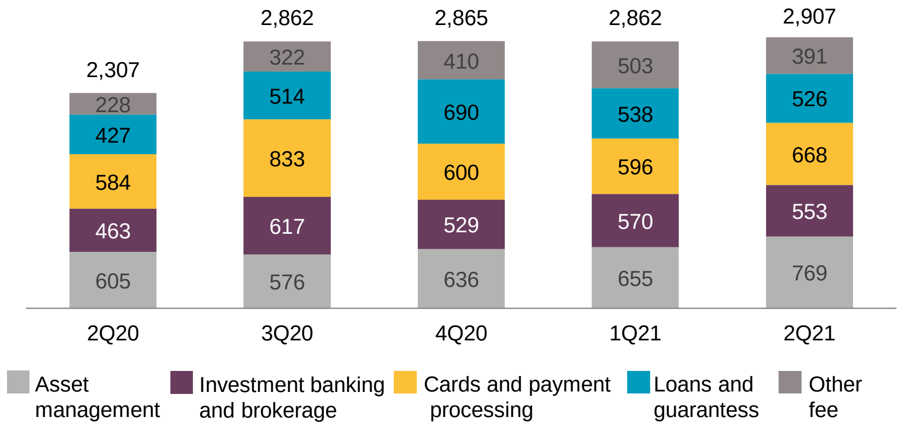
Highlights

- YoY increase in net fee and commission income YoY is well distributed across business units
- Increase in asset management due to strong inflows into equity funds, balanced funds and asset portfolios, as well as performance related fees
- Net income in investment banking and brokerage grew by ISK 90m
- Continuous growth in the Bank's loan portfolio explains the increase in fees from loans and guarantees

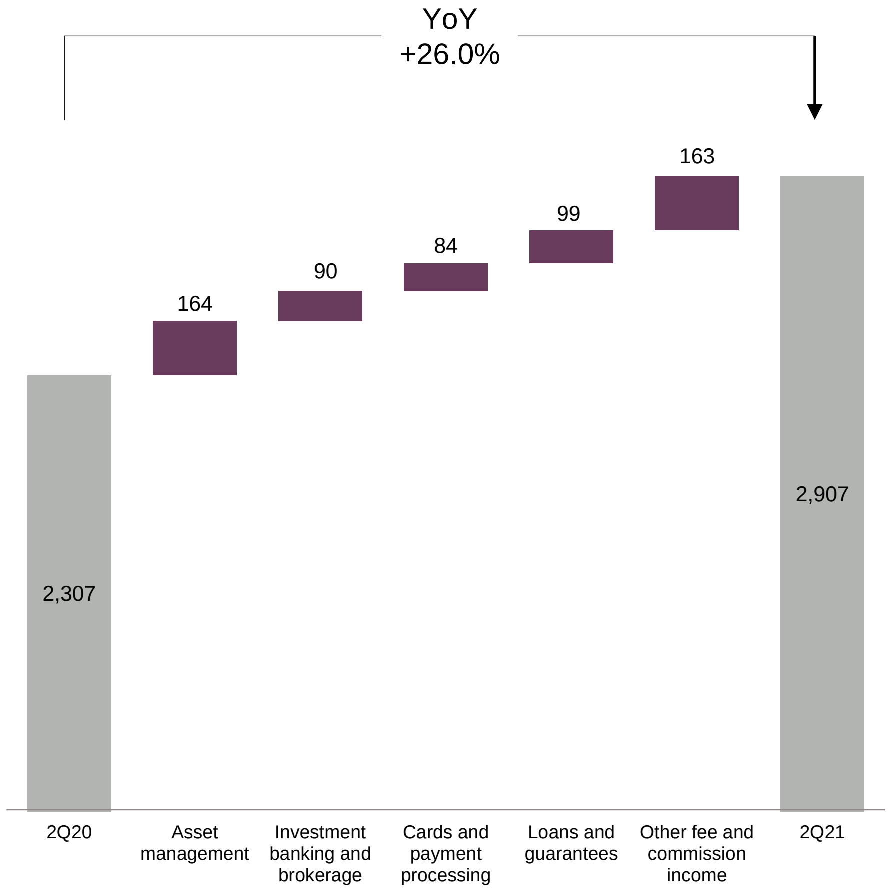
Net fee and commission income
Business segments, ISKm



Net fee and commission income
By type, ISKm



NFCI – Comparison 2Q YoY
ISKm



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Positive turnaround in net financial income

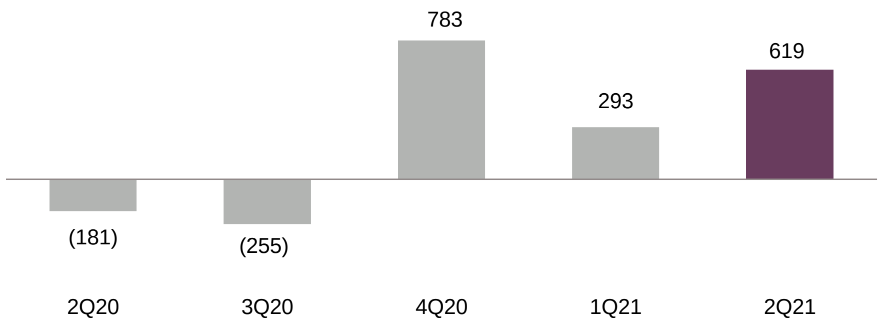
Strong domestic equity market performance in the quarter

Highlights

- Net financial income in 2Q21 is mainly driven by income from shares and equity instruments
- The domestic equity market index rose by 21% in 1H21
- Low interest rates, good operating results and the opening of the economy all contributed to higher equity prices
- Approximately ISK 900m of listed shares are assets in domestic bond funds

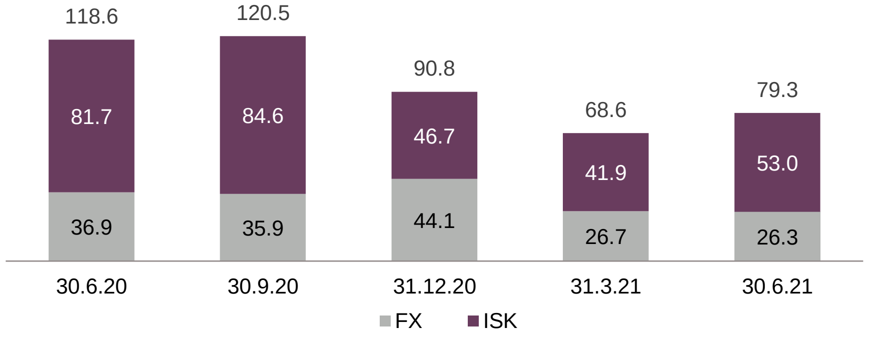
Net financial income (expense)

ISKm



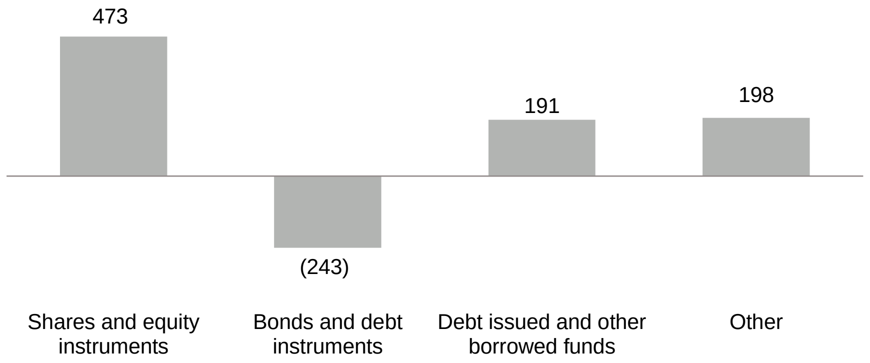
Bonds and debt instruments[1]

ISKbn



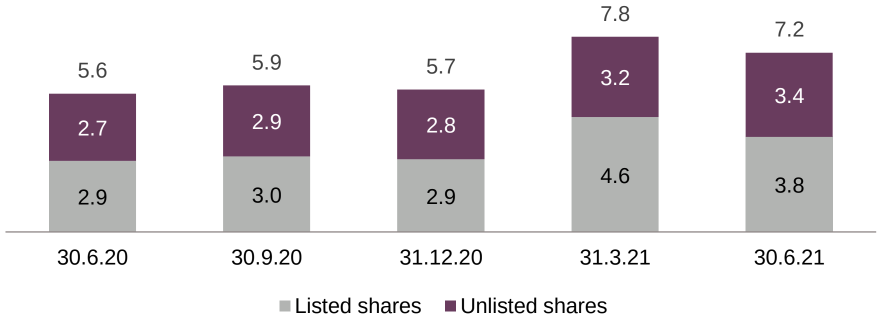
Net financial income by type in 2Q21

ISKm



Shares and equity instruments[2]

ISKbn



1. Excluding listed bonds and debt instruments used for economic hedging 2. Excluding listed shares and equity instruments used for economic hedging

Substantial YoY reduction in C/I ratio

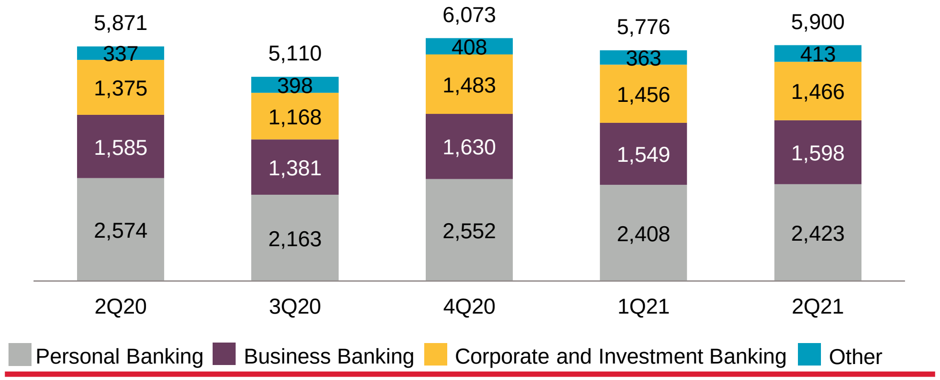
Strong historical track record of real cost savings

Highlights

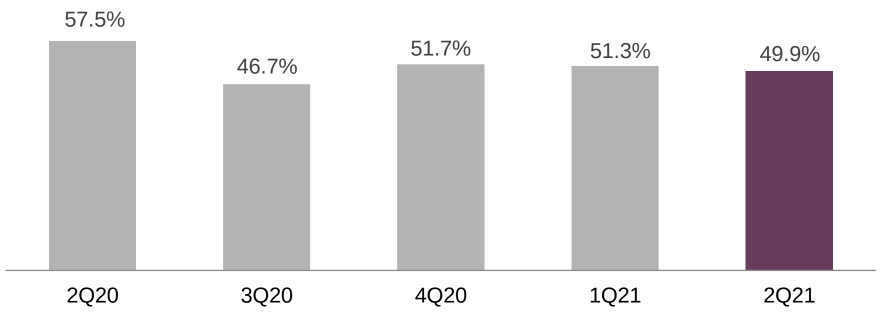
- Depreciation was lower in 2Q21 than in 2Q20 mainly as a result of higher depreciation of assets in 2Q20 due to closing of one of the Bank's branches
- Cost-to-income ratio was 49.9% in 2Q21 and is 50.6% for 1H21
- Excluding one-off cost, the Bank saw approximately 4% real reduction in YoY costs in 2Q21

Administrative expenses[1]

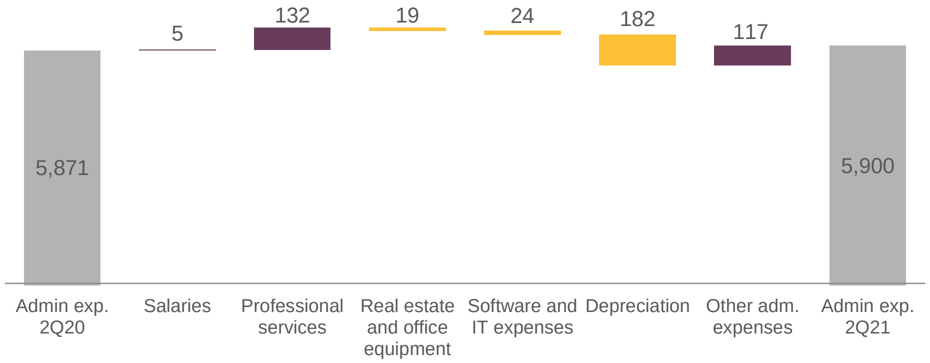
ISKm



Cost-to-income ratio[2,3]

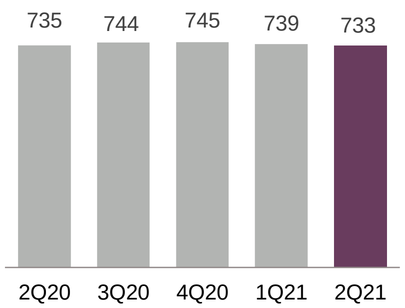


Administrative expenses – comparison 2Q YoY[1]



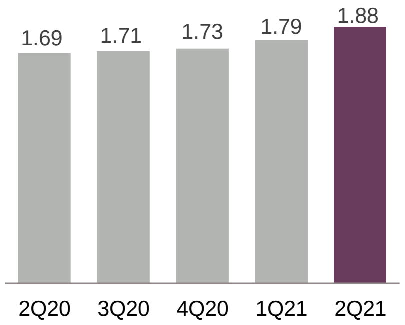
Period end FTE numbers[4]

Parent company



Total assets / FTE[4]

ISKbn



1. Administrative expenses in 1Q21 and 2Q21 are excluding one-off cost related to the Bank's IPO, 76m in 1Q21 and 588m in 2Q21. 2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items). 3. IPO costs in 1Q21 were not adjusted for in the 1Q21 results presentation. 4. FTE numbers exclude seasonal employees.

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3. Balance sheet

Balance sheet reflects balanced loan and funding profile

Broad product offering, strong liquidity portfolio and stable funding

Assets

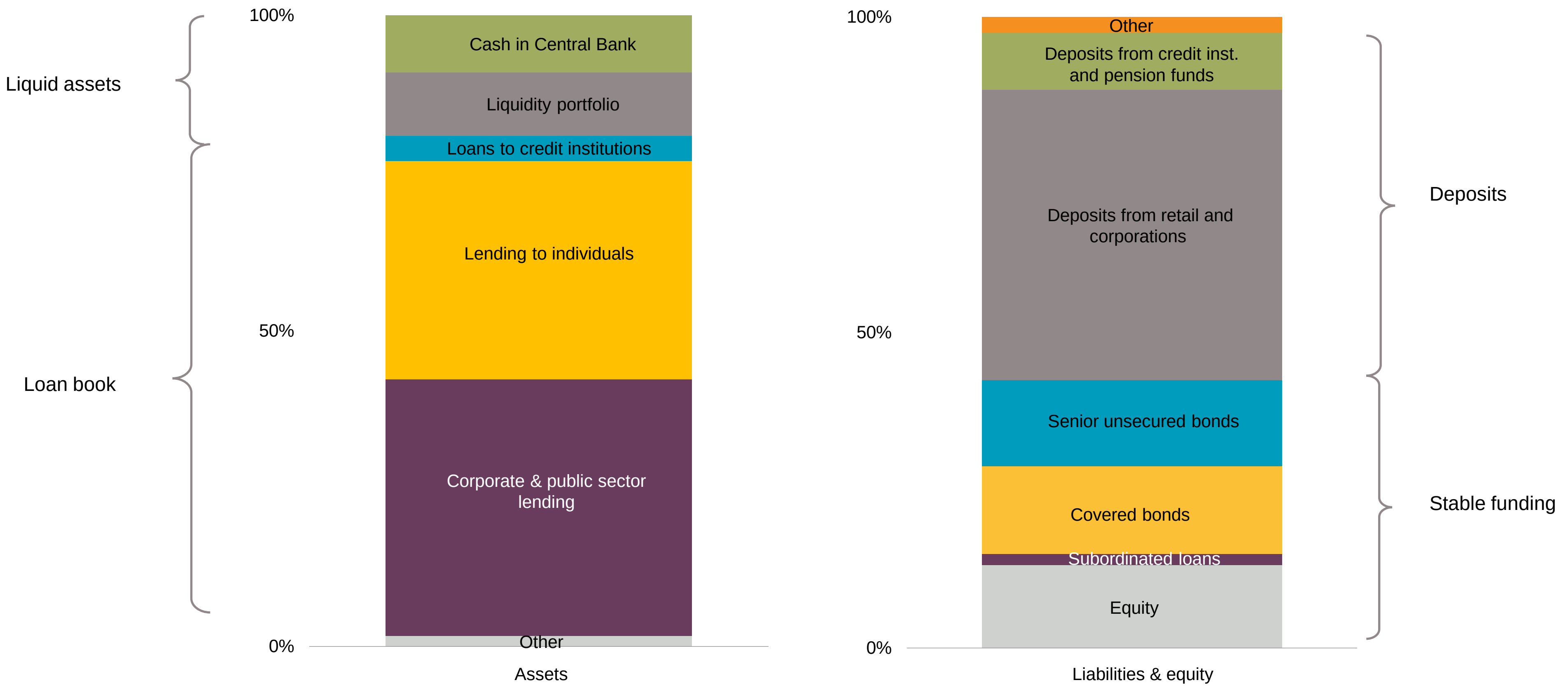
- Vast majority of assets consist of lending to both individuals and corporates
- Strong liquidity portfolio is a consistent factor in balance sheet management
- Very limited exposure to non-liquid or non-lending assets

Liabilities

- Deposits from retail and corporations are the single largest funding source
- Bonds and debt instruments have become a more prominent part of the funding mix thanks to continuous focus on attracting new pockets of demand (including foreign currency and ESG issuance)

Simplified balance sheet structure

30.6.2021, ISK 1,447bn



Growth in total assets

6% growth in loans to customers in 2Q21 driven by mortgages

Highlights

- Four line items:
  - cash and balances with the Central Bank
  - loans to credit institutions
  - bonds and debt instruments, and
  - shares and equity instruments,

  amounted to about ISK 331bn of which ISK 312bn are liquid assets
- Loans to customers grew by 5.9% in 2Q21, with ISK 29bn growth in mortgages
- Increase in shares and equity instruments are due to growth in equity forwards
- The Bank's assets encumbrance ratio was 18.9% at the end of 2Q21 compared to 18.3% at the end of March

