

# ARION BANK

INVESTOR PRESENTATION  
JANUARY 2018

# Overview

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- 1 Strong Economy
- 2 Leading Universal Banking Franchise in Iceland
- 3 Strong Balance Sheet and Good Asset Quality
- 4 Strong Capital Position and Sound Funding Profile
- 5 Medium Term Targets



1

## Strong Economy

# Iceland at glance – strong and modern economy...

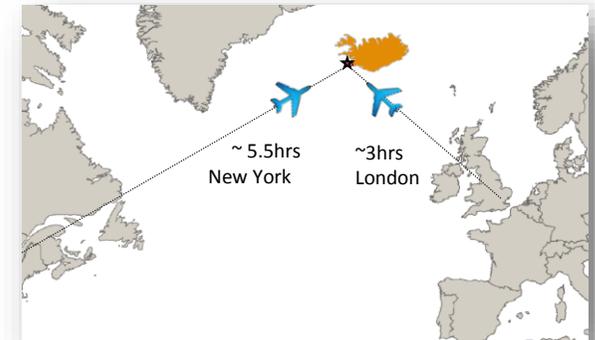
## Strong economy with further upsides

- Iceland became fully independent from Denmark in 1944
- The second half of the 20th century saw substantial economic growth driven primarily by the fishing industry
- The economy diversified greatly after the country joined the EEA in 1994
- Iceland's Scandinavian-type social-market economy combines a capitalist structure and free-market principles with an extensive welfare system

<b>State</b>	Republic
<b>Capital</b>	Reykjavik
<b>Life expectancy world rank 2016</b>	8
<b>Least corruption world rank 2016</b>	14
<b>Gender equality world rank 2016</b>	1
<b>Contribution of renewables to energy supply in OECD countries 2014</b>	1

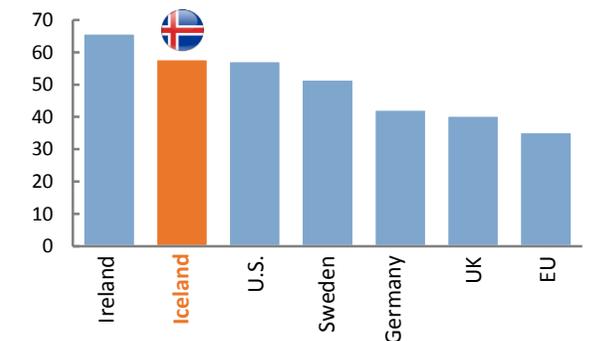
- 1944**  
Full independence from Denmark
- 1946**  
United Nations member
- 1948**  
OECD founding member
- 1949**  
NATO founding member
- 1970**  
Joined EFTA
- 1994**  
Access to European Economic Area (EEA)
- 1995**  
WTO member

## Central location



## GDP per capita among highest in the world

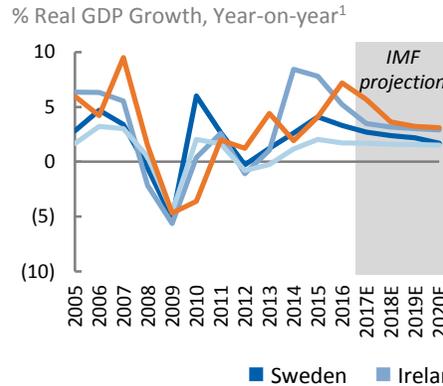
GDP per capita 2016, USD thousands<sup>1</sup>



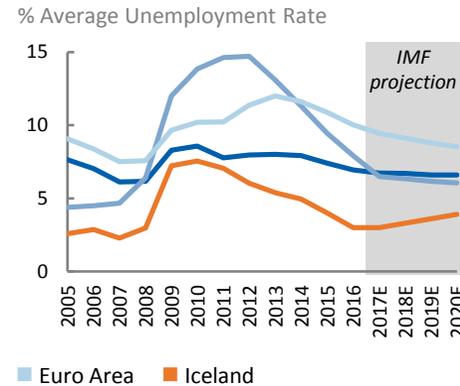
# Strong and modern economy with positive economic fundamentals...

- High standards of living
- Strong culture and heritage
- Modern public institutions and legislative framework
- Strong economic recovery post crisis
- Flexible and resilient economy
- Diversified economy built on 4 export pillars:
  - Tourism<sup>3</sup>
  - Marine/Seafood industry
  - Energy
  - Knowledge

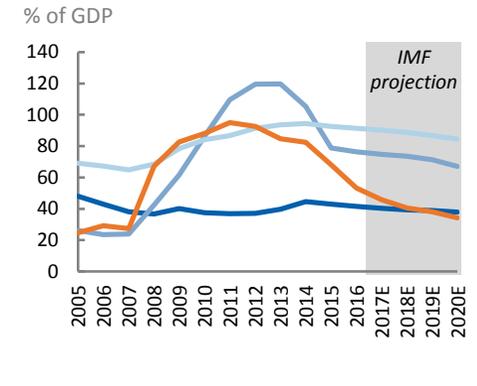
## Economic recovery since 2010 with strong outlook



## Unemployment rate significantly below other countries



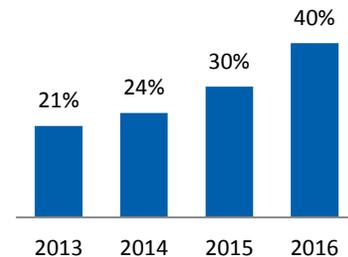
## General government gross debt (% of GDP)



## Accelerated growth in tourism contributing to exports and strength in GDP

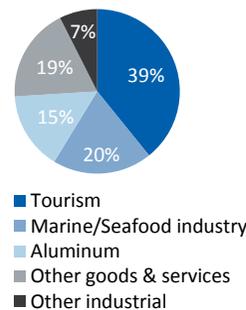
### Growth in Tourism

% Change YoY in # Tourists<sup>2</sup>



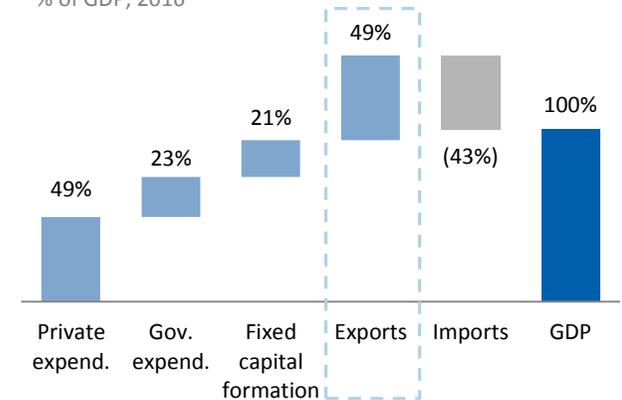
### Export Contribution by Industry

% Contribution, 2016



### Breakdown of GDP

% of GDP, 2016

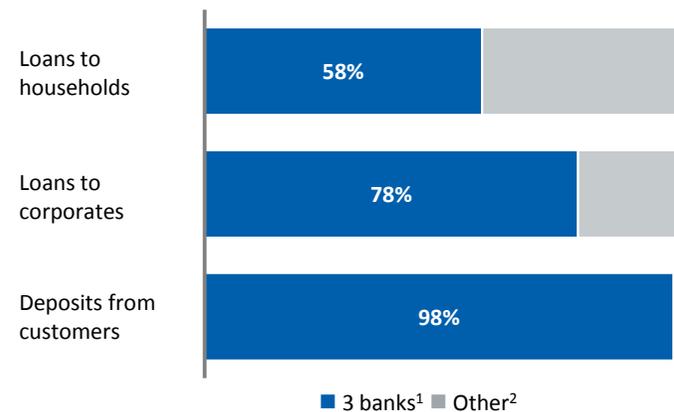


# ...supporting a growing and stable banking sector

- Highly consolidated banking sector concentrated around 3 main banks
  - Arion Bank - privately owned
  - Landsbankinn - government owned
  - Islandsbanki - government owned
- High correlation between GDP and banking sector growth
- Capital controls lifted on individuals, firms and pension funds in March 2017
  - Reserve requirements to curb carry trade and restrictions on unhedged derivatives in ISK remain in place

## The Icelandic banking sector is highly concentrated

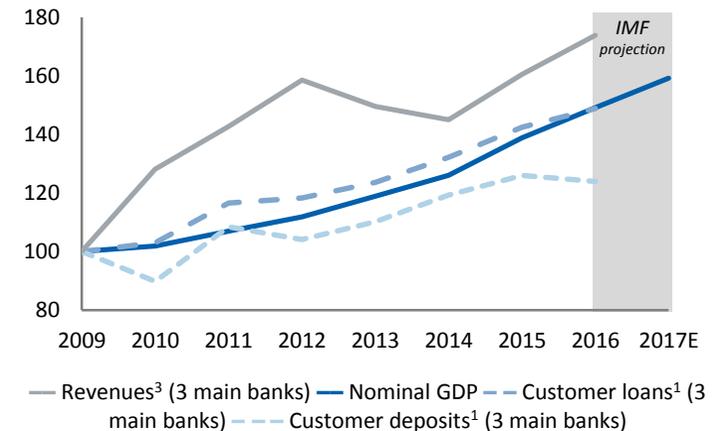
Market shares 2016, %



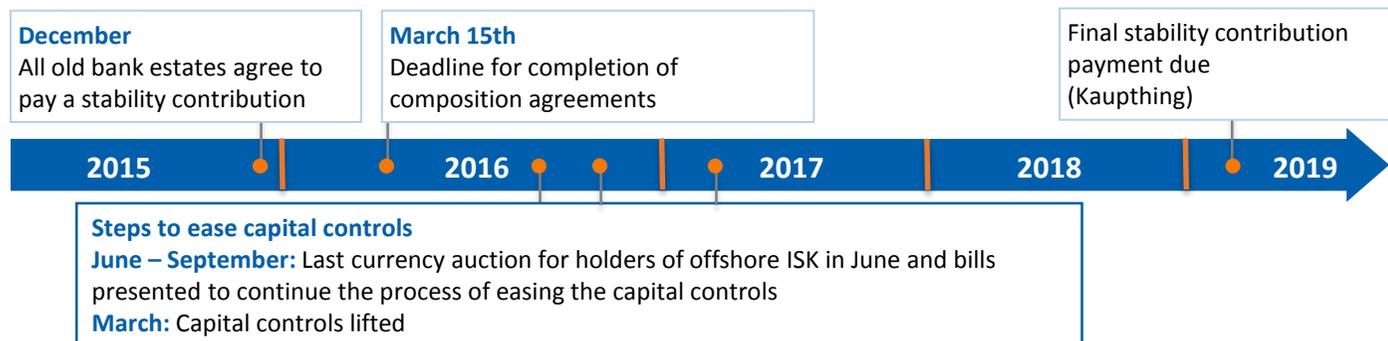
## High correlation between GDP and banking sector growth

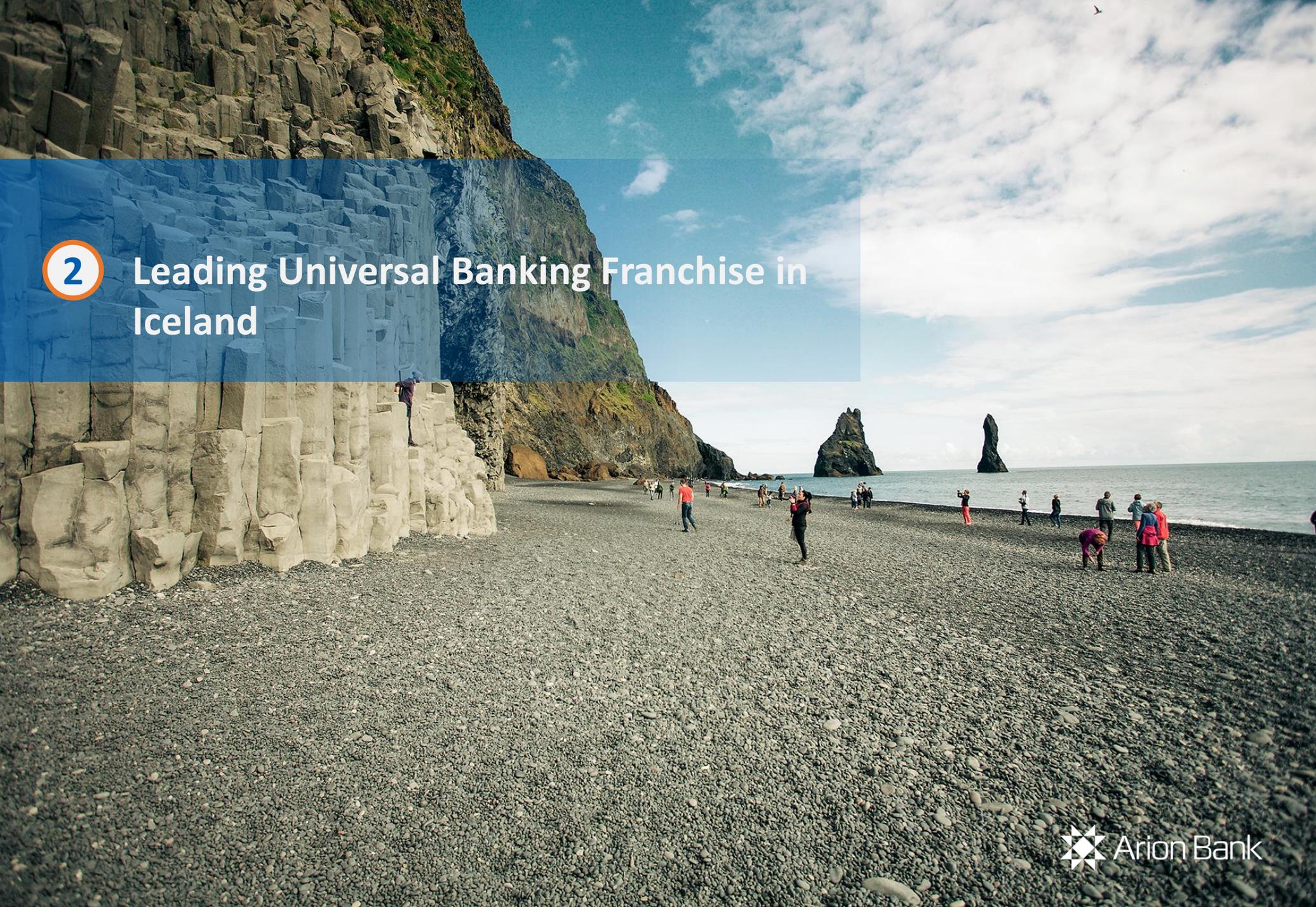
### GDP Growth vs. Banking Sector

Indexed numbers based on 2009



## Lifting of capital controls





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## Leading Universal Banking Franchise in Iceland