Assets, ISKm	30.6.21	31.3.21	Δ	Δ%	31.12.20	Δ	Δ%
Cash and balances with Central Bank	**130,968**	88,748	42,220	47.6%	78,948	52,020	65.9%
Loans to credit institutions	**57,793**	103,333	(45,540)	(44.1%)	89,920	(32,127)	(35.7%)
Bonds and debt instruments	**110,499**	103,627	6,872	6.6%	128,216	(17,717)	(13.8%)
Derivatives	**2,649**	2,536	113	4.5%	6,647	(3,998)	(60.1%)
Loans to customers	**1,089,723**	1,029,415	60,308	5.9%	1,006,717	83,006	8.2%
Shares and equity instruments	**31,751**	25,763	5,988	23.2%	14,851	16,900	113.8%
Investment in associates	**911**	841	70	8.3%	775	136	17.5%
Property and equipment	**7,246**	7,191	55	0.8%	7,341	(95)	(1.3%)
Intangible assets	**3,307**	3,357	(50)	(1.5%)	3,478	(171)	(4.9%)
Other assets	**10,474**	17,566	(7,092)	(40.4%)	4,125	6,349	153.9%
Non-current assets and disposal groups held for sale	**1,539**	2,858	(1,319)	(46.2%)	3,173	(1,634)	(51.5%)
Total Assets	**1,446,860**	**1,385,235**	**61,625**	**4.4%**	**1,344,191**	**102,669**	**7.6%**

Key ratios

Risk Exposure Amount (REA)	**924,375**	954,712	(30,337)	(3.2%)	933,521	(9,146)	(1.0%)
Non-performing loans (NPL) ratio[1]	**2.1%**	2.4%			2.9%		
Asset encumbrance ratio	**18.9%**	18.3%			18.7%		

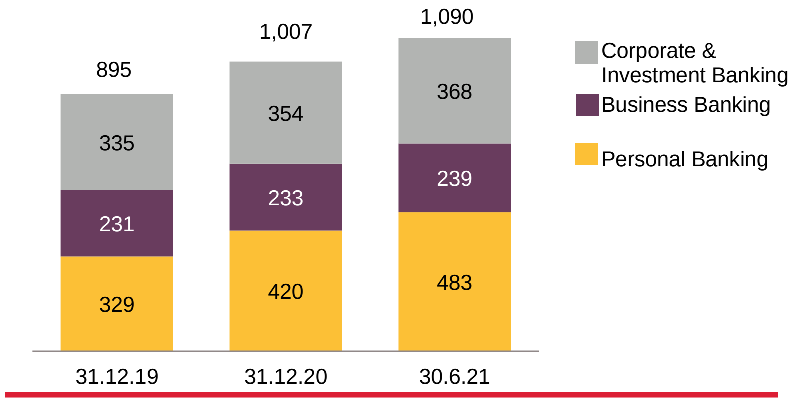
1. Stage 3, loans to customers, gross carrying amount

Diversified and highly collateralised loan portfolio

Loans to individuals are 46% of loans to customers, mainly residential mortgages

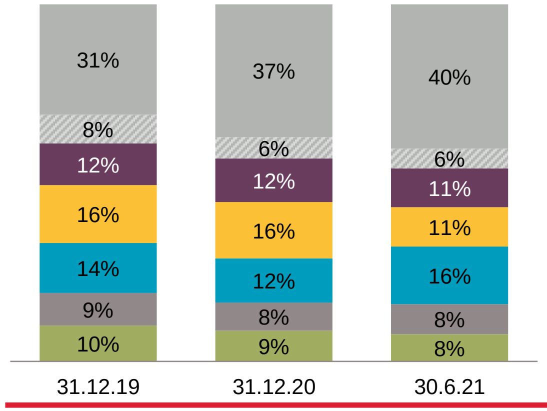
Loans to customers

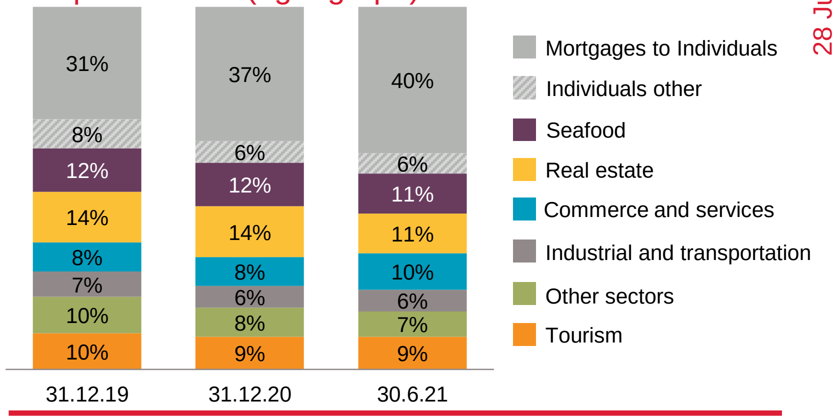
By business division, ISKbn



Loans to customers

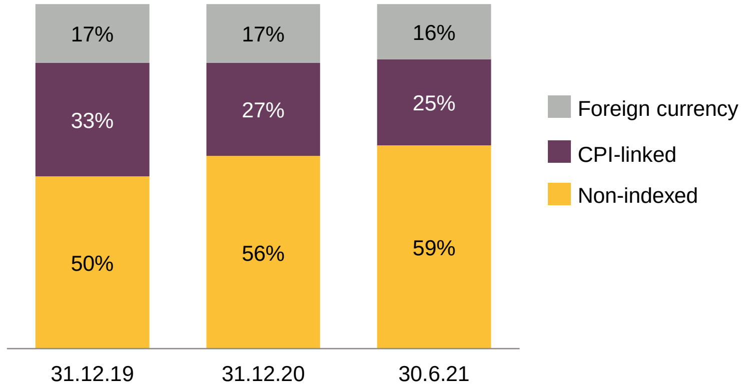
By sector, standard sectors (left graph) and with tourism as a quasi-sector (right graph)





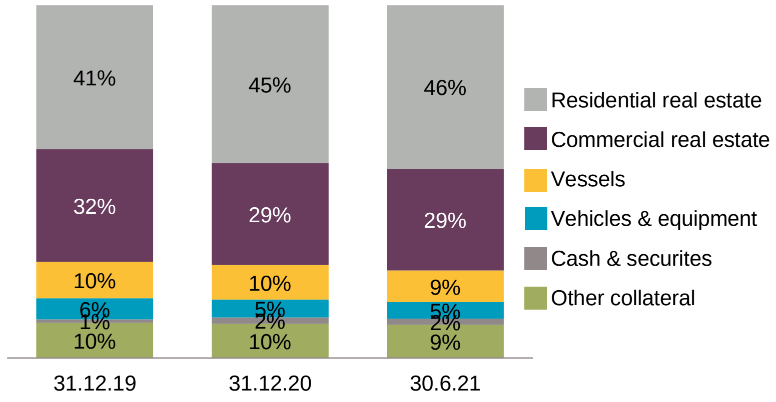
Loans to customers

By currency type



Credit exposure covered by collateral: ISK 1,046bn

By collateral type



Comments

- The sector classification is generally based on information from the tax authorities although the Bank has the possibility to reclassify customers internally based on a “see-trough principle” when another sector is more descriptive of the underlying risk
- In the case of real estate companies, this can be appropriate if the real estate is specialised and the credit risk depends more on the operations located in the building than general real estate or rental prices
- In 2Q21 around ISK40bn was reclassified from Real estate, mostly to Commerce & services (hotel buildings) and Industrial & transportations. The result is visible in the centre graph above

LTV distributions point to healthy coverage ratios

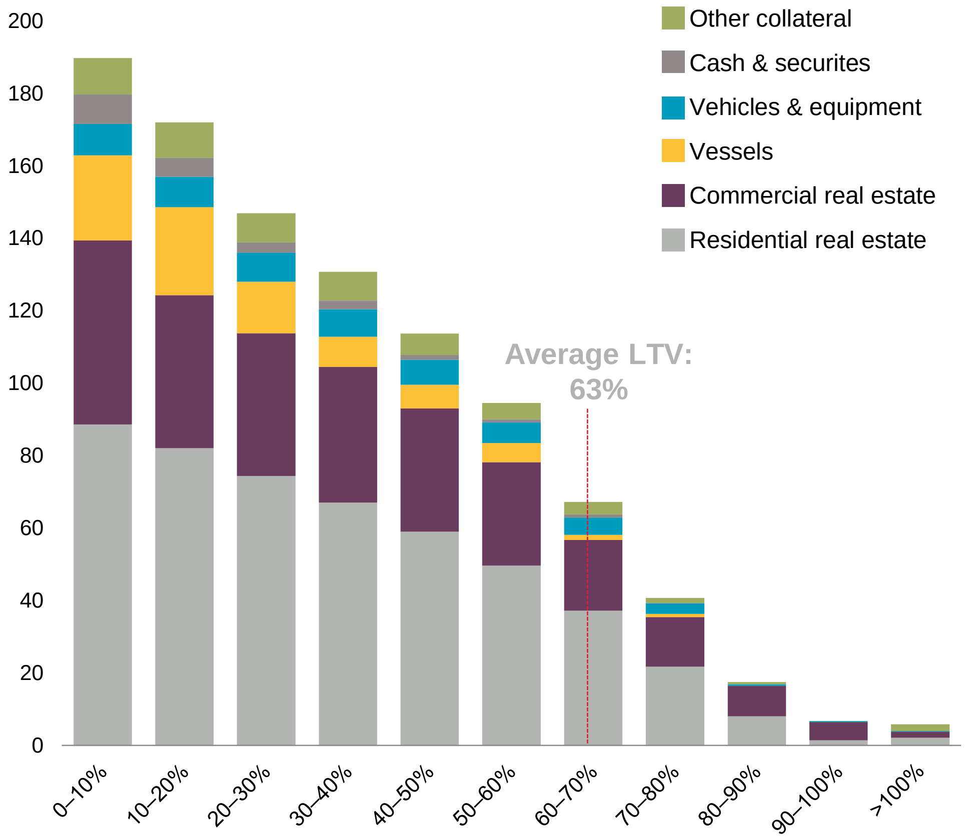
Majority of collateral is in residential and commercial real estate

Highlights

- The weighted average LTV for mortgages[1] was 66% at end of Q2, compared to 64% at year-end 2020. Increase in LTV due to strong new loan origination, where new mortgages are often at close to 80% LTV
- The LTV distribution for commercial real estate is shown for the industry sectors where this is the most important collateral type: real estate, commerce & services and industrials & transportation
- Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability
- Íslandsbanki's registered value of commercial real estate is less vulnerable to market fluctuations as collateral valuation has risen at a much slower rate and lagged market prices in prior years

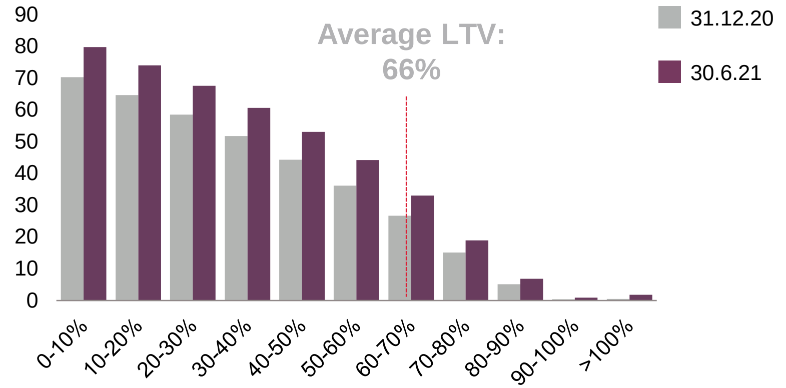
LTV distribution by underlying asset class

30.6.2021, loan splitting approach, ISKbn



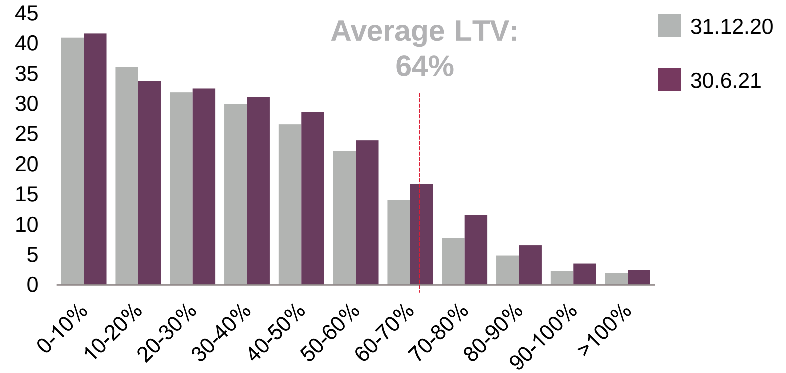
LTV distribution of mortgages to individuals

Loan splitting approach, ISKbn



LTV distribution of loans secured by commercial real estate

Loan splitting approach, ISKbn



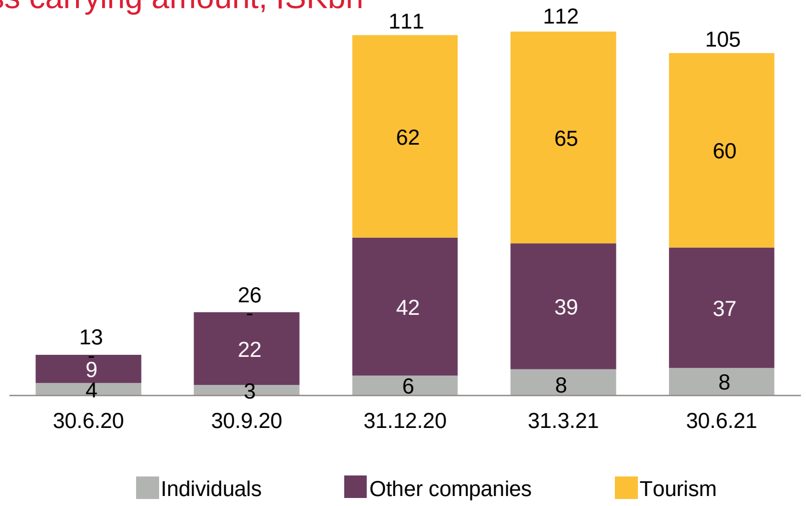
1. The average LTV can be calculated in different ways and therefore the definition is important for comparison to other banks. For mortgages to individuals, the weight is Íslandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Íslandsbanki's loans of the property. See more in the Pillar 3 Report. For other portfolios with more complex collateral agreements a generalised method is used.

COVID-19 moratoria over, more clarity on forbearance

Temporary moratorium uniformly executed and broadly applied during 2020 providing shelter for customers as they weathered the storm. Payments have resumed for 62% of loans in forbearance

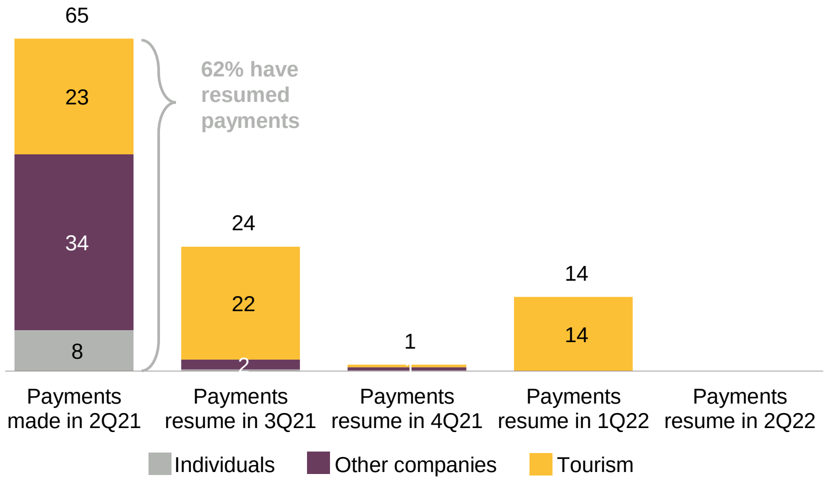
Performing loans with forbearance

Gross carrying amount, ISKbn



Indication on when payments resume after moratorium

Gross carrying amount, ISKbn



Further extension of moratorium

- The forbearance increase at end of 2020 was mostly due to extension of COVID-19 moratoria to companies in the tourism sector
- Loans that have been granted extended moratoria are primarily with collateral in residential or commercial real estate
- The definition of forbearance includes a 24-month probation period and therefore loans are classified with forbearance even after normal payments have resumed
- The fall in performing loans with forbearance is due to loans that are fully repaid

Clarity on when payments are expected to resume

- Loans amounting to ISK 105bn are classified as performing with forbearance, but ISK 65bn have already begun regular payments or 62%
- Performing loans with forbearance that have not yet started regular payments are almost exclusively in the tourism industry
- According to current schedule, additional ISK 24bn should resume regular payments again in the next quarter
- Note that some customers might request further extension of moratoria when the current moratoria expires

Impairment allowance sufficient, uncertainty accounted for

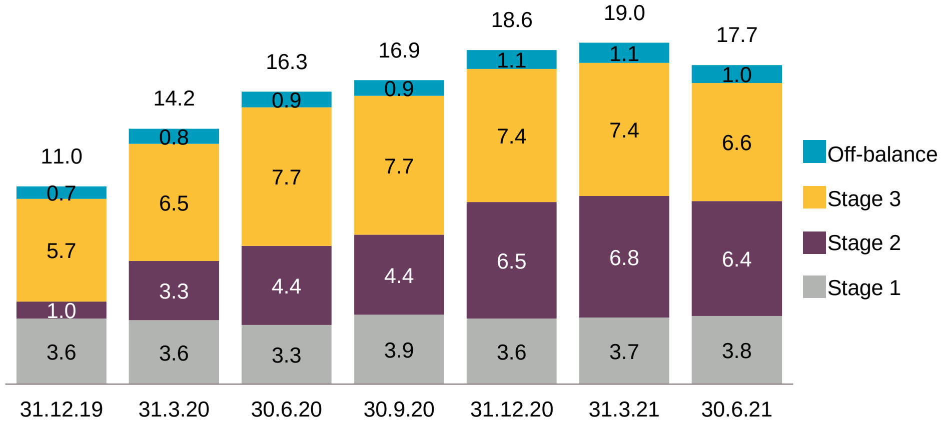
Exposures in Stage 2 rose due to the COVID-19 pandemic, but Stage 3 has decreased

Highlights

- The distribution in risk classes and strong collateral ensures a modest credit risk profile
- The impairment allowance account has risen by ISK 6.6bn since beginning of COVID-19 due to uncertainty, but the loss has not been, and might not be, realised
- The fall in Stage 2 is mostly due to repayments
- The share of credit-impaired loans to customers was only 2.1% (gross) down from 2.9% at year-end, following full repayments of exposures in Stage 3
- The reserve coverage ratio (RCR) in Stage 3 was 11.8% for individuals, similar to year-end. The low percentage is explained by good collateral coverage and high cure rate
- The RCR for companies was 34.1% at end of June, an increase from 29.8% at year-end
- The collateral coverage in Stage 3 was around 66% (ISK 15bn) at the end of June

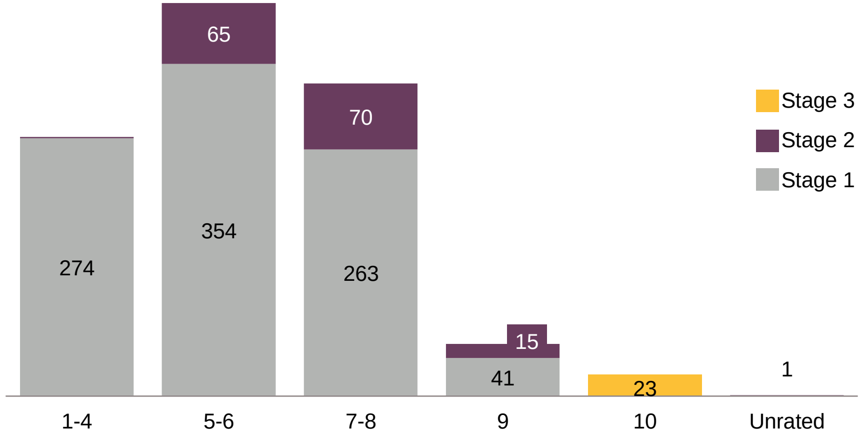
Loans to customers & off-balance sheet items

Impairment allowance account, ISKbn



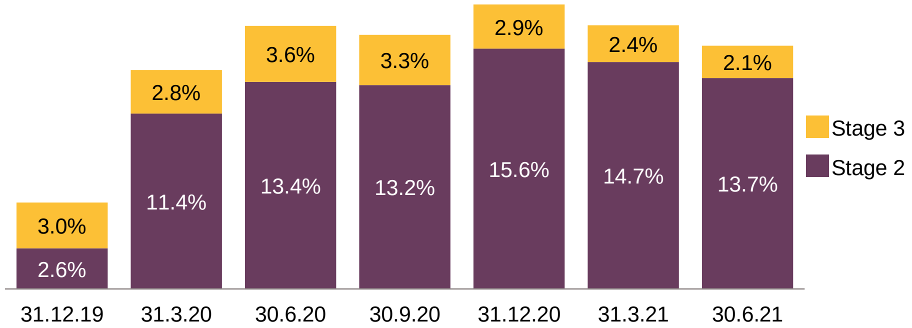
Loans to customers: gross carrying amount

30.06.2021, risk class and impairment stage, ISKbn



Loans to customers: Stage 2 and 3

Development of gross carrying amount as ratio of total loans



Loans to customers: credit quality

30.06.2021, Break-down of loans to customers

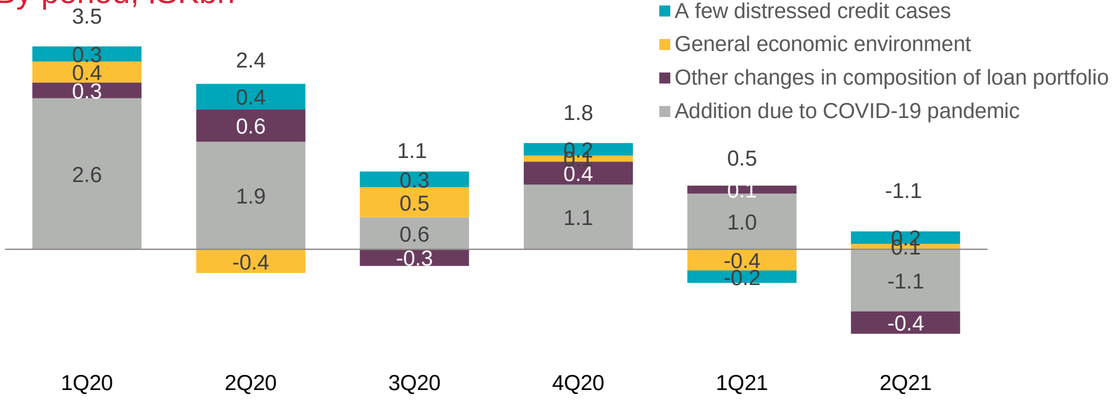
	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISKbn)	% of total	(ISKbn)	RCR	(ISKbn)	% of total
Stage 1	932	84,2%	3,8	0,4%	928	85,2%
Stage 2	151	13,7%	6,4	4,2%	145	13,3%
Stage 3	23	2,1%	6,6	28,5%	16	1,5%
Total	**1.106**	**100,0%**	**16,7**	**1,5%**	**1.090**	**100,0%**

Majority of net impairments are COVID-19 related

Tourism sector hit hard and fully in Stage 2, overlay factors to account for uncertainty

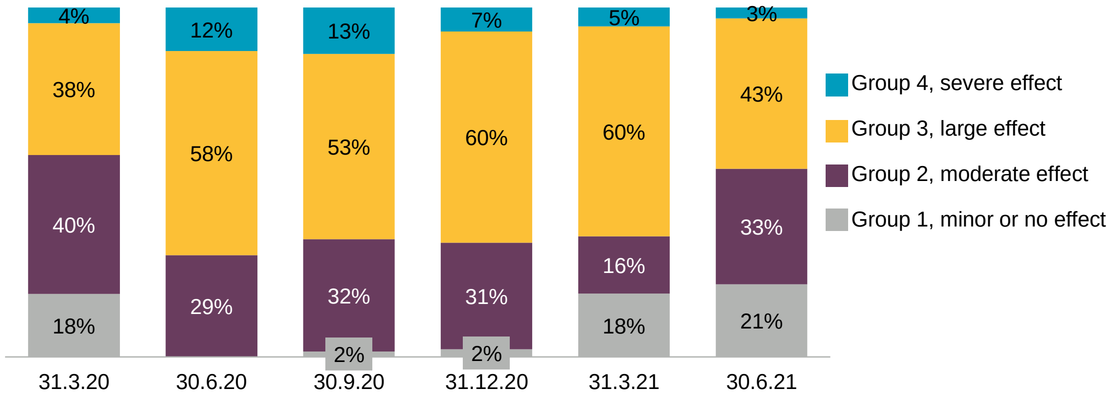
Net impairment on financial assets

By period, ISKbn



Exposure to tourism by effect of COVID-19 crisis

A proportion of approximately ISK 100bn



Macroeconomic scenario applied to IFRS 9 model[1]

Baseline forecast assumes 700 thousand tourists in 2021

Change in economic indicators %	2020	2021	2022	2023	2024
Economic growth	(6.6)	2.7	4.9	2.9	2.8
Housing prices in Iceland	6.4	11.3	6.7	4.4	3.5
Purchasing power	3.5	4.0	1.9	1.5	1.6
ISK exchange rate index	11.1	(3.2)	(4.7)	(1.3)	0.0
Policy rate, Central Bank of Iceland	1.5	1.0	1.8	2.8	3.3
Inflation	2.8	4.1	2.6	2.4	2.5
Capital formation	(6.8)	1.9	4.8	5.9	3.5
thereof capital formation in industry	(8.7)	2.7	8.4	5.5	3.0

1. The table shows the assumptions used in the forward-looking IFRS 9 model, figures for 2020 were estimates while the other years are based on forecast.

Highlights

- Annualised cost of risk was -0.42% in 2Q21 and -0.12% in 1H21, compared to +0.91% for the full year 2020 and 1.03% for 2Q20. The average cost of risk in 2019 and 2020 excluding the effect of COVID-19 amounts to 0.35%
- The positive net impairment in 2Q21 is mostly due to a brighter outlook for the tourism industry, reflected both in a shift from impact group 3 to group 2 and in the weights of scenarios
- The impairment model of IFRS 9 is forward-looking and reflects a probability weighted average of possible outcomes. In addition to the baseline forecast, scaling factors are produced for an optimistic and pessimistic case
- The probability weights of the scenarios were set to 15% (good), 50% (baseline), and 35% (bad) at end of 2Q, effectively shifting 5% from baseline to good compared to end of 1Q
- A shift of 5% weight from the baseline to the pessimistic scenario would increase the impairment allowance by ISK 0.75bn while a 5% shift from the baseline to the optimistic scenario would decrease the allowance by ISK 0.25bn

Diversified funding base

Deposits largest source of funding

Highlights

- Deposits from customers grew by 12.7% from year-end and 67bn in the quarter, of which large part is linked to the settlement of the Bank's IPO and thus temporary
- Deposits from retail and corporations are the Bank's main source of funding, comprising 46% of the Bank's total funding sources and 83% of the Bank's total deposit base at period end

Liabilities & Equity, ISKm	30.6.21	31.3.21	Δ	Δ%	31.12.20	Δ	Δ%
Deposits from Central Bank and credit institutions	**32,240**	31,565	675	2.1%	39,758	(7,518)	(18.9%)
Deposits from customers	**765,614**	698,575	67,039	9.6%	679,455	86,159	12.7%
Derivative instruments and short positions	**10,079**	9,533	546	5.7%	6,936	3,143	45.3%
Debt issued and other borrowed funds	**398,786**	398,225	561	0.1%	387,274	11,512	3.0%
Subordinated loans	**25,297**	25,259	38	0.2%	27,194	(1,897)	(7.0%)
Tax liabilities	**6,025**	5,947	78	1.3%	5,450	575	10.6%
Other liabilities	**18,464**	30,660	(12,196)	(39.8%)	11,920	6,544	54.9%
Total Liabilities	**1,256,505**	1,199,764	56,741	4.7%	1,157,987	98,518	8.5%
Total Equity	**190,355**	185,471	4,884	2.6%	186,204	4,151	2.2%
Total Liabilities and Equity	**1,446,860**	**1,385,235**	**61,625**	**4.4%**	**1,344,191**	**102,669**	**7.6%**

Key ratios

Key ratios	30.6.21	31.3.21	31.12.20
Customer loans to customer deposits ratio	**142%**	147%	148%
REA/total assets	**63.9%**	68.9%	69.4%
Liquidity coverage ratio (LCR)	**187%**	172%	196%
Net stable funding ratio (NSFR)	**122%**	119%	123%
Total capital ratio	**22.9%**	21.9%	23.0%
Tier 1 capital ratio	**20.1%**	19.2%	20.1%
Leverage ratio	**12.4%**	12.6%	13.6%

Stable deposits remain the main source of funding

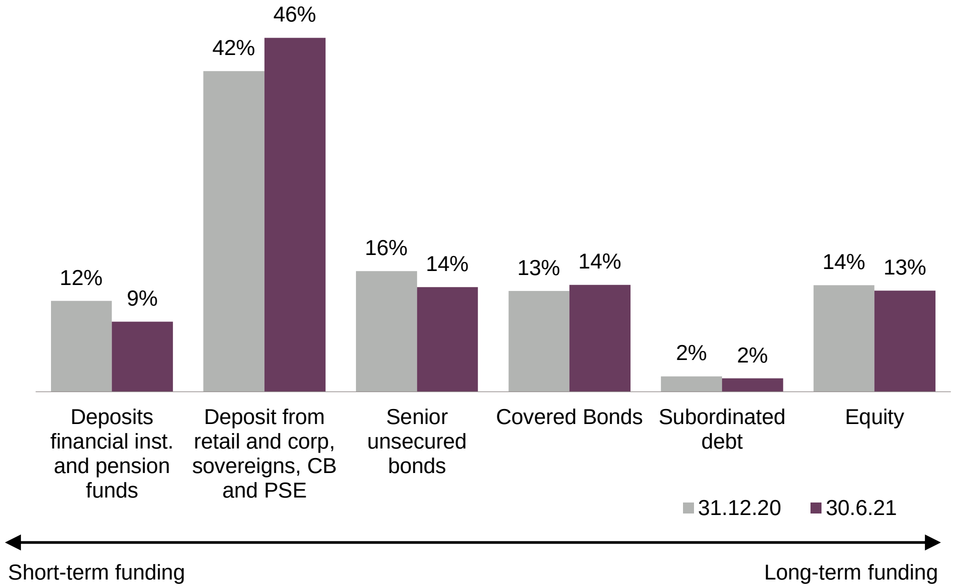
Long term funding sources grew steadily during the year

Highlights

- Total increase in deposits amounted to ISK 79bn in 1H21
- A substantial part of the increase in Corporations and sovereigns (ISK 55bn) is due the settlement of the ISB IPO
- Term deposit are 20% of total deposits
- Deposit concentration is stable. 19% of the Bank's deposits belonged to the 10 largest depositors and 34% to the 100 largest depositors at 1Q21, compared to 15% and 30% respectively at 1Q21
- On 30.6.2021, 79% of deposits were in non-indexed ISK, 11% CPI-linked and 10% in foreign currencies

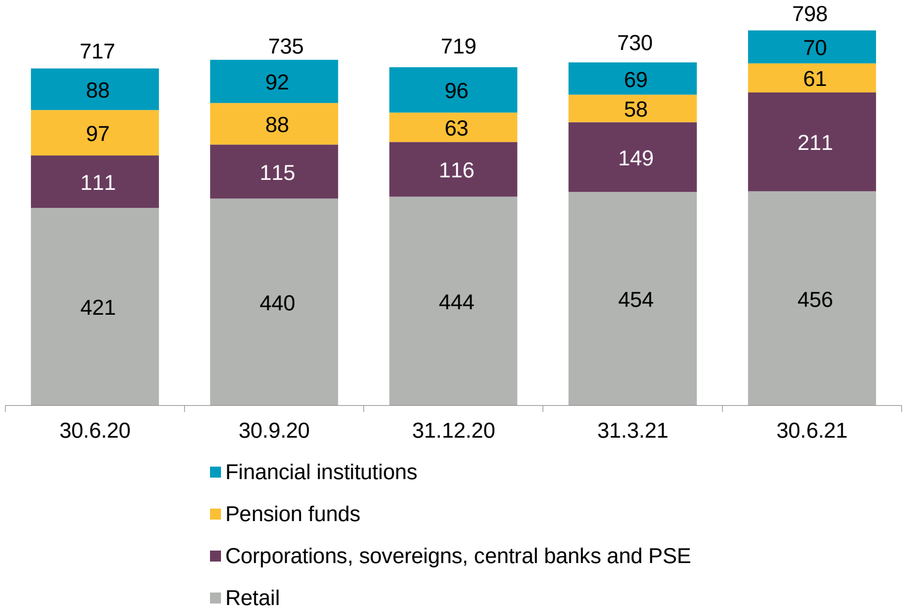
Funding sources

By type, % of total liabilities and equity



Deposits from customers and credit institutions

Development, by LCR category, ISKbn



Seasoned and diversified long-term funding programme

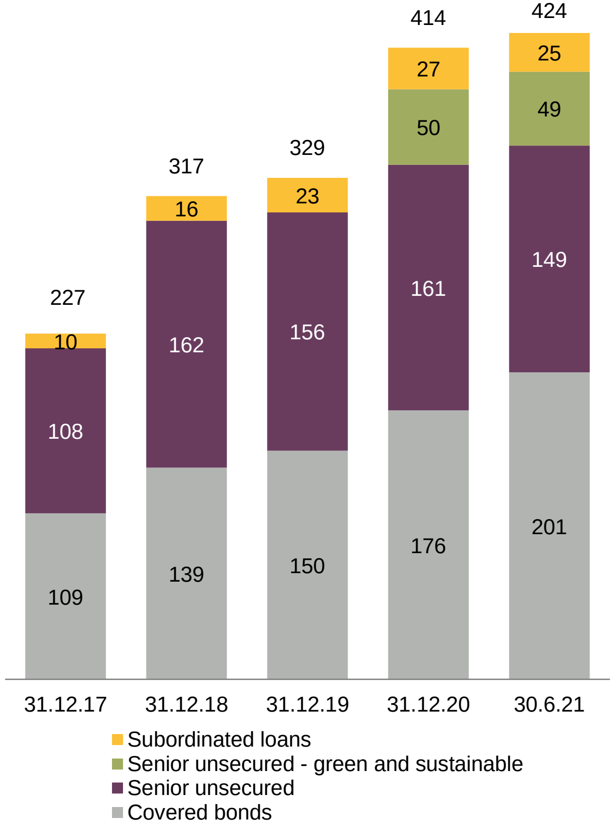
Recent issues demonstrate the depth of the available investor pool for targeted issues

Highlights

- The Bank's funding model is designed in a straightforward way to:
  - Limit refinancing and liquidity risks
  - Optimise cost of funding and use of proceeds
- Credit spreads continued to compress globally, and the Bank saw an opportunity to print two transactions in late June. Firstly, a SEK 200 million floating rate note (FRN) and a NOK 475 million FRN
- The Bank continued its successful issuance of covered bonds during the quarter to fund the increase in mortgage lending. In 2021 the Bank has sold ISK 28bn of outstanding series, thereof ISK 18bn in 2Q21
- In April, the Bank increased its green issuance by tapping its outstanding ISK green bond, ISB GB 25, for ISK 1.2bn at a fixed rate of 3.5%