# A leading universal relationship bank in Iceland with a differentiated and innovative approach



1. Capacent. Based on monthly customer survey (individuals) 2016. Q: What is your main retail bank?

2. SMEs are defined as corporates in Retail Bank with loans up to ISK 2 Bn

3. Management belief based on interim financial statement and company information 1H 2017. SMEs are covered by Retail Bank but included in the Corporate Banking market share

4. Vörður acquisition received approval from the Icelandic Competition Authority at the end of September 2016

5. Based on 2016 annual accounts (Valitor, Borgun and Kortþjónustustan)

# A universal relationship bank

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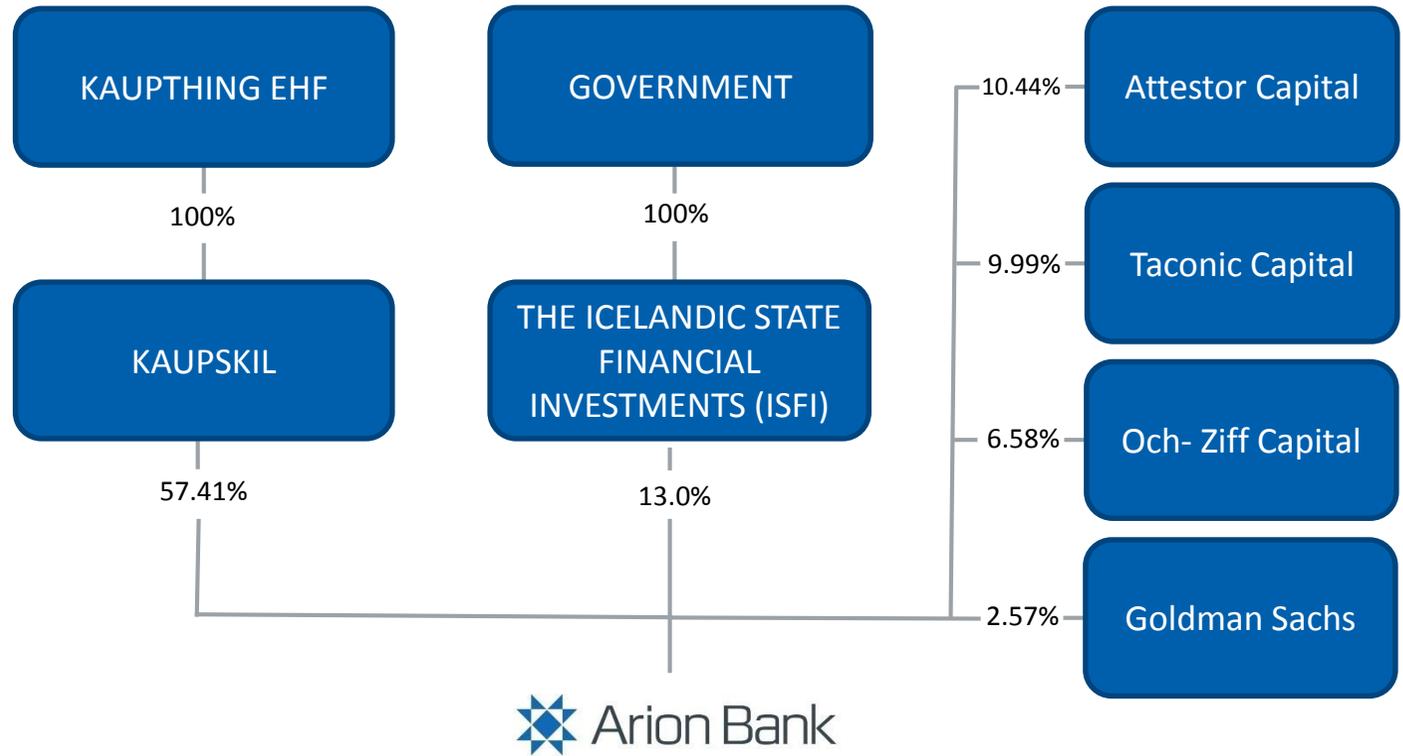
- Primary emphasis on **corporations** and **individuals** seeking a **variety of financial solutions**
- Focus on building and strengthening **long-term customer relationships** by delivering **excellent service and tailored solutions**
- Operations in the greater Reykjavík area as well as the largest urban areas around the country
- Contributes to a positive development of the Icelandic economy and society
- A leading position within the domestic financial market in terms of **return on equity, operational efficiency** and **service offerings**
- Provides financial **services outside of Iceland**, mainly to companies related to the **seafood industry in Europe and North America**



# Current ownership structure

Recent changes in the ownership structure

- On the 19th of March, 2017, Kaupskil sold a 29% share in Arion Bank in a private placement



# Fully restructured bank, with potential for further value creation

## 2010-2012:

“Restructuring of the bank and its customers”

- Operations consolidated under Arion Bank
- Clean and newly valued balance sheet post crisis
- Acquired loan portfolios from the old bank (fair value was a discount to the face value of the loans)
- Discount of loan portfolios progressively released
- Restructuring and systematically driven improvements in underlying asset quality

## 2013-2014:

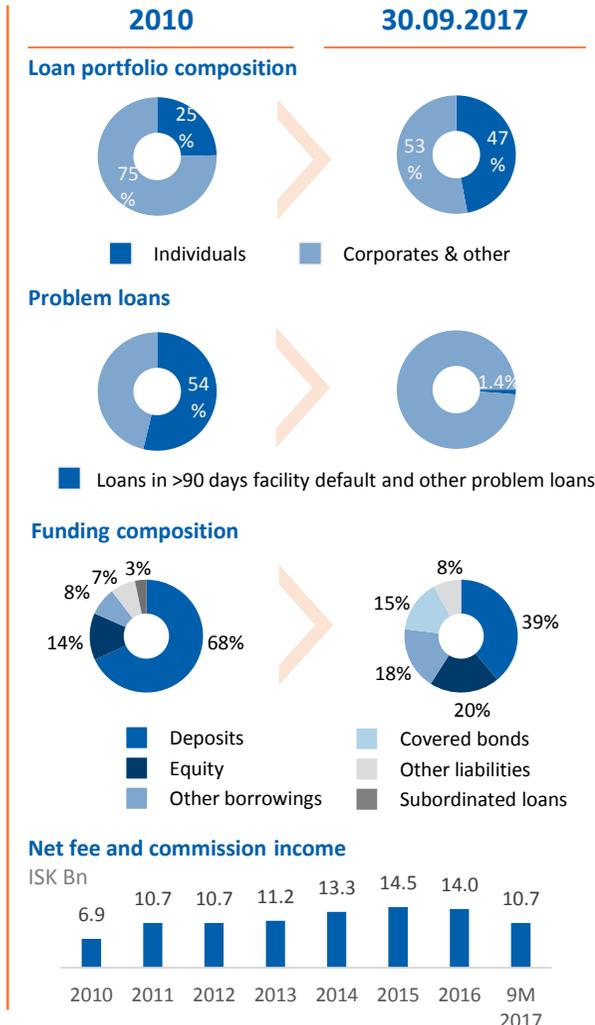
“Streamlining and building of the business”