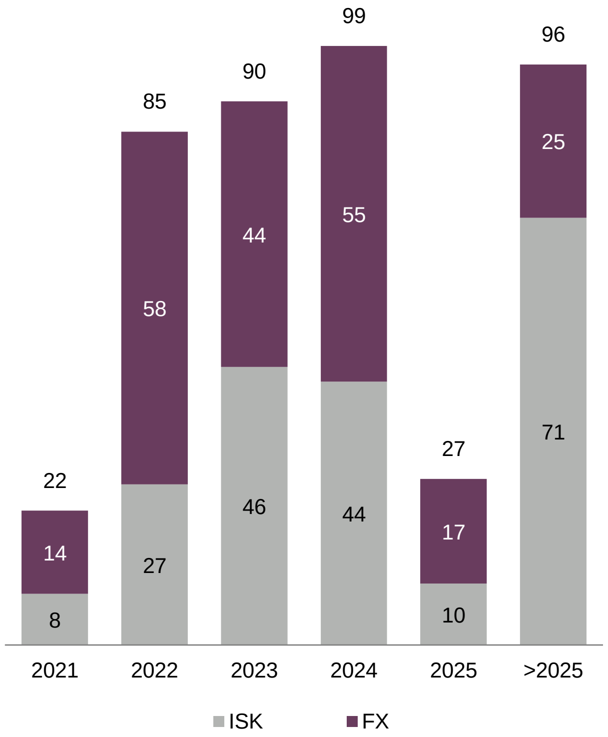
Sources of market borrowings

Book value, ISKbn



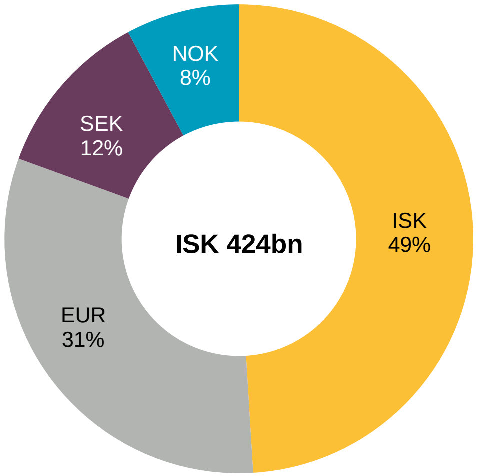
Maturity profile of long-term funding

30.6.2021, nominal value, ISKbn



Currency split of capital market transactions

30.6.2021



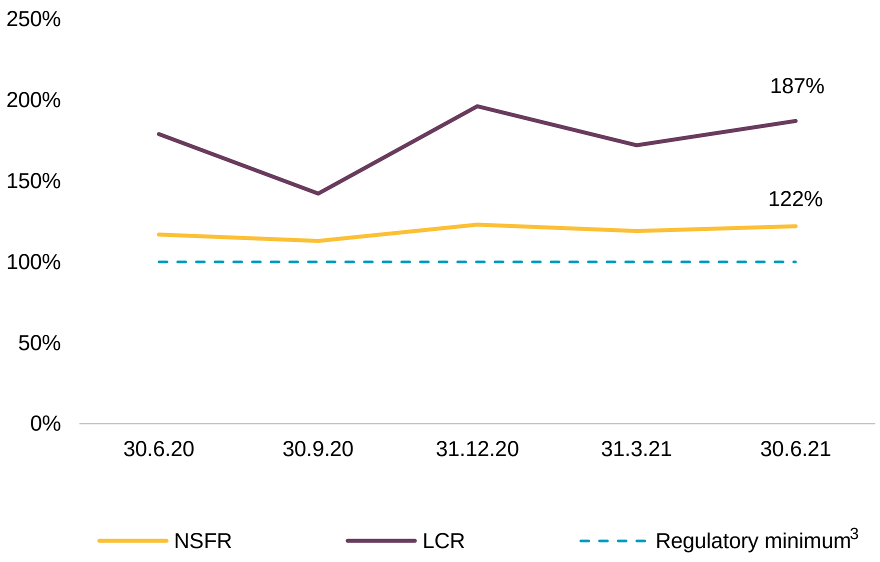
Sound liquidity management, meeting all requirements

Liquid assets of ISK 312bn are prudently managed, representing 22% of total assets

Highlights

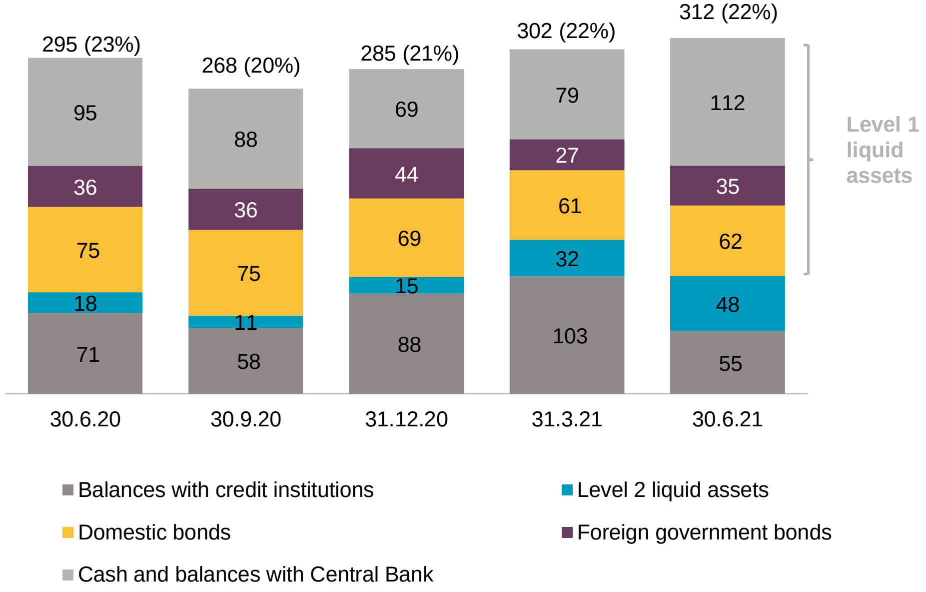
- The Icelandic Central Bank postponed a planned increase in the minimum requirements for LCR in ISK. The minimum requirements will therefore continue to be 30% for the year 2021 but will rise to 40% in 2022
- On 28 June, the Central Bank implemented new regulations for NSFR in all currencies according to the CRR II regulation, setting the regulatory minimum at 100%. Simultaneously, minimum requirements for NSFR in foreign currencies were annulled
- After the Central Bank decided to stop offering one-month term deposits the Bank shifted ISK liquidity to Treasury bills, short-dated Treasury bonds and covered bonds to earn higher yield
- As the Bank's liquidity position remains strong across currencies and above requirements, the Bank may consider debt buybacks or exchanges of outstanding transactions during 2021

Total liquidity coverage ratio[1] (LCR) and total net stable funding ratio[2] (NSFR)



Liquid assets

% of total assets, ISKbn



1. LCR in ISK was 133% at 30.6.21 compared to 95% at YE20. The increase is partially (20 percentage points) linked to the settlement of ISB IPO and thus temporary. LCR in foreign currencies decreased to 287% at 30.6.21 from 463% YE20.
2. NSFR in foreign currencies was 154% at 30.6.21 compared to 179% at YE20.
3. Total NSFR minimum requirements took effect on 28 June 2021.

Market risk well within appetite

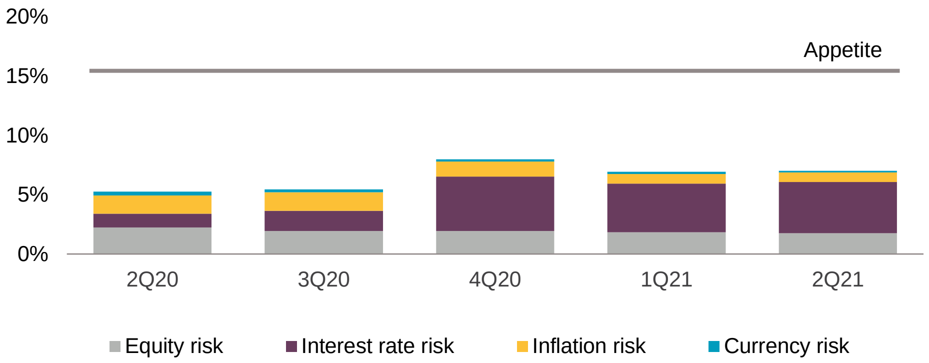
The Bank has a modest market risk profile

Highlights

- The Bank's market risk mainly derives from aggregate balance sheet imbalances in interest rate, inflation and currency positions as well as the Bank's liquidity portfolio managed by Treasury
- Equity risk derives from strategic investments and market making activities

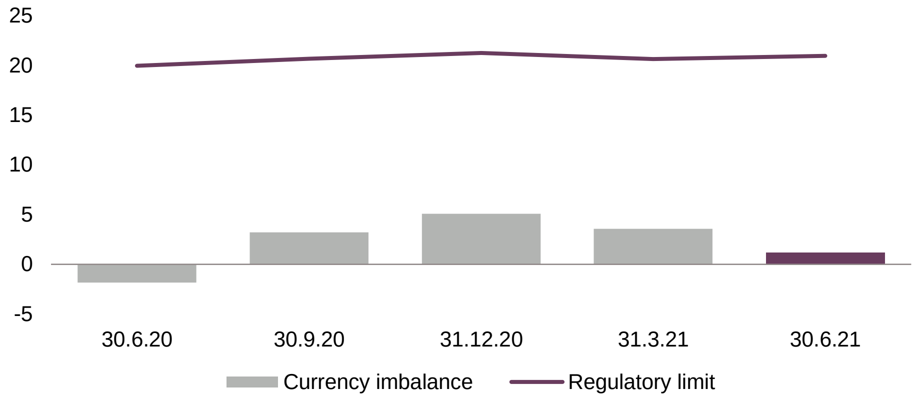
Market risk exposure and market risk appetite

Average positions per quarter, % of total capital base[1]



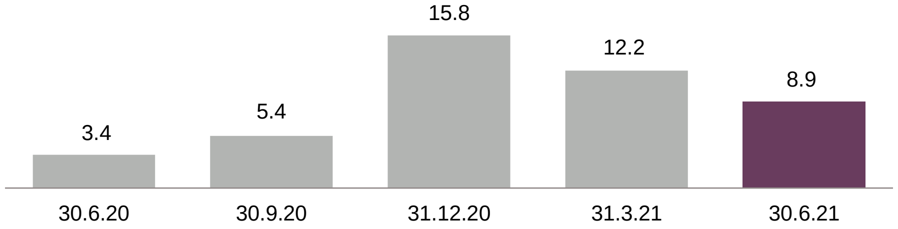
Currency imbalance, compared with regulatory limit

End of quarter, ISKbn



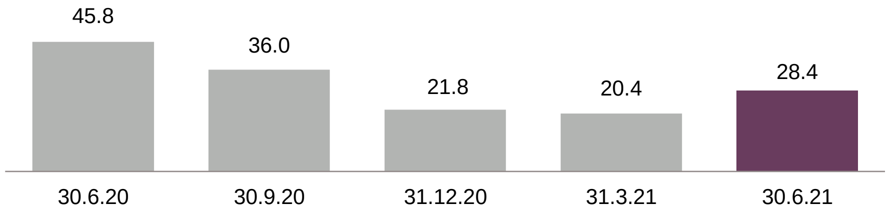
Interest rate risk in the banking book

Weighted average BPV, end of quarter, ISKm



Banking book inflation imbalance

End of quarter, ISKbn



1. The market risk measurement for 4Q20 has been revised since the 4Q20 financial results.

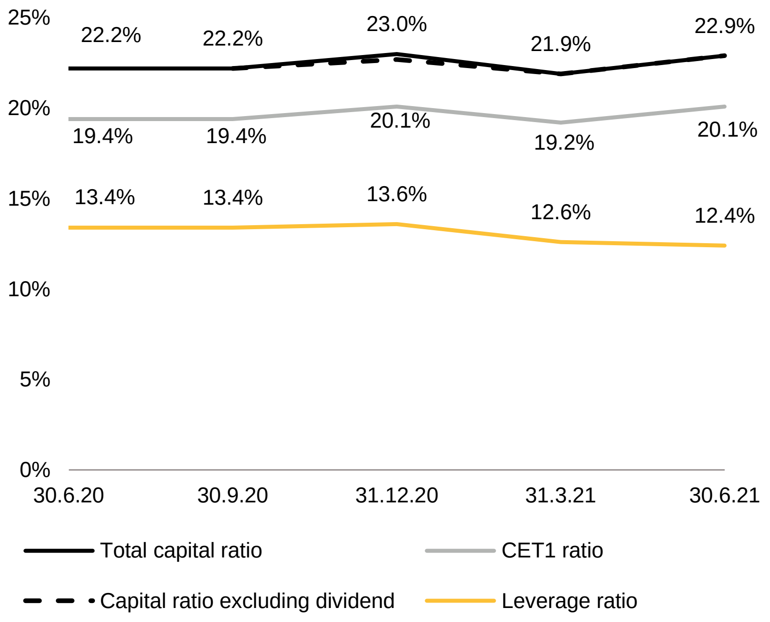
Sound capital position

High REA density and high leverage driven by CRD IV standardised approach

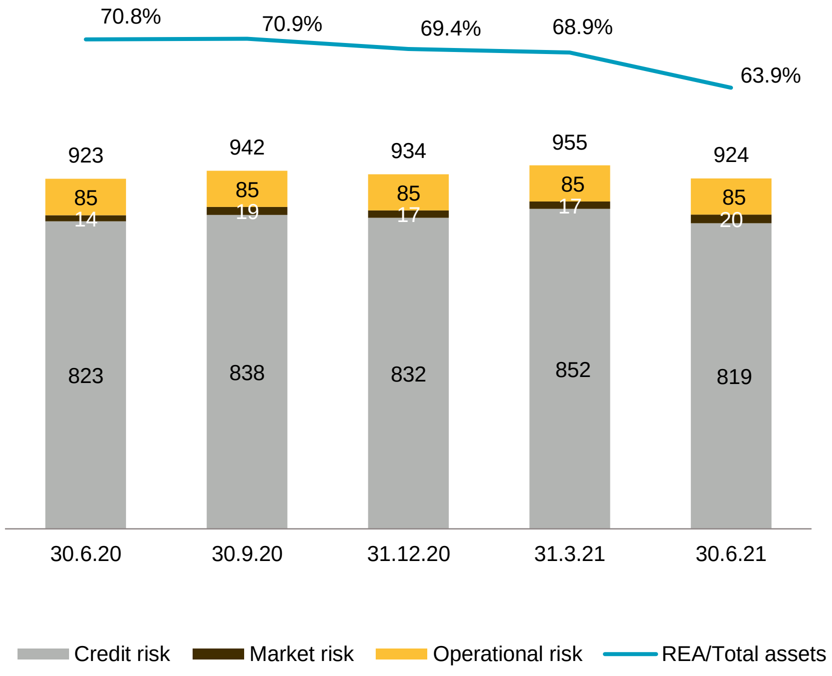
Highlights

- An ISK 3.4bn dividend payment was paid out in March and the coefficient for the IFRS 9 transitional rules fell from 70% to 50% in January 2021 lowering the CET1 capital by ISK 1.3bn
- These two changes contribute to a fall in CET1 capital to ISK 186bn at the end of June (2020: ISK 188bn)
- The appreciation of the ISK lowered the value of the subordinated loan, reducing the capital base to ISK 212bn (2020: ISK 215bn)
- The presentation of the total capital ratio has been changed, where expected dividend, based on 50% of profit, is deducted from 1Q21 onwards
- The implementation of EU regulation 2019/876 (CRR II) in Iceland caused a reduction in REA, contributing in turn to a 60bp rise in the capital ratios. As a result, the ratio of REA/total assets fell sharply
- The most material effect was the amendment of the SME supporting factor, lowering the REA by ISK 35bn

Capital ratios and leverage ratio



Risk exposure amount (REA)
ISKbn



Íslandsbanki’s capital ratios well above target

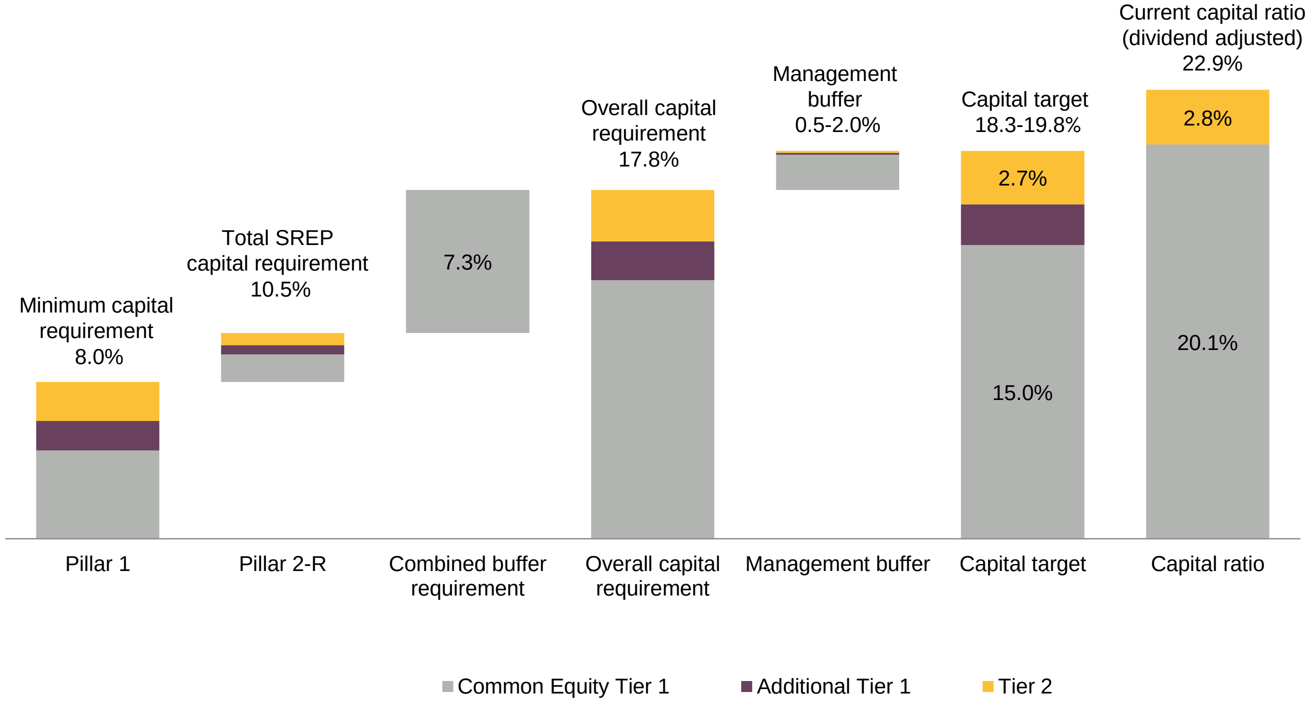
Excess capital of ISK ~30bn including capital structure optimisation

Highlights

- The Pillar 2-R capital requirement has been revised following the SREP process, leading to an increase from 1.7% to 2.5%
- The Pillar 2-R requirements were expected to rise temporarily as a result of COVID-19 and this result is in line with the Bank’s expectations
- The overall capital requirement is therefore at 17.8% of REA
- Íslandsbanki's total capital target ratio is based on the overall regulatory requirement in addition to a 50-200bp management buffer and is therefore currently at 18.3–19.8%
- The countercyclical capital buffer was lowered from 2% to 0% in March 2020 as a response to COVID-19. Assuming that the countercyclical buffer increases to 2% and the COVID-19 effect on the Pillar 2-R is reversed, the long-term target range is 19.5-21.0% with a CET1 target of 16%
- Excess CET1 capital based on long-term CET1 capital target[1] is ISK ~30bn