- Launched “lean banking initiative” and implemented changes to core banking operations
- Optimised branch network
- Built Icelandic market leadership in core products
- Further improvements in underlying asset qualities

## 2015+

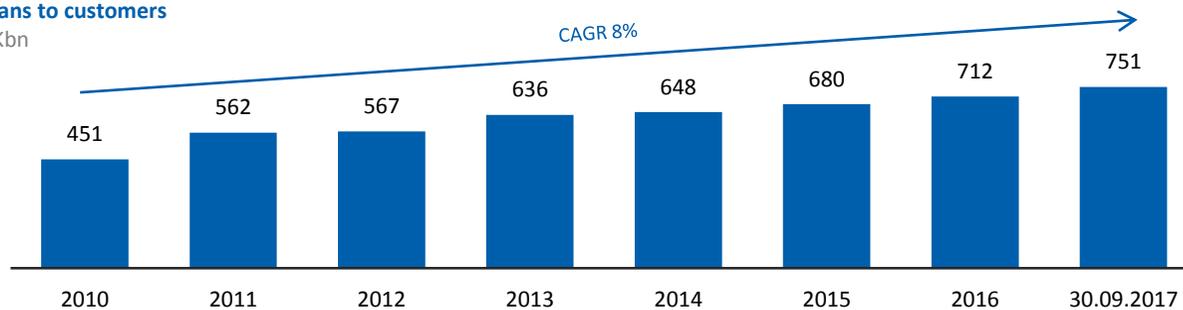
“Strengthening market leadership and harvesting full value potential”

- Further strengthening market leadership and scaling of presence
- Harvesting value from operational efficiency and scaling of digitalisation
- Continued investments in IT infrastructure
- Driving commercial excellence in business divisions and actively exploring new business opportunities
- Optimising capital structure



## Loans to customers

ISKbn

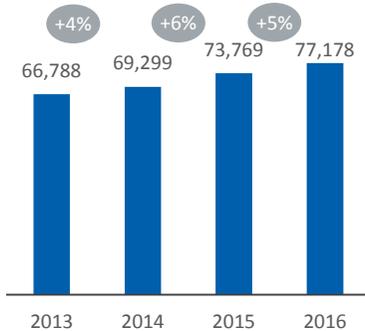


# Digitalised banking framework

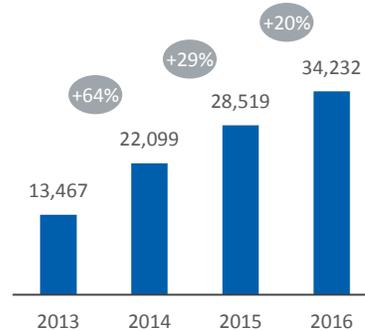
With strong customer focus

## Increasing digital impact

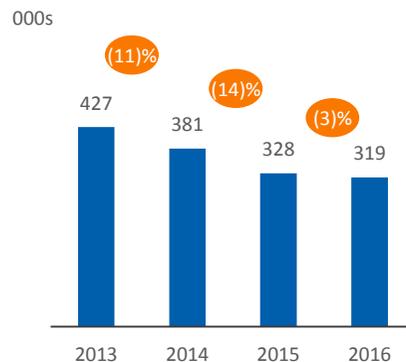
Active online bank users<sup>1</sup>



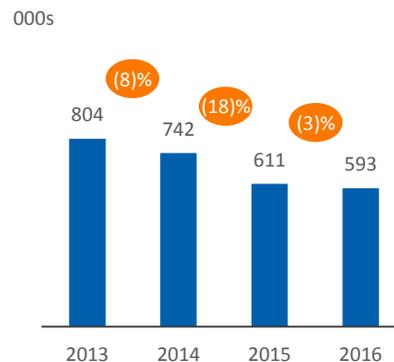
Active Arion Bank app users<sup>1</sup>



Number of calls to the call centre<sup>2</sup>



Number of visits to branches<sup>2</sup>



## Key digital initiatives

- **On-boarding of a new customer:** Took number of visits to a branch, phone calls, printing and signing of several documents. Now it only takes a few minutes to sign up through our website, both for individuals and corporates.
- **Credit assessments:** Took up to 10 days but now our fully digital credit assessment only takes 3 minutes to perform online.
- **Mortgage applications:** Our digital mortgage applications have dramatically decreased customers waiting time for mortgage approvals.

Other customer journeys that have already been reshaped into fully digital flows, accessible online 24/7, include:

- Opening new bank accounts
- Applying for payment cards
- Credit card payment plans
- Managing credit card limits
- Digital mortgage refinancing
- Online bond applications and signing
- Regular savings
- Short term financing
- Car financing

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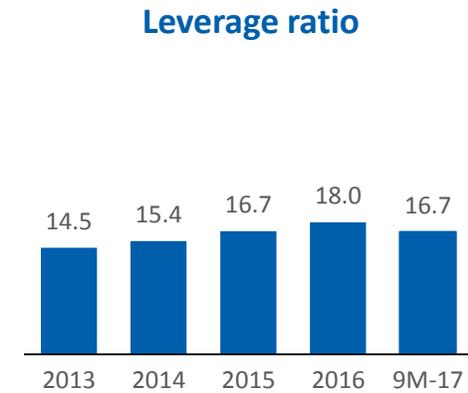
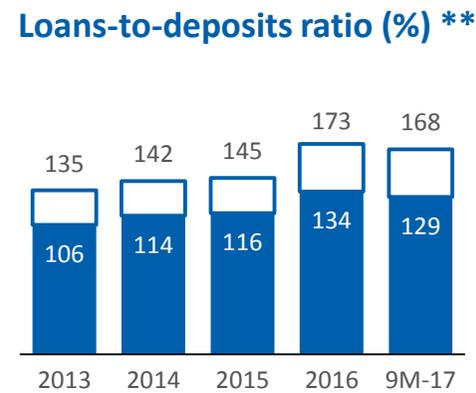
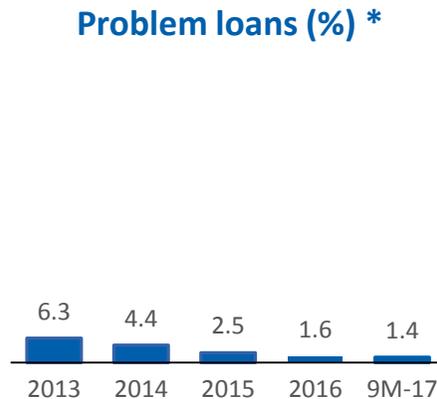
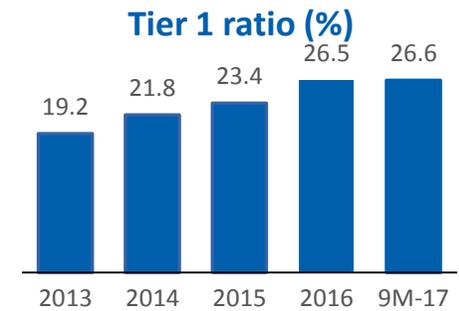
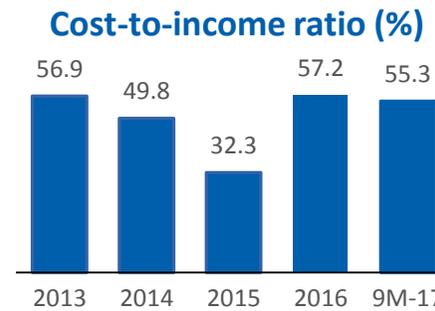
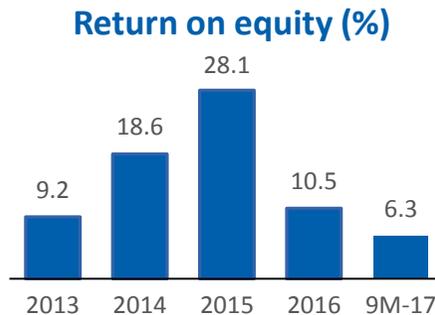
## Strong Balance Sheet and Good Asset Quality