Current regulatory requirements and minimum capital target

30.6.2021, by capital composition



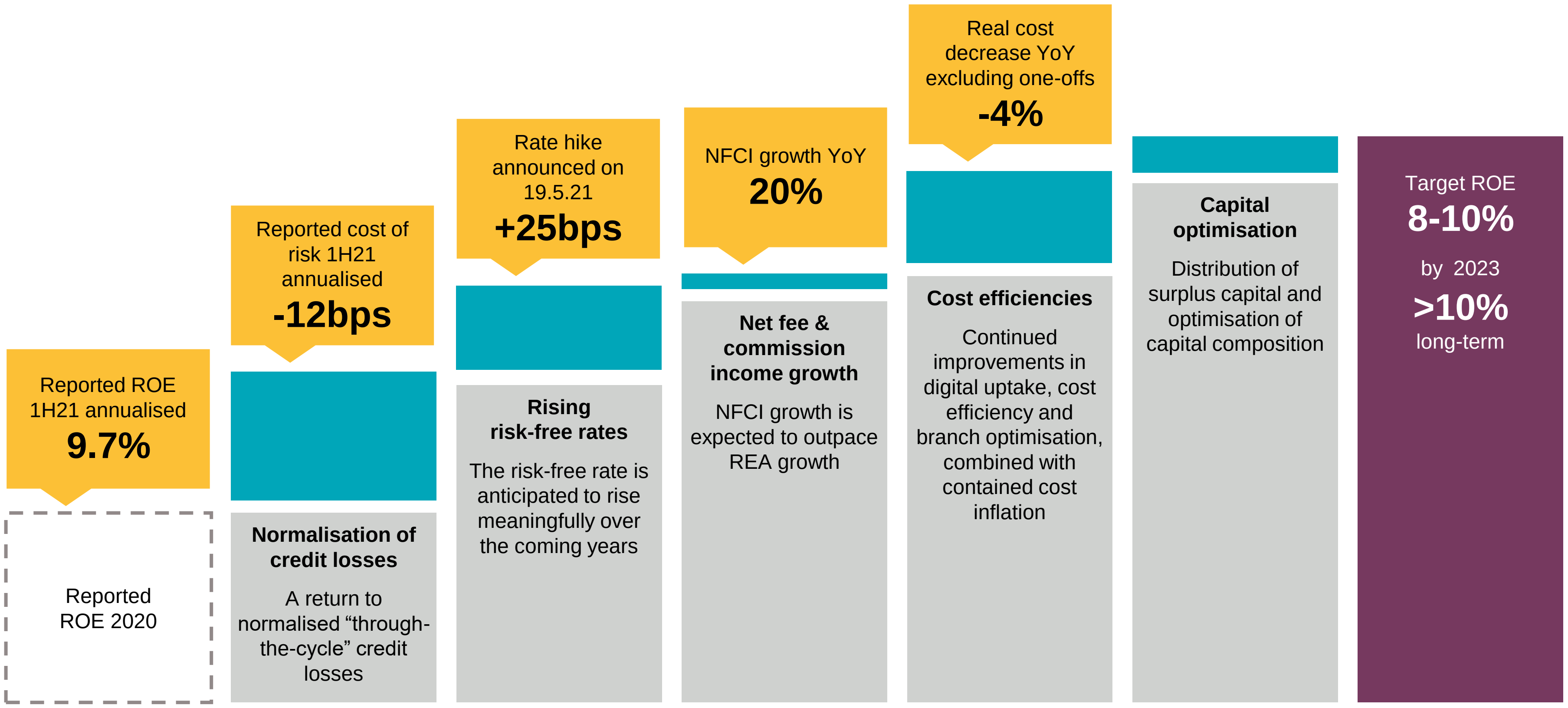
Excess capital based on long-term capital targets

ISK ~30bn

1. Based on current regulatory requirements, excess CET1 capital amounts to approximately ISK 48bn. Based on expected changes to the regulatory capital requirements, the Bank estimates that the long-term excess CET1 capital is approximately ISK 30bn.

Clear path to a double-digit ROE

A realistic plan to reach ambitious and yet achievable ROE target



Q&A

4. Annex – About Íslandsbanki and financial overview

This is Íslandsbanki

Moving Iceland forward by empowering our customers to succeed

Vision and Values

Vision to be
#1 for service

Passion
Professionalism
Collaboration

The Bank

FTEs
733
number of FTEs at Íslandsbanki at period end

12 branches

Market share[1]

32% retail customers

37% SMEs

35% large companies

Sustainability 2Q21

Commitment to reaching net zero emissions by 2040 and only Icelandic founding member of NZBA (Net-Zero Banking Alliance)

In April Íslandsbanki topped Reitun's ESG rankings with 90 points out of 100

Íslandsbanki received environmental award from Ministry for the Environment and Natural Resources in April

Key Figures 2Q21

ROE	11.6%	LCR Group, all currencies	187%
Cost-to-income ratio	49.9%	NSFR Group, all currencies	122%
Total capital ratio	22.9%	Leverage ratio	12.4%
Tier 1 capital ratio	20.1%	Total assets	ISK 1,447bn

Ratings and certifications

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

EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

Digital milestones 2Q21

The "funds in app" enables trading of IS funds and includes fund details and performance

SmartId enables our customers to move seamlessly between channels without having to log in again

Record number for digital origination of trading accounts in June

1. Based on Gallup surveys regarding primary bank. 2021 average for retail customers and SMEs and 2020 average for large companies.

Financial overview

Key figures & ratios

		2Q21	2Q20	1H21	1H20	2020
PROFITABILITY	After tax profit (loss), ISKm	**5,431**	1,245	**9,046**	(131)	6,755
	Return on equity	**11.6%**	2.8%	**9.7%**	(0.1%)	3.7%
	Net interest margin (of total assets)	**2.4%**	2.6%	**2.4%**	2.7%	2.6%
	Cost-to-income ratio[1]	**49.9%**	57.5%	**50.6%**	60.1%	54.3%
	Cost of risk	**(0.42%)**	1.03%	**(0.12%)**	1.28%	0.91%

		30.6.21	31.3.21	31.12.20	30.9.20	30.6.20
BALANCE SHEET	Loans to customers, ISKm	**1,089,723**	1,029,415	1,006,717	970,309	933,320
	Total assets, ISKm	**1,446,860**	1,385,235	1,344,191	1,328,724	1,303,256
	Risk exposure amount, ISKm	**924,375**	954,712	933,521	942,339	923,133
	Deposits from customers, ISKm	**765,614**	698,575	679,455	698,610	681,223
	Customer loans to customer deposits ratio	**142%**	147%	148%	139%	137%
	Non-performing loans (NPL) ratio[2]	**2.1%**	2.4%	2.9%	3.3%	3.6%
LIQUIDITY	Liquidity coverage ratio (LCR), for all currencies	**187%**	172%	196%	136%	179%
	Net stable funding ratio (NSFR), for all currencies	**122%**	119%	123%	113%	117%
CAPITAL	Total equity, ISKm	**190,355**	185,471	186,204	182,509	179,722
	Total capital ratio	**22.9%**	21.9%	23.0%	22.2%	22.2%
	Tier 1 capital ratio	**20.1%**	19.2%	20.1%	19.4%	19.4%
	Leverage ratio	**12.4%**	12.6%	13.6%	13.4%	13.4%

1.Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).
2. Stage 3, loans to customers, gross carrying amount.

5. Annex – Icelandic economy update

Economic recovery to take root this year and blossom in 2022

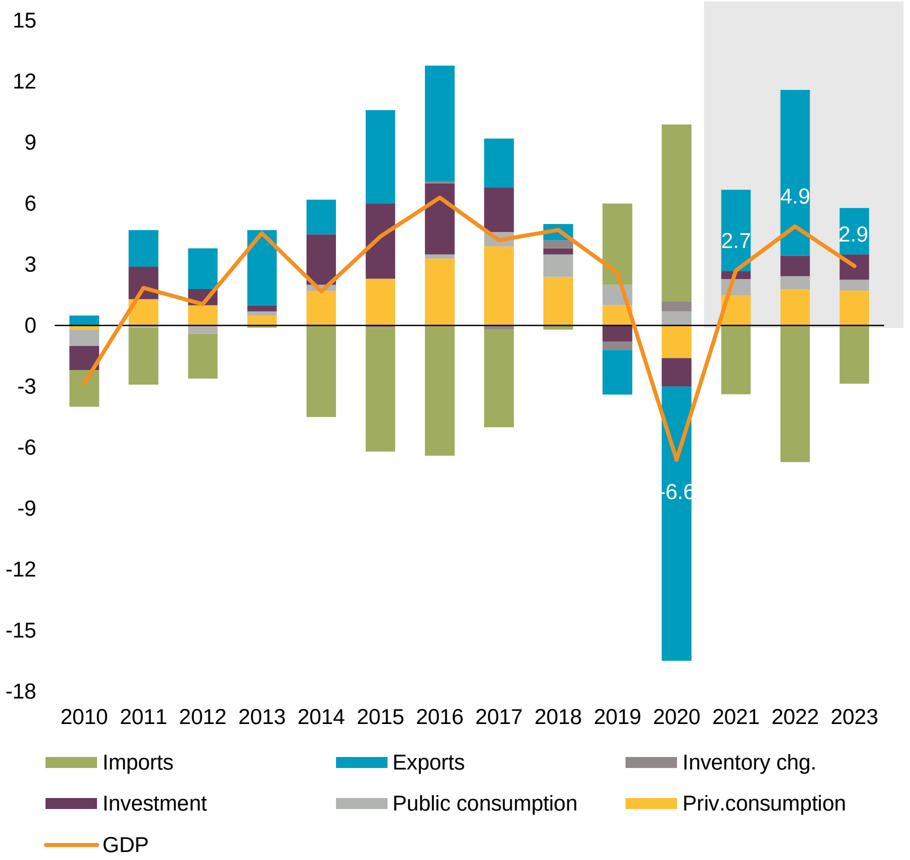
GDP growth to gain pace in 2H2021; robust growth expected in 2022

Highlights

- The COVID-19 pandemic impact on the Icelandic economy has been more protracted than many hoped
- GDP contracted by 6.6% in 2020 following an upwardly-revised 2.6% growth in 2019. The contraction was milder than expected due to more resilient domestic demand than forecast
- A sharp decline in exports and a moderate contraction in private domestic demand contributed to the fall in GDP while decreasing imports and increased public consumption softened the impact
- ISB Research forecasts GDP growth at 2.7% in 2021, driven mainly by the recovery of exports and moderate growth in consumption and investment
- In 2022 the outlook is for 4.9% growth, as both exports and domestic demand are expected to rebound even more strongly.
- In 2023, growth at just under 3% is projected
- Other recent forecasts paint a similar recovery picture although views differ on the relative pace of growth in 2021 and 2022

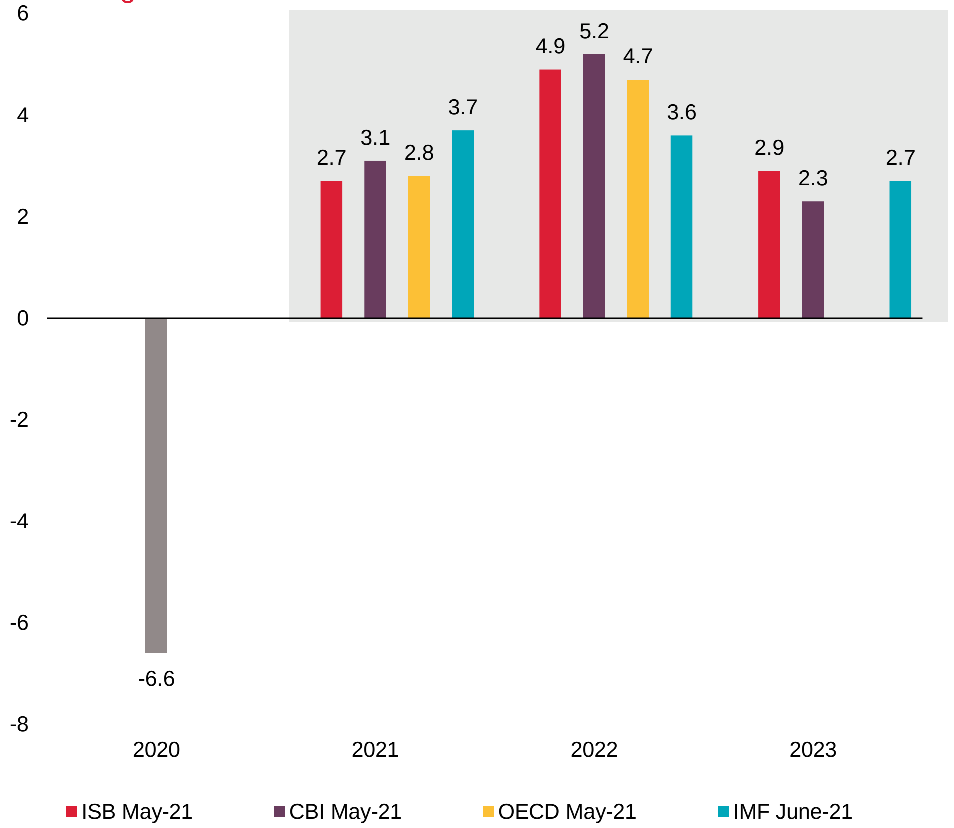
GDP and the contribution of major subitems

YoY change %



GDP forecast comparison

YoY change %



Shaded areas indicate forecasts.
Source: Statistics Iceland, ISB Research, the Central Bank of Iceland, OECD, IMF.

28 July 2021

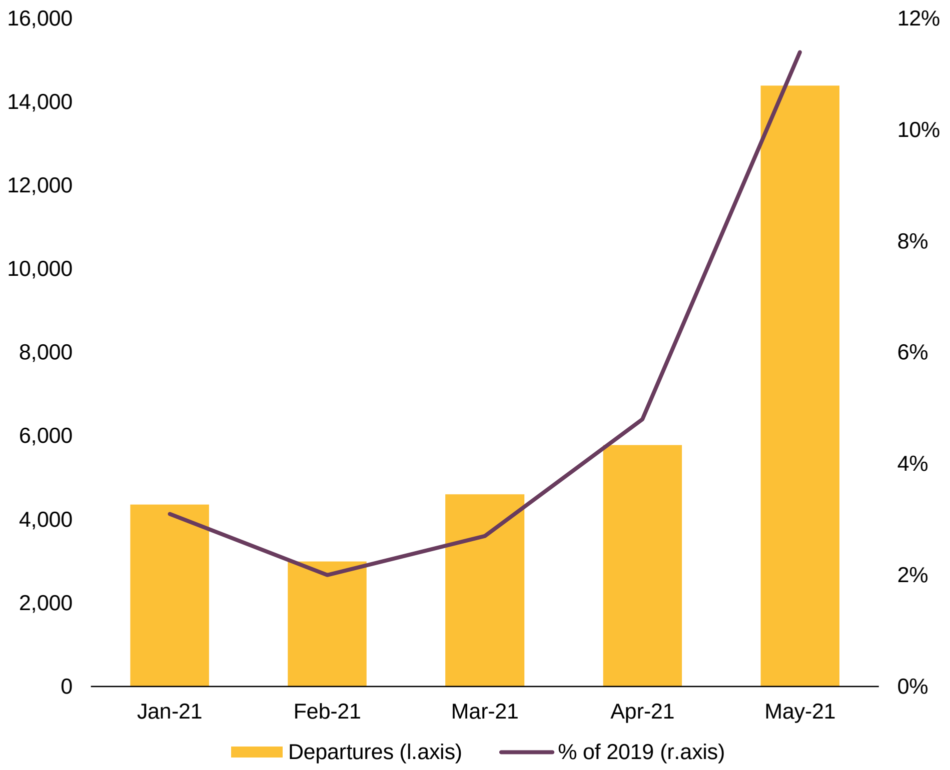
Tourism sector hit hard by COVID-19 pandemic

Uptick in tourist arrivals has started and is likely to accelerate in coming quarters

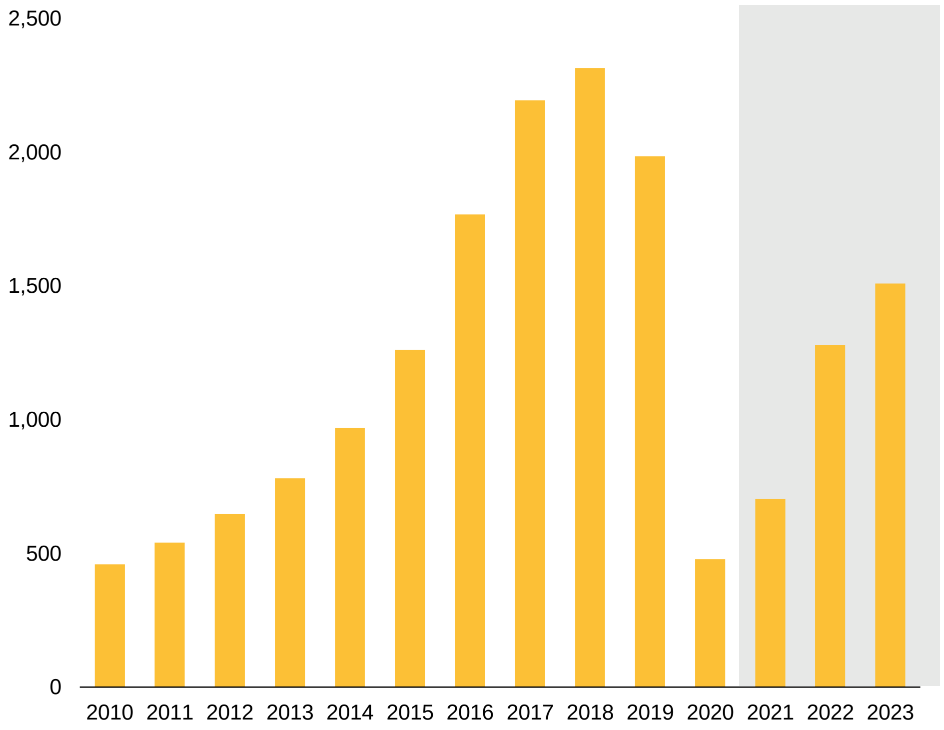
Highlights

- An upswing in tourist arrivals in the coming term will be the main determinant of how quickly the economy rights itself
- Although the revival of tourism has been delayed throughout 1H, there are signs the uptick in arrivals is starting
- May 2021 was the first month since 3Q2020 where tourist arrivals exceeded 10,000
- Iceland is viewed by many as a desirable destination as the pandemic fades due to successful pandemic management, strong infrastructure and abundance of open spaces
- Tourism is expected to rebound in 2H2021 with 700 thousand foreign nationals visiting the country in 2021
- ISB Research then expects tourist numbers to nearly double in 2022, to about 1.3 million, and forecasts a more moderate rise to 1.5 million in 2023
- There are signs that tourists are staying longer, and they are generally spending more
- Revenue per visitor could therefore rise compared to pre-pandemic era

Foreign visitors
Departures through KEF airport and share of same month in 2019



Foreign visitors
Departures through KEF airport, thousand



Shaded areas indicate ISB Research forecasts.
Source: Iceland Tourist Board, ISB Research