# All key financial indicators performing

Arion bank has consistently delivered a strong financial performance

- Solid level of capitalization due to strong profit generation
- Steadily improving asset quality
- Continued improvement in problem loans



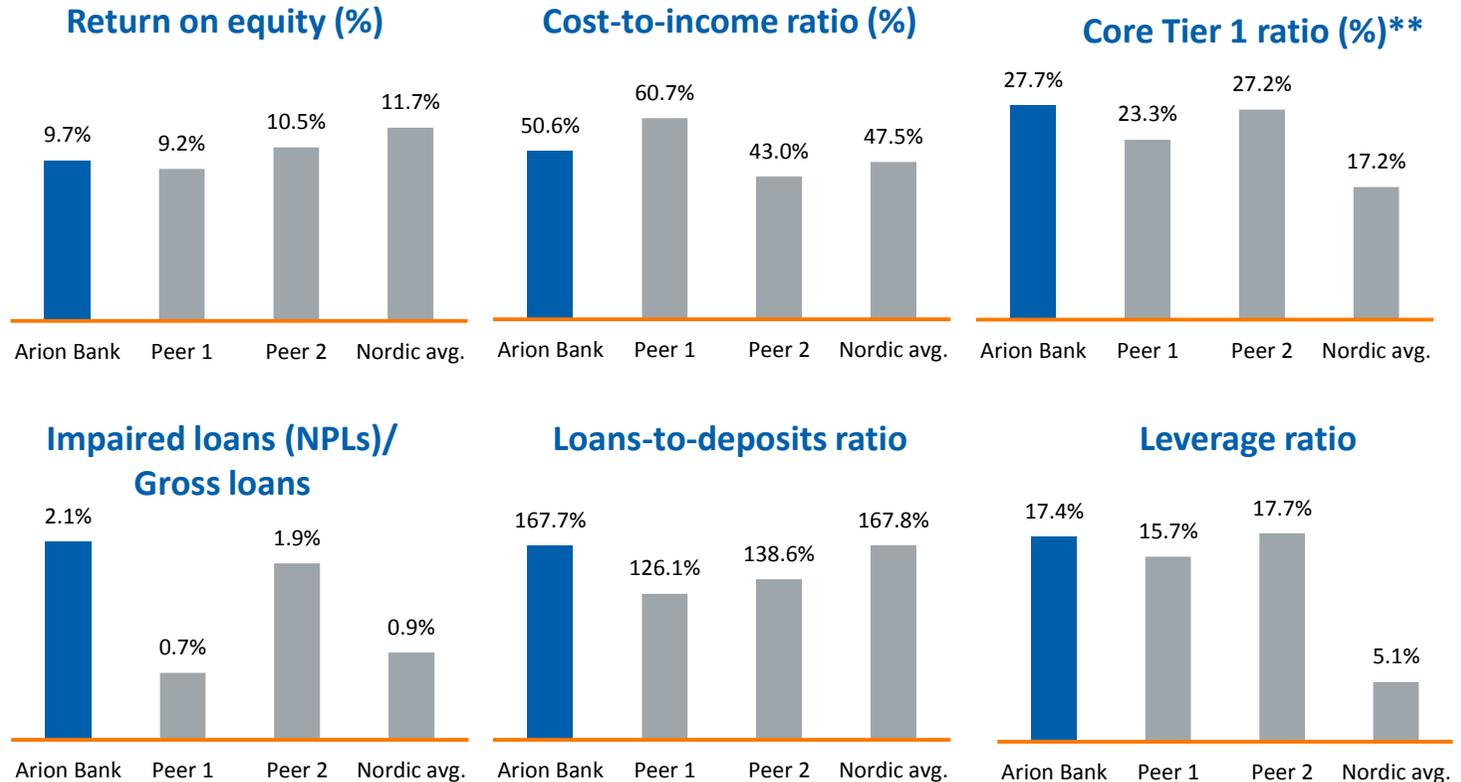
\* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

\*\* The lower ratio is loans-to-deposits excluding mortgages funded with long term covered bonds

# Comparison with peer group (H1 2017)

Arion bank compares well with local competitors and Nordic banks\*

- Strong capitalization compared to Nordic peers
- RWA calculated according to standardized approach
- Strong Leverage ratio
- Efficiency in line with Nordic banks
- Loans to deposit ratio conservative compared to peer group



\* Nordic banks = Handelsbanken, SEB, Nordea, DNB and Danske Bank

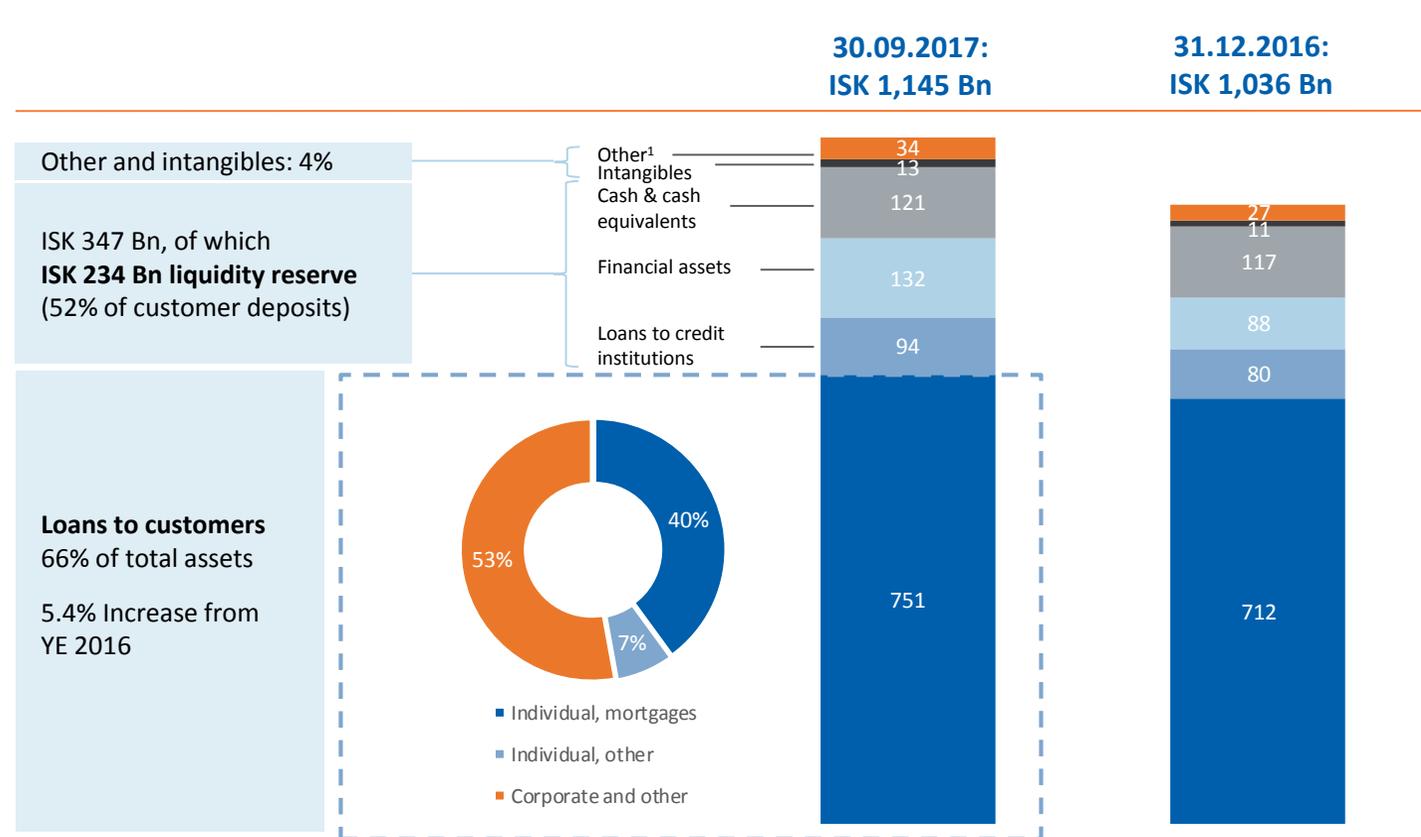
\*\* The Icelandic Banks are using the Standardized Approach for calculating the Credit Risk capital requirement

# Balance sheet - Assets

All amounts in ISK billion

## Robust loan growth – strong liquidity position

- The balance sheet grew by 10.5% during the first nine months, partially due to pre-financing for upcoming bond maturities
- Strong growth in loans to customers during the period
- The pension funds continued aggressive mortgage lending to their policy holders in the period, limiting mortgage lending growth
- Strong liquidity position due to pre-financing of upcoming bond maturities



1. Other assets include investment property, investment in associates, tax assets and other assets

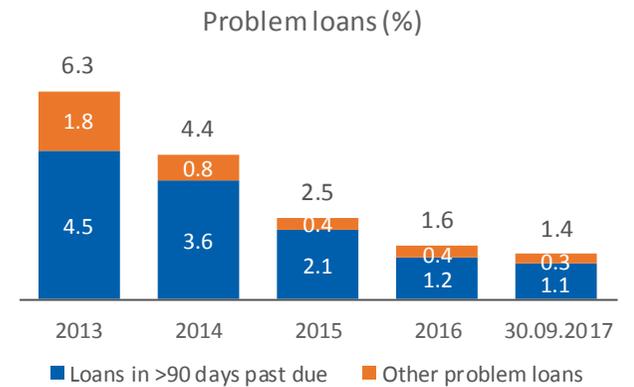
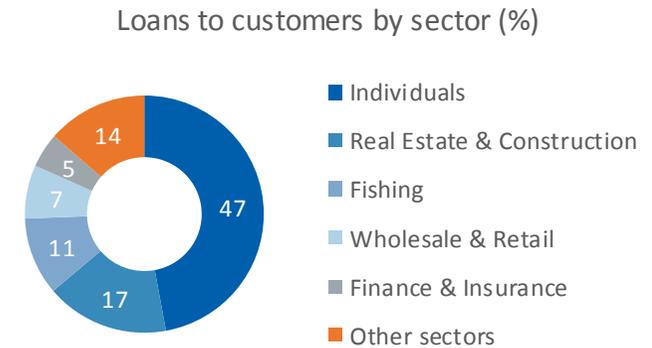
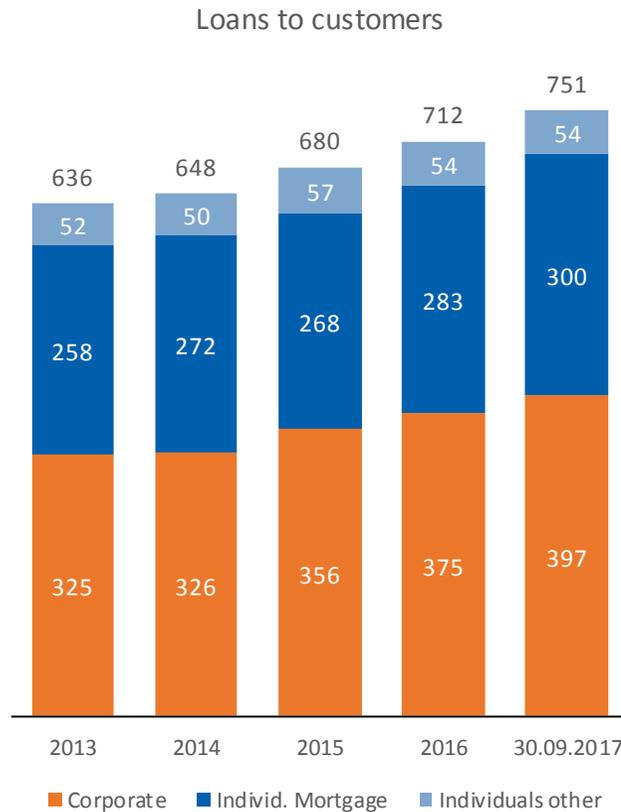
# Loans to customers

All amounts in ISK billion

## Good balance in loans to corporates and individuals

- Loans to customers increased by 5.4% during the first nine months

- The mortgage portfolio grew by 6% despite strong competition from pension funds
- The corporate loan portfolio grew by 6%
- Good diversification in the corporate loan book
- Problem loans continue to decrease
- Loan commitments of ISK 92 billion at the end of the period mostly corporate loans