Current account surplus to increase again in coming years

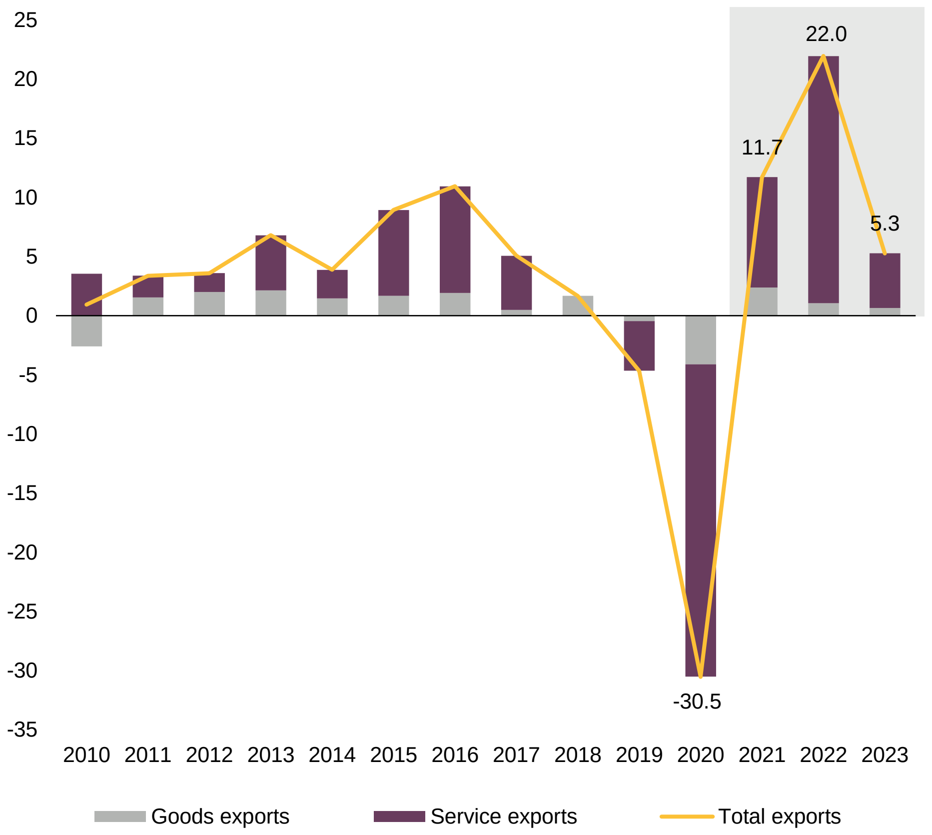
The recovery of tourism will support both the current account and GDP growth in coming years

Highlights

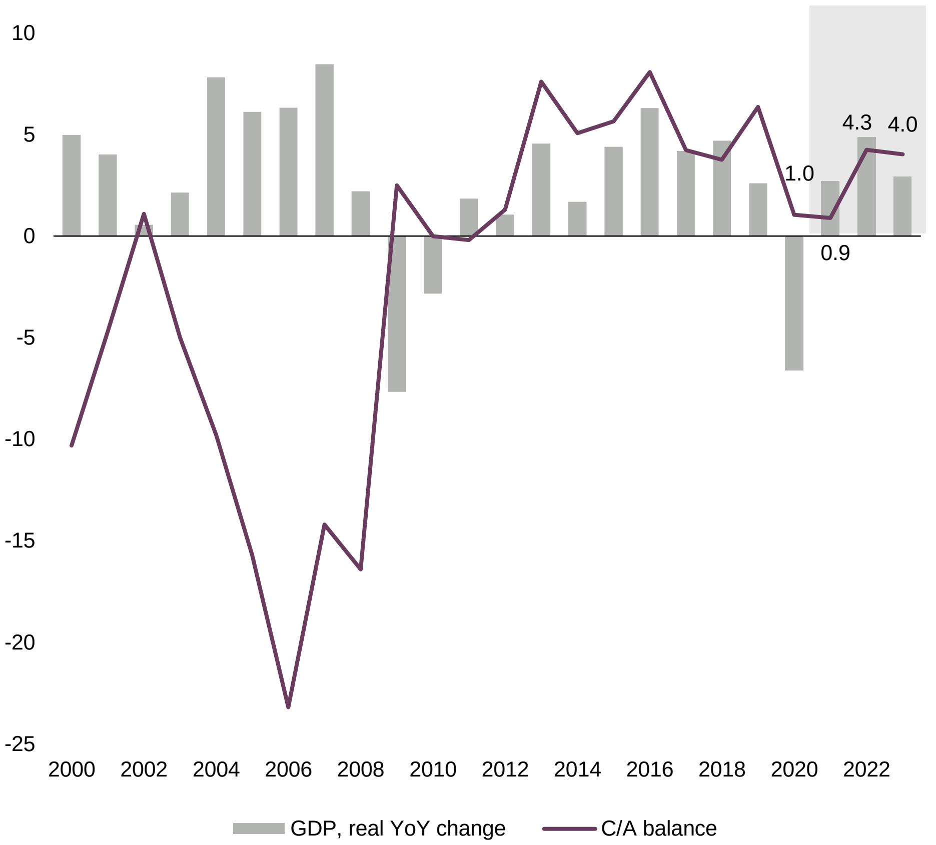
- This year's rise in foreign visitor numbers explains most of the one-fourth increase in services exports that is expected in 2021
- Added to this is modest growth in goods exports, particularly to include farmed fish, aluminium, and silicon metal
- A surge in tourist arrivals will deliver the lion's share of the forecasted 22% export growth in 2022 and just over 5% growth in 2023
- Imports will broadly follow the export trend at a more moderate pace
- Despite the nearly 1/3 drop in exports, the current account balance was positive by 1% of GDP in 2020, the ninth consecutive surplus year
- A steep decline in imports and a handsome surplus on primary income offset the export drop
- The outlook is for a continued surplus throughout the forecast horizon
- The CA surplus is expected to measure 0.9% of GDP, or ISK 30bn, this year. In 2022 and 2023, it will measure 4.0% or more of GDP, according to ISB Research's forecast

Export volume

YoY change, %



Current account balance[1] and GDP growth

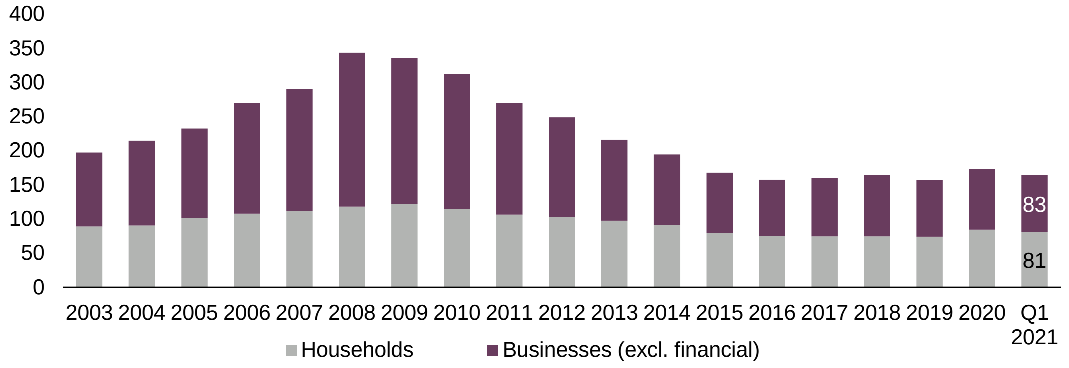


1. Excluding old banks' estates 2009-2015.
Shaded areas indicate ISB Research forecasts.
Source: Central bank of Iceland, Statistics Iceland and ISB Research.

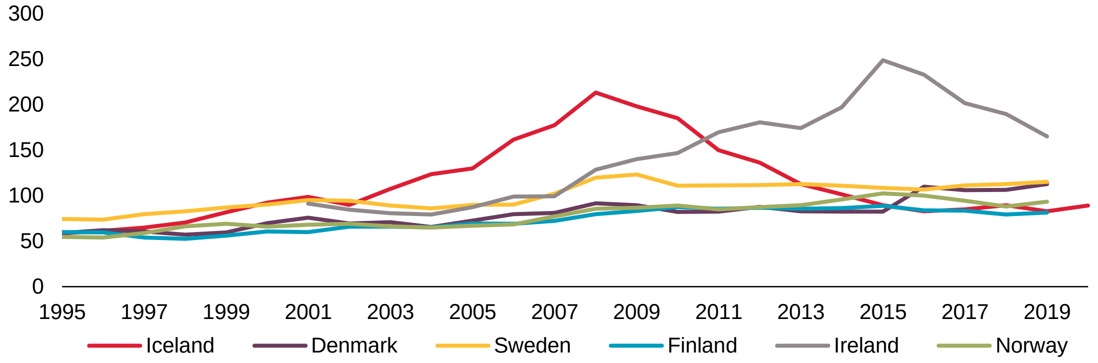
Domestic balance sheets remain healthy despite COVID-19

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

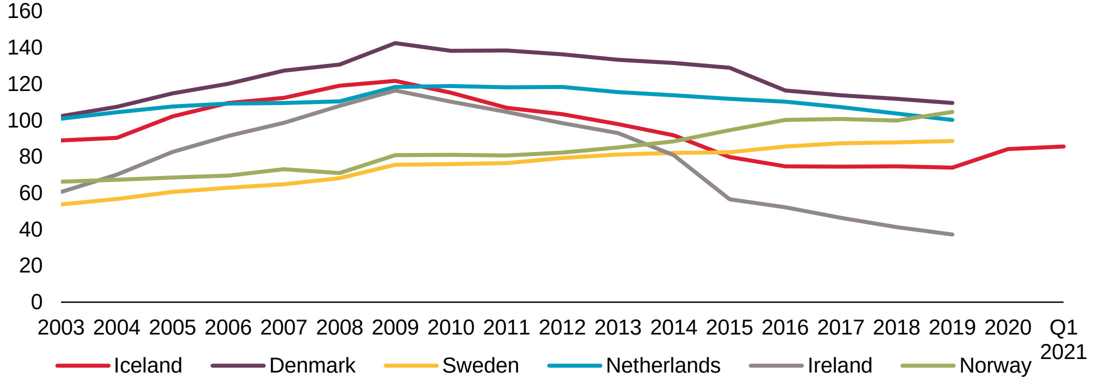
Private sector debt
% of GDP



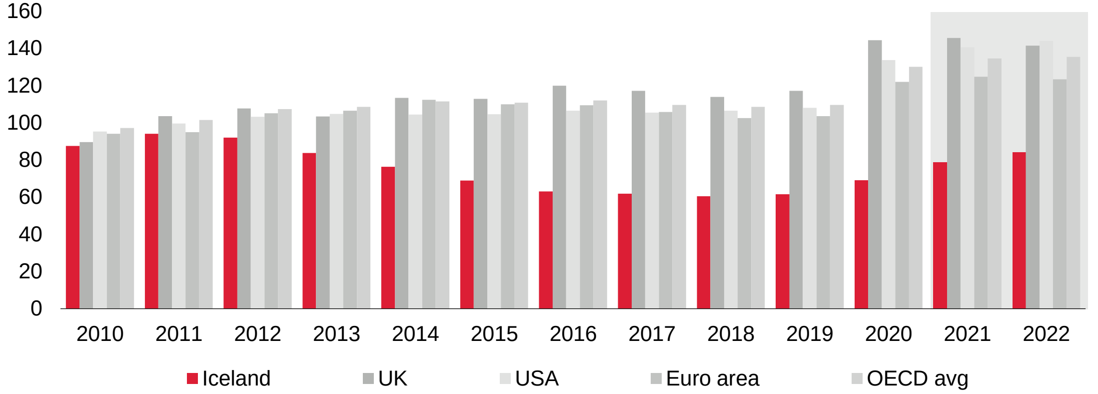
Corporate debt
% of GDP



Household debt
% of GDP



General government gross financial liabilities
% of GDP



Shaded areas indicate OECD forecasts.
Source: Central bank of Iceland, Statistics Iceland, OECD and ISB Research.

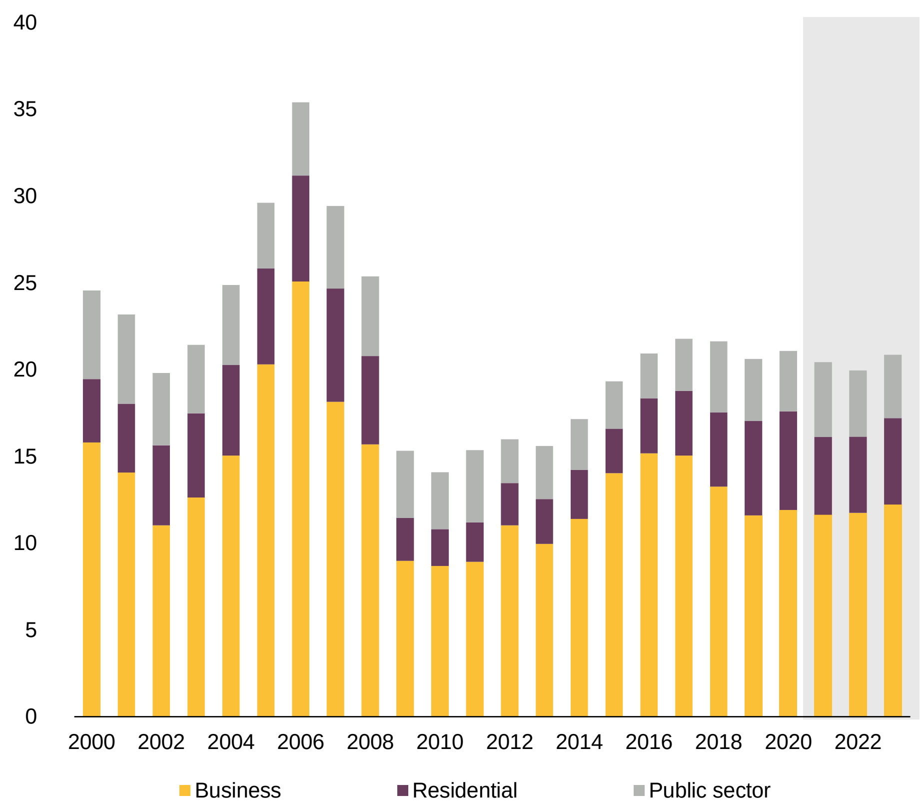
Public sector to lead investment growth in 2021

Private sector to take the lead thereafter

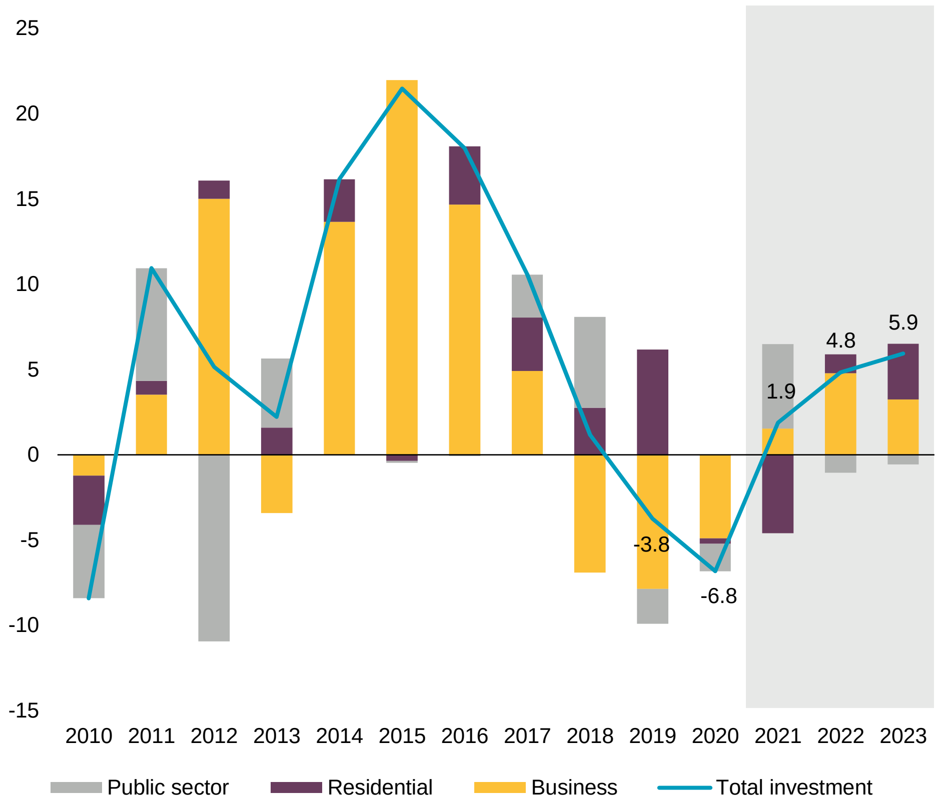
Highlights

- Investment has sagged for two years running, after a period of relatively robust growth early in the 2010s
- Between 2018 and 2020, investment contracted by a total of over 10%
- The investment-to-GDP ratio has not suffered much, however, unlike the post-financial crisis situation
- For 2021, the public sector will lead the way in investment growth, after a two-year contraction in total investment
- We expect public investment to grow by 30% this year, as the Government's COVID-related investment initiative is set to peak
- In 2022 and 2023, however, private sector investment will be in the driver's seat
- Total investment to grow by nearly 2% this year, nearly 5% in 2022, and nearly 6% in 2023
- The investment-to-GDP ratio will remain relatively stable, however, at around 20%

Investment
% of GDP



Investment, real change, and contribution of subcomponents
%



Shaded areas indicate OECD forecasts.
Source: Statistics Iceland, ÍSB Research.