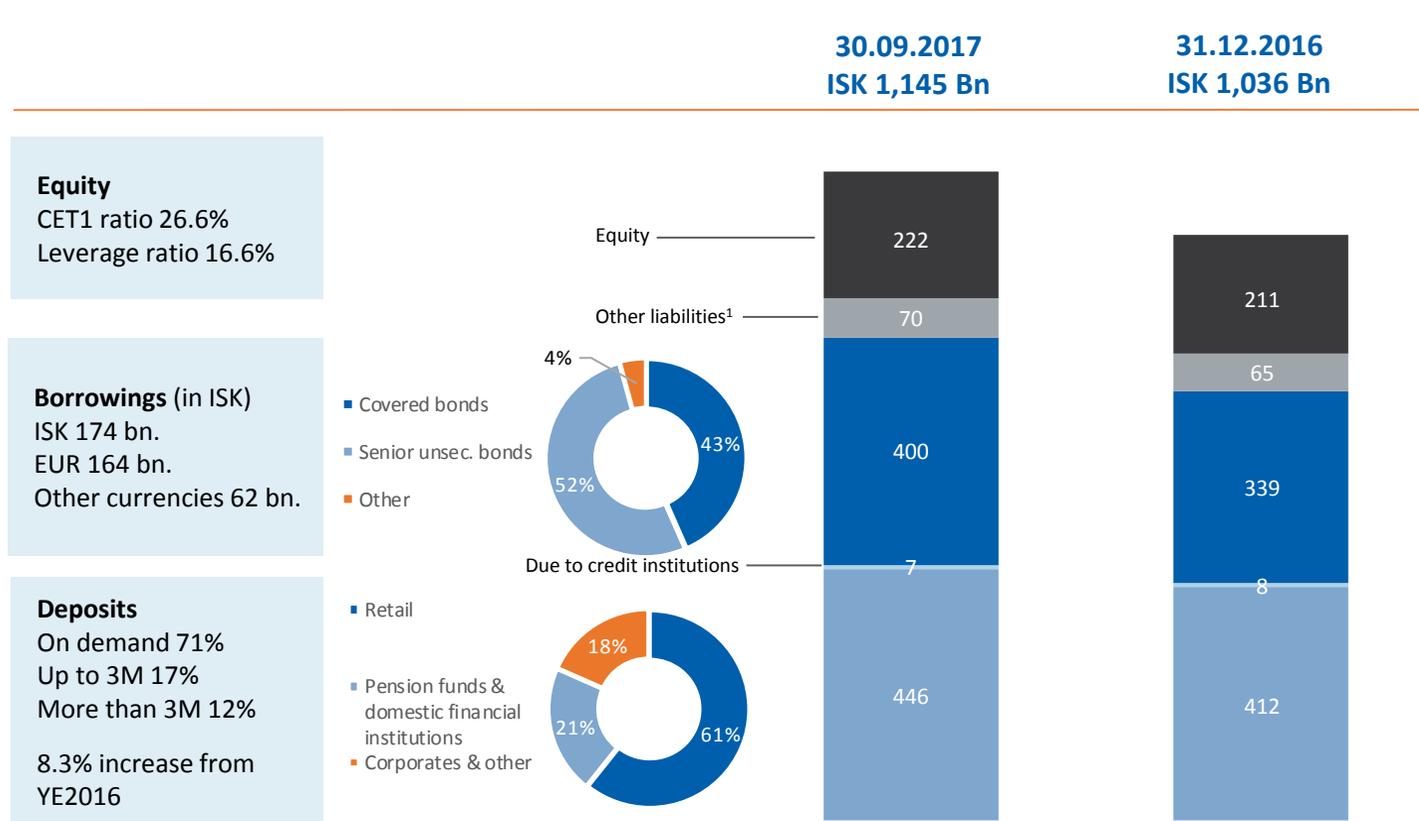


# Balance sheet – Liabilities and Equity

All amounts in ISK billion

## Successful international bond issues – Strong equity position

- Increase in deposits, mainly from retail customers
- New and successful international bond issues during the first nine months
- Strong equity position



1. Other liabilities include Financial liabilities at fair value, tax liabilities and Other liabilities



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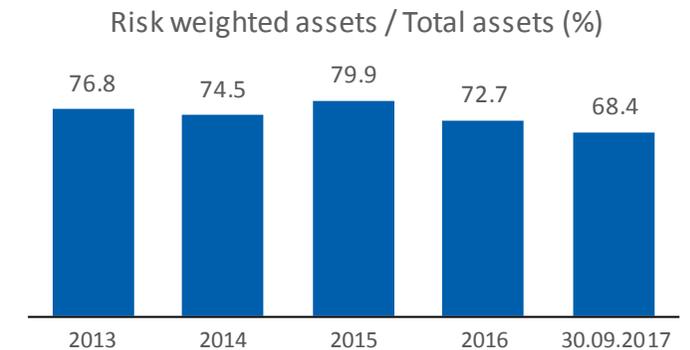
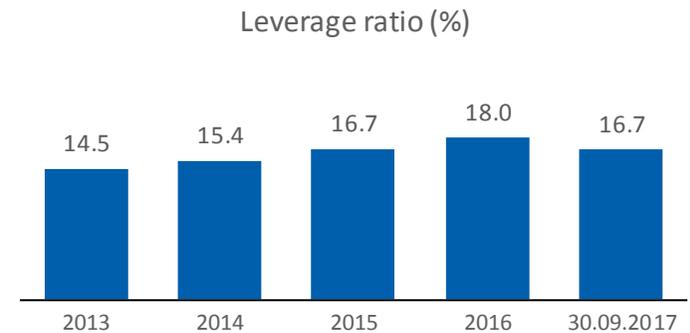
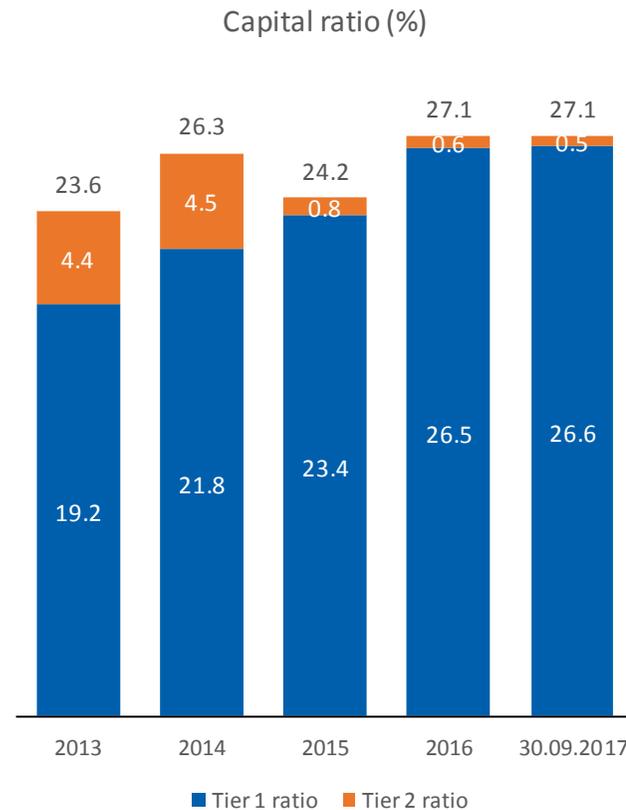
## Strong Capital Position and Sound Funding Profile