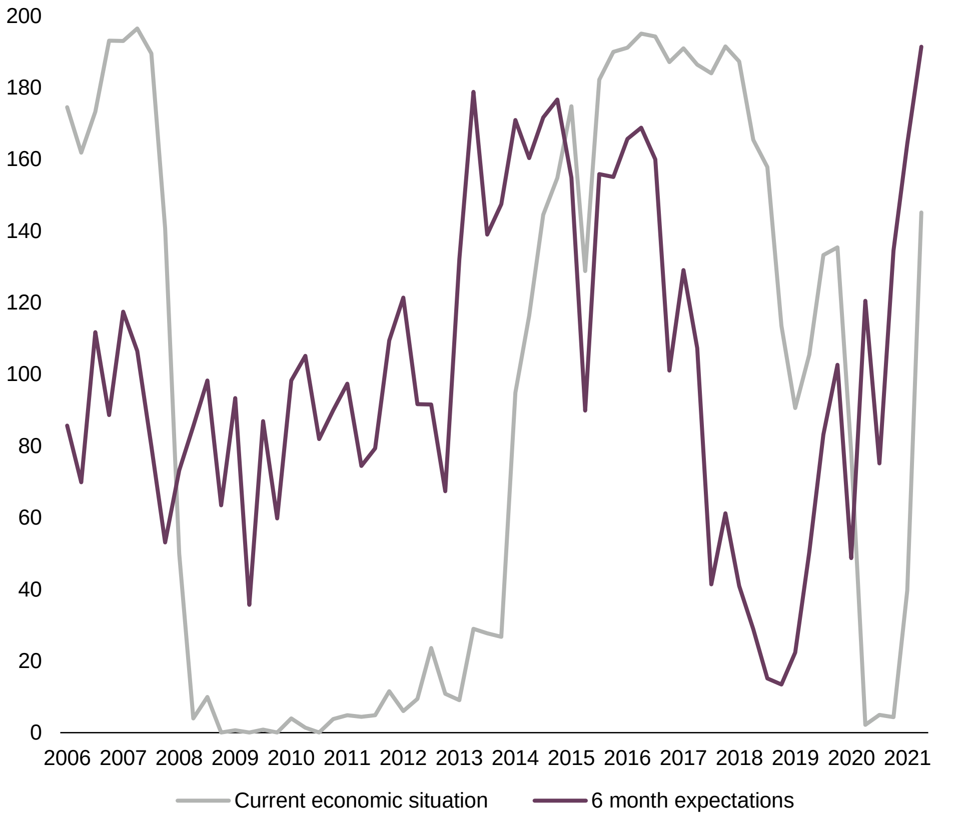
Rising business sentiment signals investment growth to come

Reduced uncertainty and favourable financing conditions should put an end to the contraction in business investment

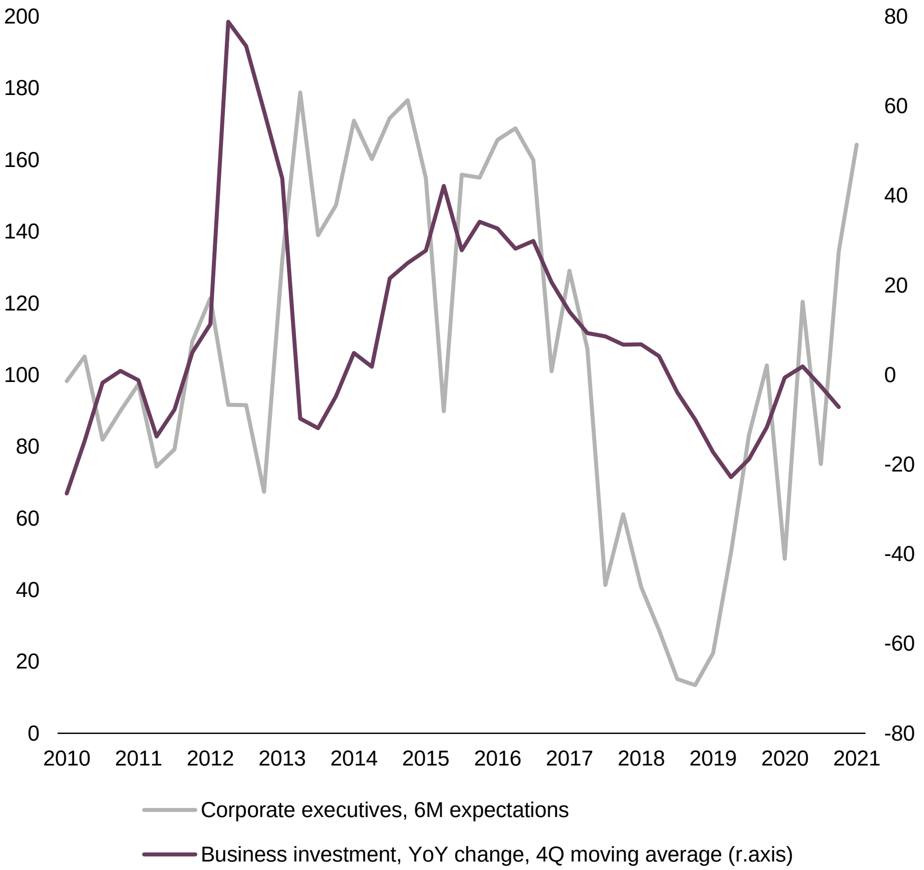
Highlights

- The slump in business investment over the past three years (excluding hotels and other tourism-related investment) gives cause for some concern
- In all, business investment has contracted by 28% in the past three years
- Luckily, there are signs that the situation will turnaround this year and that business investment will grow each year of the forecast horizon
- Executives' expectations concerning near-term economic conditions have risen markedly in recent quarters
- The latest assessment of present conditions also shows a sizeable positive jump
- Lending growth to businesses has slowed markedly after peaking in 2H2018. Corporate lending was almost unchanged over the year 2019 and growth has remained stable since
- Added to this, most firms are financially sound, and favourable financing conditions should help pave the way for investment once pandemic-related uncertainty subsides

Business sentiment, 400 largest companies
Index



Executives' expectations and business investment
Index value (left) and % change year-on-year (right)



Source: Statistics Iceland, the Central Bank of Iceland and Gallup.

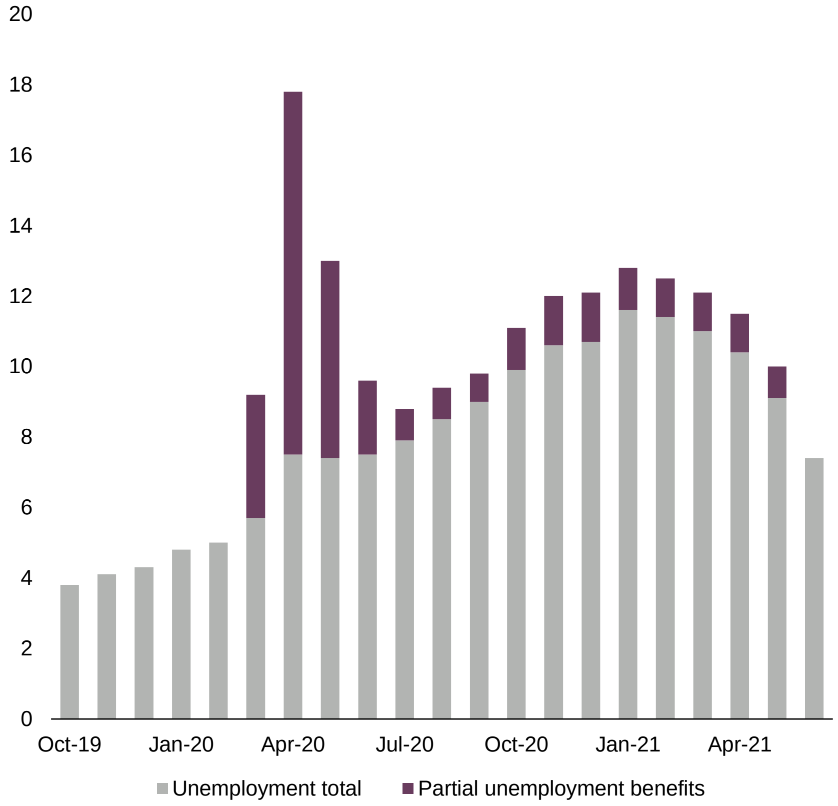
Unemployment more persistent than previously hoped

Equilibrium unemployment will probably be higher further ahead

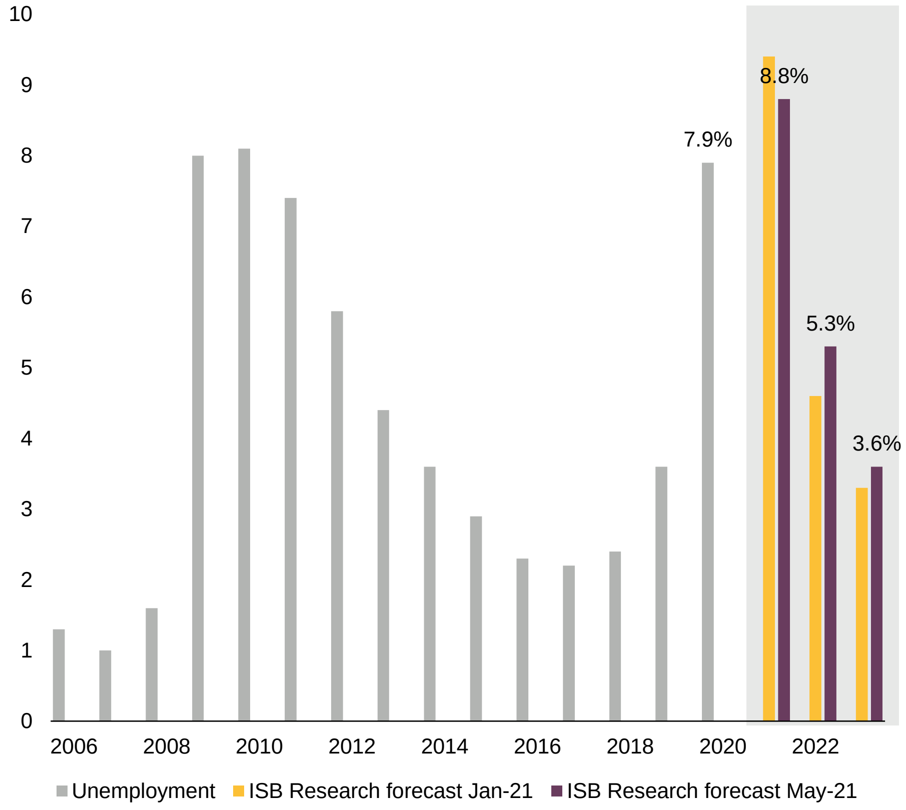
Highlights

- Unemployment rose rapidly from mid-2020 to 1Q2021, as 15% of jobs in the labour market were directly related to tourism
- It peaked at 11.3% in 1Q2021 and would probably have been much higher without government measures
- We expect the jobless rate to taper off rather quickly this year, as tourism regains momentum
- The labour market has started improving and the improvement looks set to gather steam in Q3
- However, unemployment is likely to remain relatively high in the coming term, as it will take time for tourism and other hard-hit sectors to recover fully
- Furthermore, with rapidly rising wage costs, unemployment will likely be more persistent than previously hoped, probably pushing equilibrium unemployment above its historical average
- Unemployment is expected to average 8.8% in 2021, 5.3% in 2022, and 3.6% in 2023

Unemployment [1]
% of workforce, monthly average



Unemployment
% of workforce, annual average



1. The partial unemployment benefit scheme expired in June 2021
Shaded areas indicate forecasts.
Source: Statistics Iceland, the Directorate of Labour and ISB Research.

Robust real wage growth supports private consumption

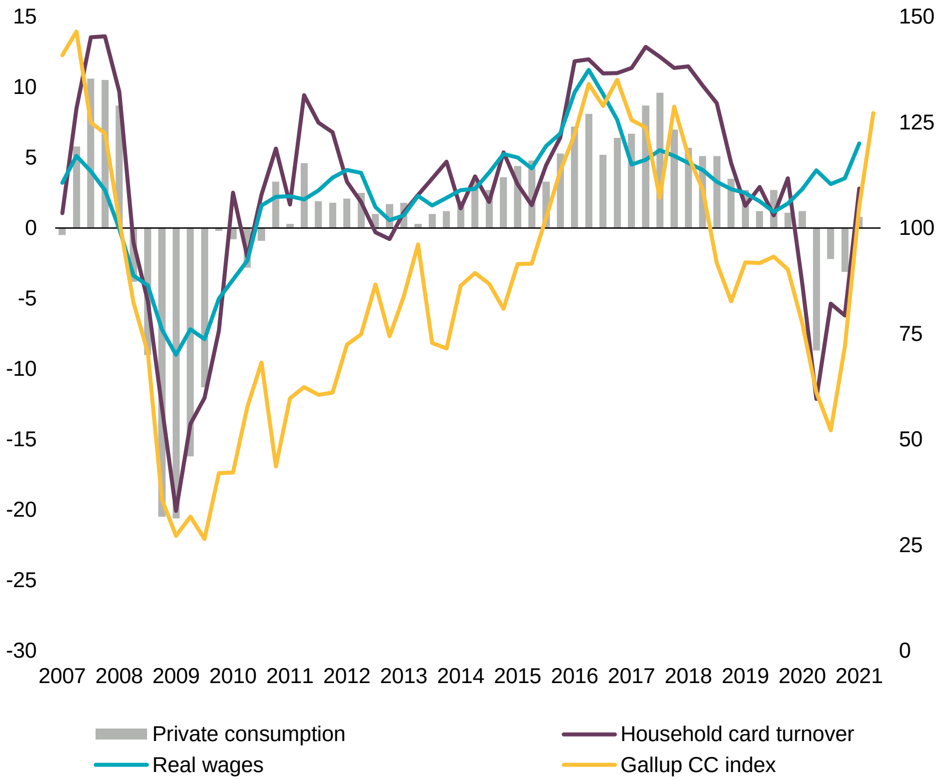
Private consumption growing steadily once again

Highlights

- Although private consumption contracted by 3.3% in 2020, the contraction was concentrated in consumption abroad while consumption within Iceland largely held its own
- Households' strong asset position, higher real wages on average and the effects of interest rate cuts have boosted consumers' appetite for spending and will continue to do so
- Although real wages have been rising on average, there has been significant divergence as low-wage earners have seen large rises while the highest-earning group has seen a real wage decline
- Rising consumer expectations and real wage growth have recently been reflected in increased card turnover
- On the other hand, high unemployment has had a significant negative impact although rising employment will support consumption further afield
- ISB Research forecasts that private consumption will grow by 2.9% in 2021, 3.5% in 2022 and 3.4% 2023
- Households' consumption will therefore act as a countercyclical force throughout the business cycle

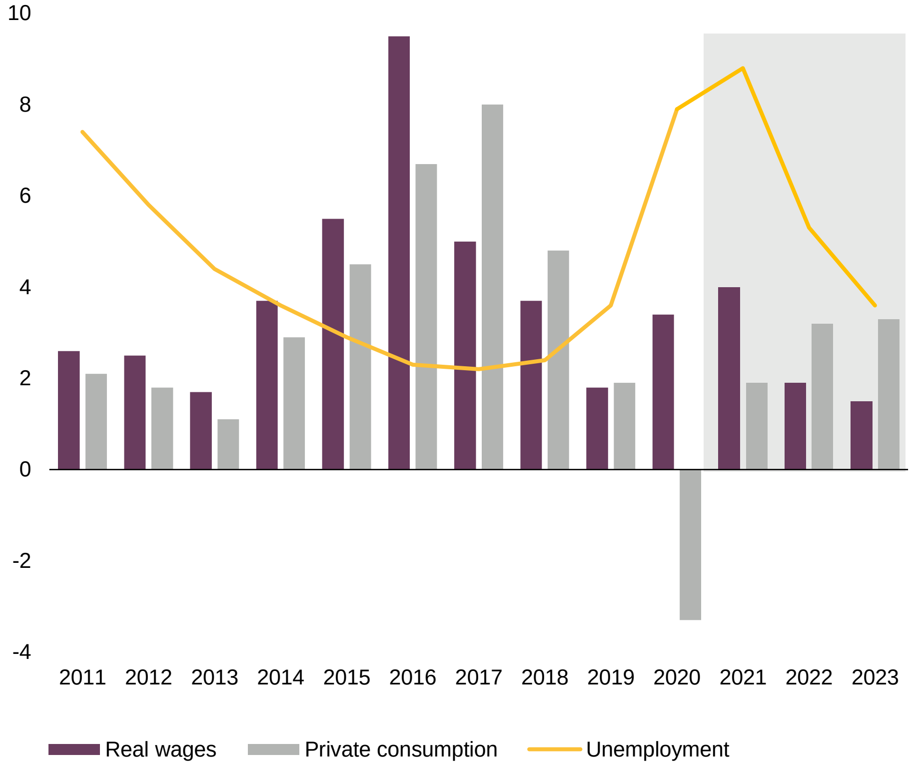
Private consumption and related indicators

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



Private consumption, unemployment and real wages

YoY % change (consumption, real wages) and % (unemployment)



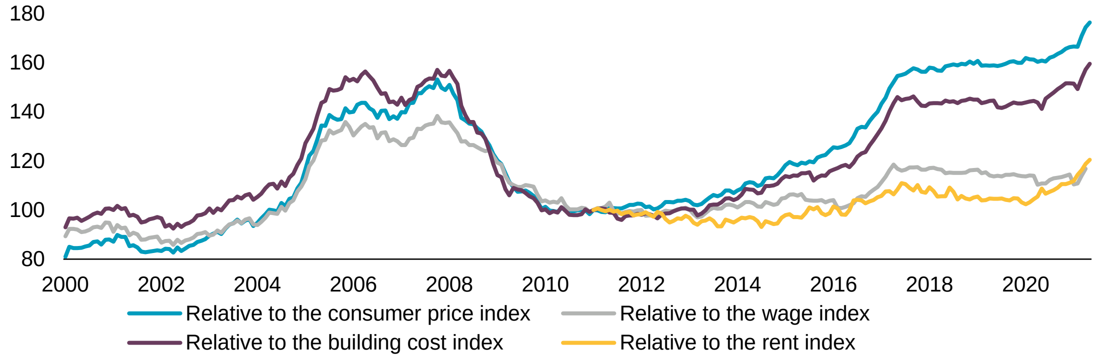
Shaded areas indicate ISB Research forecasts.
Source: Statistics Iceland, Gallup and the Central Bank of Iceland.

Real estate market resilient throughout pandemic

Residential housing market turnover has been brisk and price increase has been accelerating
Commercial property prices have stabilised after price decline in 1H2020

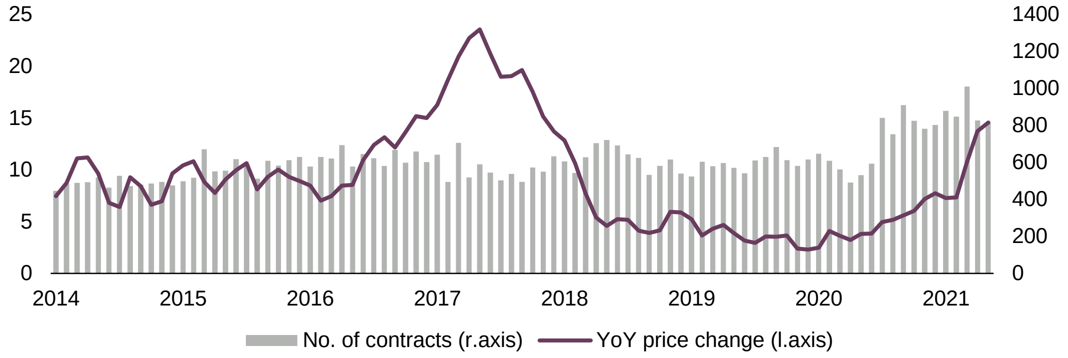
Capital area house prices relative to macroeconomic fundamentals

Index, January 2011=100



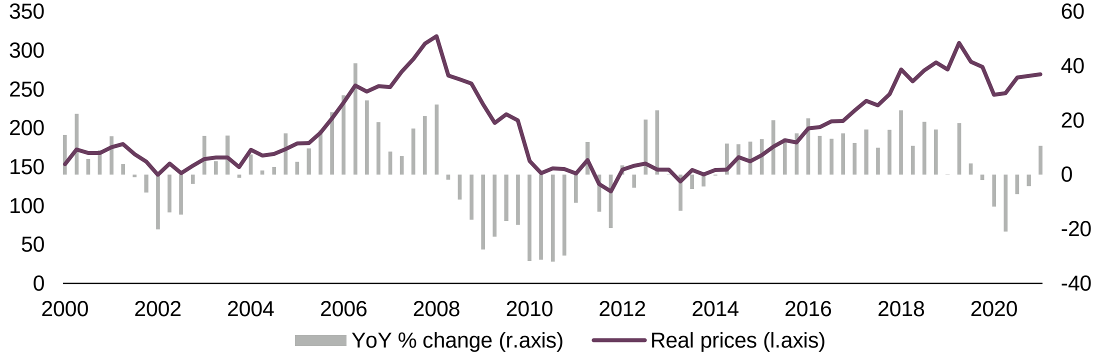
Residential house prices and turnover in greater Reykjavik

% change (l.axis) and number (r.axis)



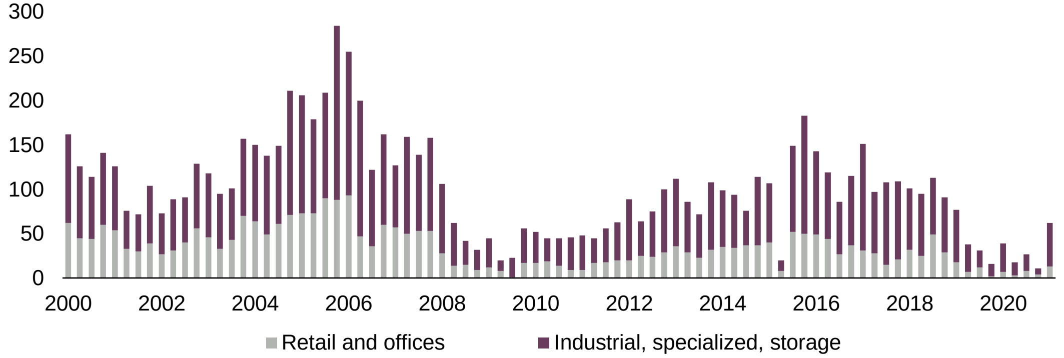
Commercial property real prices in greater Reykjavik

Index, 1995=100 (l.axis) and % change (r.axis)



Commercial real estate market activity

No. of registered purchase agreements



Source: The Central Bank of Iceland.

ISK appreciation to build a head of steam in the coming term

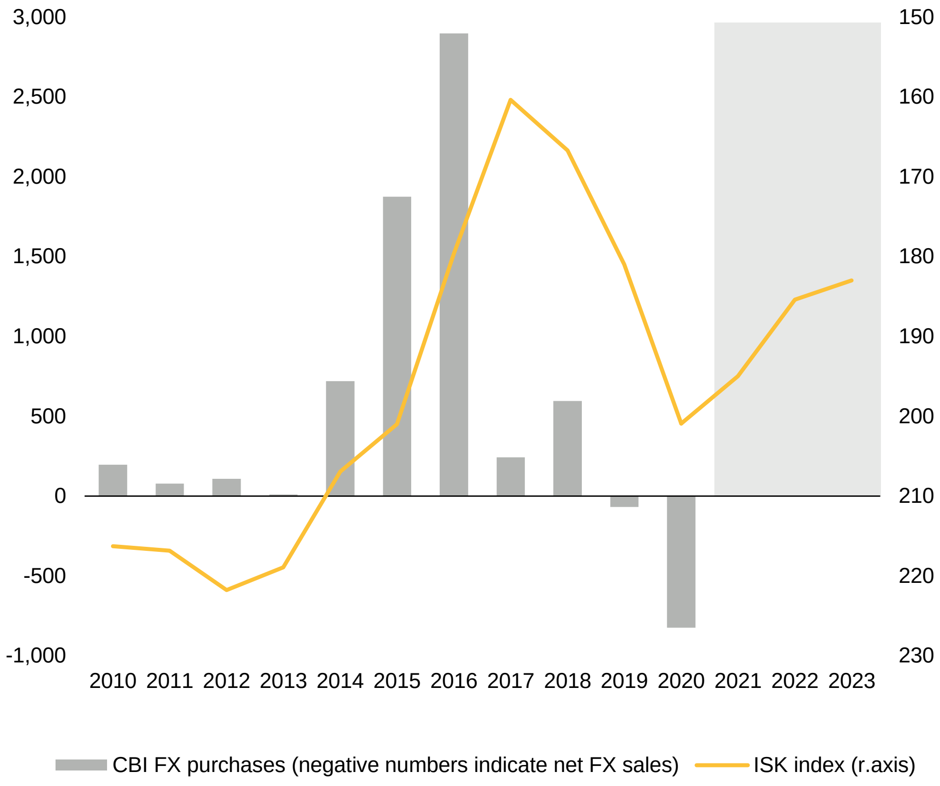
The CBI has mitigated exchange rate volatility in the past decade

Highlights

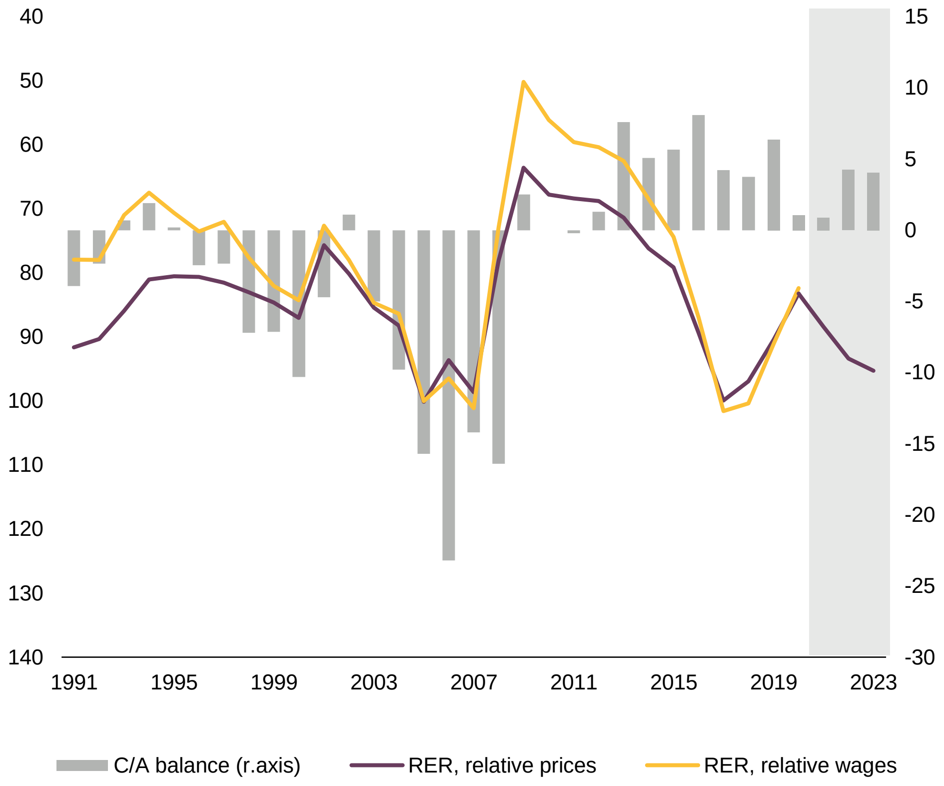
- The ISK depreciated by nearly 10% against major currencies over the course of 2020
- The CBI sold a total of EUR 820m from its FX reserves in 2020 with the aim of mitigating ISK volatility and reducing the impact of financial account outflows
- The sales in 2020 followed substantial FX purchases by the CBI in 2014-2018
- In 2021 to date, FX flows have been more balanced, and the ISK has appreciated somewhat, allowing the CBI to scale down its regular FX sales and then end them by May
- A strong net external position, measuring 30% of GDP at end-2020, and ample central bank FX reserves provide a more solid foundation for the ISK than in earlier decades
- Once the trade balance surplus increases, the ISK is expected to appreciate further as fundamentals remain sound and short-term FX obligations are at a low
- ISB Research's forecast assumes that the ISK exchange rate will be nearly 10% above its 2020 average by 2023

ISK exchange rate and Central Bank FX interventions

EUR m (left) and exchange rate index (right)



Real exchange rate indices and current account balance



Shaded areas indicate ISB Research forecasts.
Source: Central bank of Iceland, Statistics Iceland, Íslandsbanki Research.

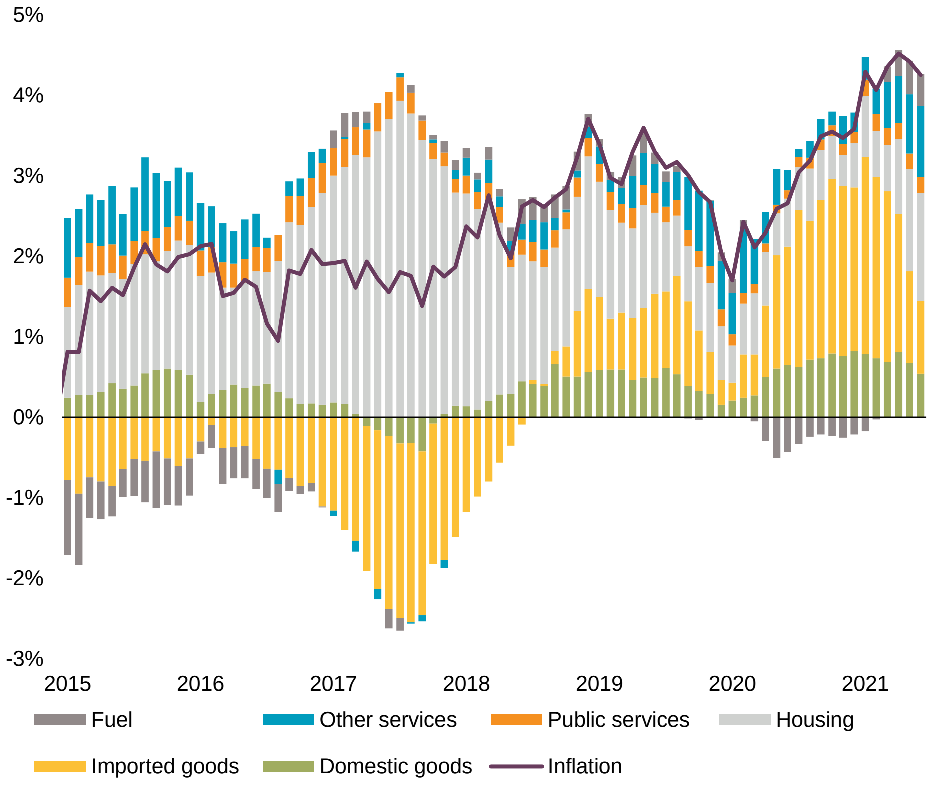
Inflation has peaked and is set to taper off

We expect inflation to align with the CBI's 2.5% inflation target around mid-2022

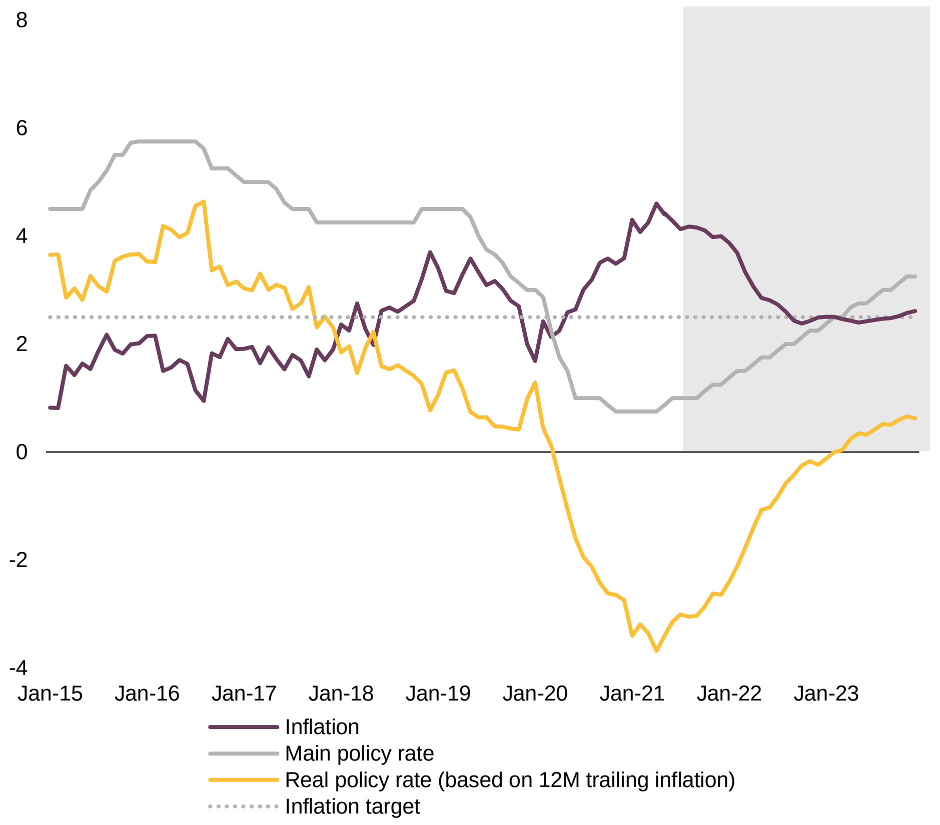
Highlights

- Inflation rose steadily from early 2020 to 2Q2021, increasing from 2.0% at end-2019 to 4.6% in April 2021
- As of June 2021, inflation measured 4.3%
- Despite the ISK appreciation this year, inflation has proven more persistent than expected
- ISK depreciation in 2020, house price increases and wage cost pressures have combined to drive inflation in recent quarters
- The outlook is for a relatively swift disinflation episode from 4Q onwards as domestic price pressures ease and the ISK appreciates further
- Inflation could reach the CBI's 2.5% target by mid-2022 and stay close to the target in 2022-2023
- Following cuts totalling 2.25% in 2020, the CBI hiked its main policy rate from 0.75% to 1.0% in May
- One further rate hike is expected this year, with a gradual further tightening thereafter, bringing the policy rate to 3.25% by end-2023
- Long-term rates have already risen from last year's trough and a moderate further increase is expected

Inflation and contribution of main subitems



Inflation, policy rate and real policy rate

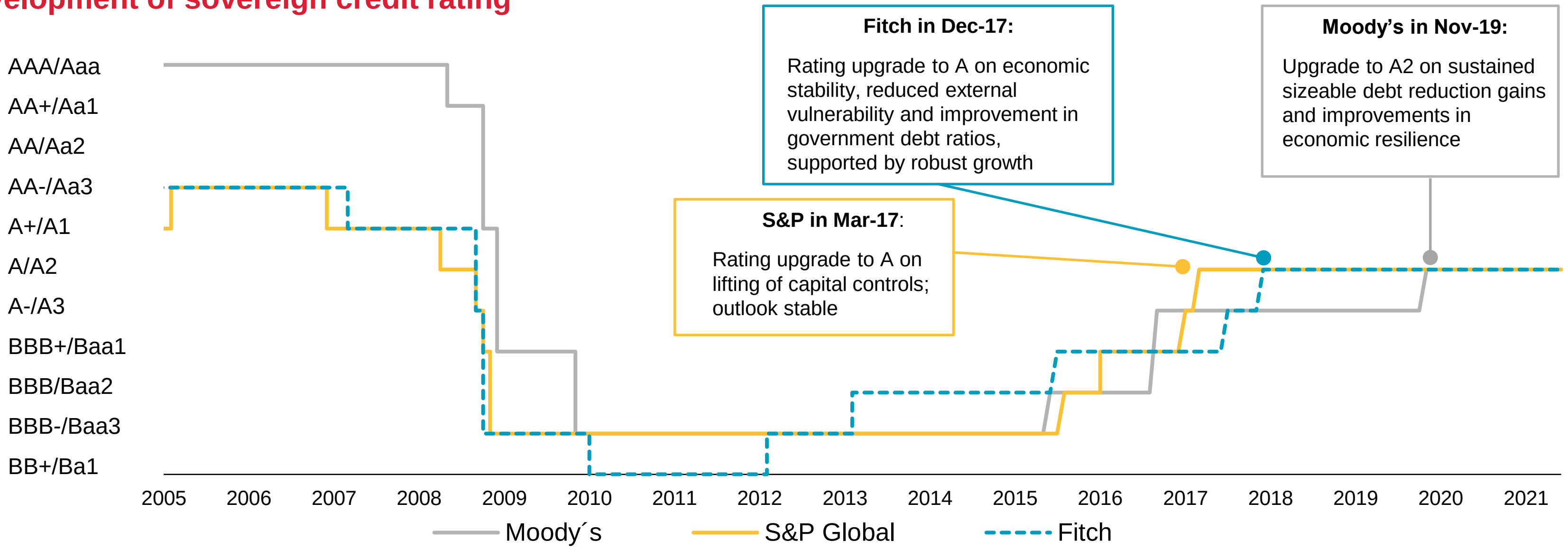


Shaded areas indicate ISB Research forecasts.
Source: Statistics Iceland, the Central Bank of Iceland and ISB Research.

Iceland’s credit rating has remained at A

Setbacks in the tourist sector have not affected the sovereign ratings

Development of sovereign credit rating



MOODY’S IN FEBRUARY 2021

- “The credit profile of Iceland is supported by its wealthy and flexible economy with favourable demographics which support its long-term growth prospects.”
- “The stable outlook reflects our view that downside risks stemming from the economy's small size and high concentration are mitigated by a robust fiscal and external position as well as reduced private sector indebtedness and improved health of the *banking sector”*

FITCH IN APRIL 2021

- Rating affirmed at A with a negative outlook
- The 'A' rating is driven by Iceland's very high income per capita, very strong performance on governance, human development and doing business indicators that are more consistent with that of 'AAA' and 'AA' rated countries
- “The Negative Outlook on Iceland’s ‘A’ rating reflects the impact of the coronavirus pandemic on the Icelandic economy and the resulting deterioration in the public finances.”

S&P IN MAY 2021

- “The stable outlook indicates that Iceland's economy is likely to continue recovering in the second half of 2021. This should allow authorities to gradually roll back much of the fiscal and monetary policy support that limited the economic contraction and exchange rate volatility during the pandemic. This will limit the increase in public debt over the next few years.”

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

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28 July 2021

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