# Capital base

All amounts in ISK billion

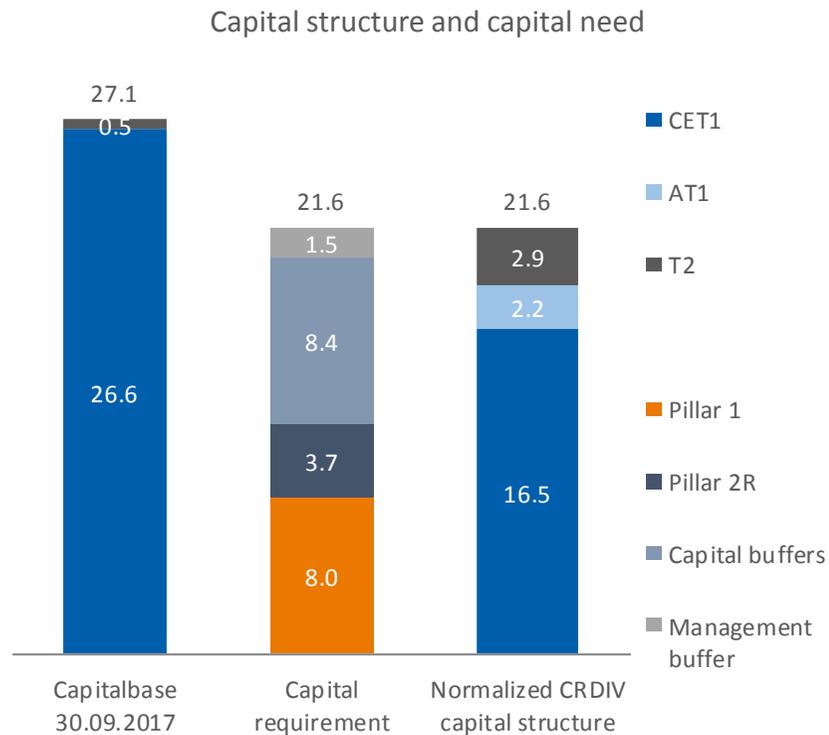
## Continued strong capital position

- Solid level of capital due to strong profit generation
- Risk-weighted assets of 68.4% are calculated on the basis of standardized approach
- The Bank's cash position with the Central Bank has increased considerably in 9M 2017. This results in lower leverage ratio and lower risk-weight density
- Tier 2 capital at 30 September 2017 consisted only of collective credit risk adjustment



# Capital base

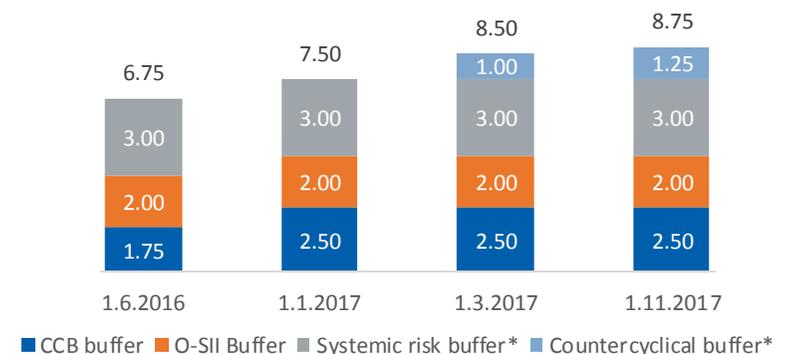
## Capital structure and requirements



- The Group's capital calculations are based on the Icelandic adoption of the EU Capital Requirement Directive and Regulation (CRD IV/CRR). Article 501 of the CRR, on capital requirement relief for small and medium enterprises, is temporarily excluded in the Icelandic regulation. The Group applies the standardized approach for all risk types.

- In Q4 of 2017, the combined capital buffer requirement will reach 8.4%, based on the Group's current risk profile.
- The FME's SREP result based on the Group's balance sheet as at 31 December 2016, indicates a total regulatory capital requirement of 20.1%, including fully-implemented buffers
- Including a management buffer of 1.5%, the Group had surplus capital of ISK 43 billion at 30 September 2017

Capital Buffer Implementation for systemically important banks in Iceland (%)



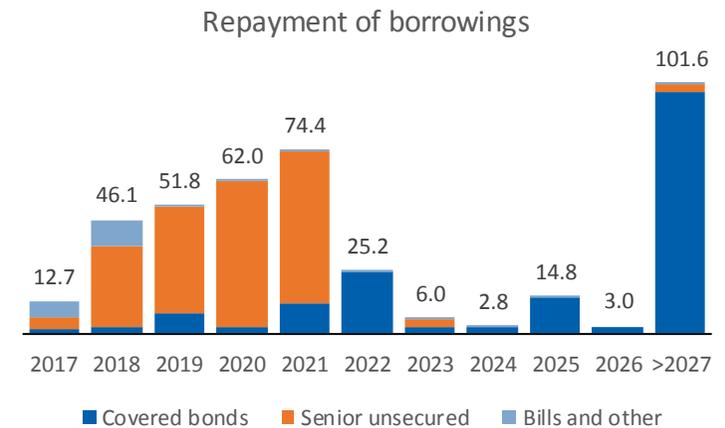
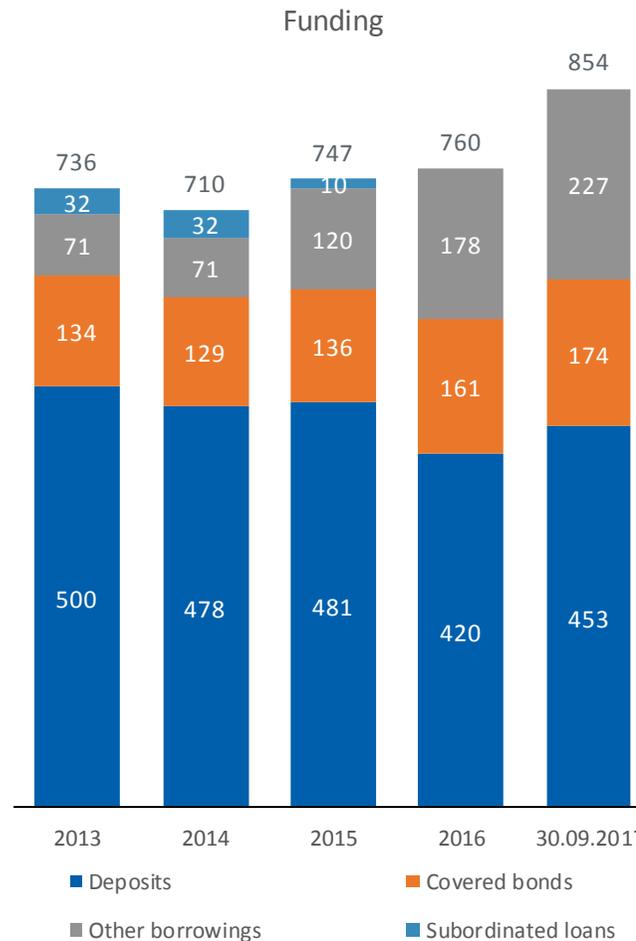
\* The effective buffers are calculated using the capital buffer level of each country of exposure, weighted using the corresponding credit risk RWA.

# Funding

All amounts in ISK billion

## Success on the international bond market – Kaupthing facility fully prepaid

- In June the Bank issued new 3 year, EUR 300 million senior unsecured bond or approx. ISK 37 billion at interest cost equal to 0.88% over interbank rates
- The Bank made the final repayment of the USD 747 million resettable note issued to Kaupthing in the beginning of 2016
- In January the Bank issued an additional EUR 200 million tap of the euro benchmark bond issued in December 2016 bringing the total to EUR 500 million or approx. ISK 60 billion
- The Bank continued to issue covered Bonds in the Icelandic market, total of ISK 19.1 billion during 9M 2017 and issued smaller private placements in the international market of approx. ISK 19.6 billion

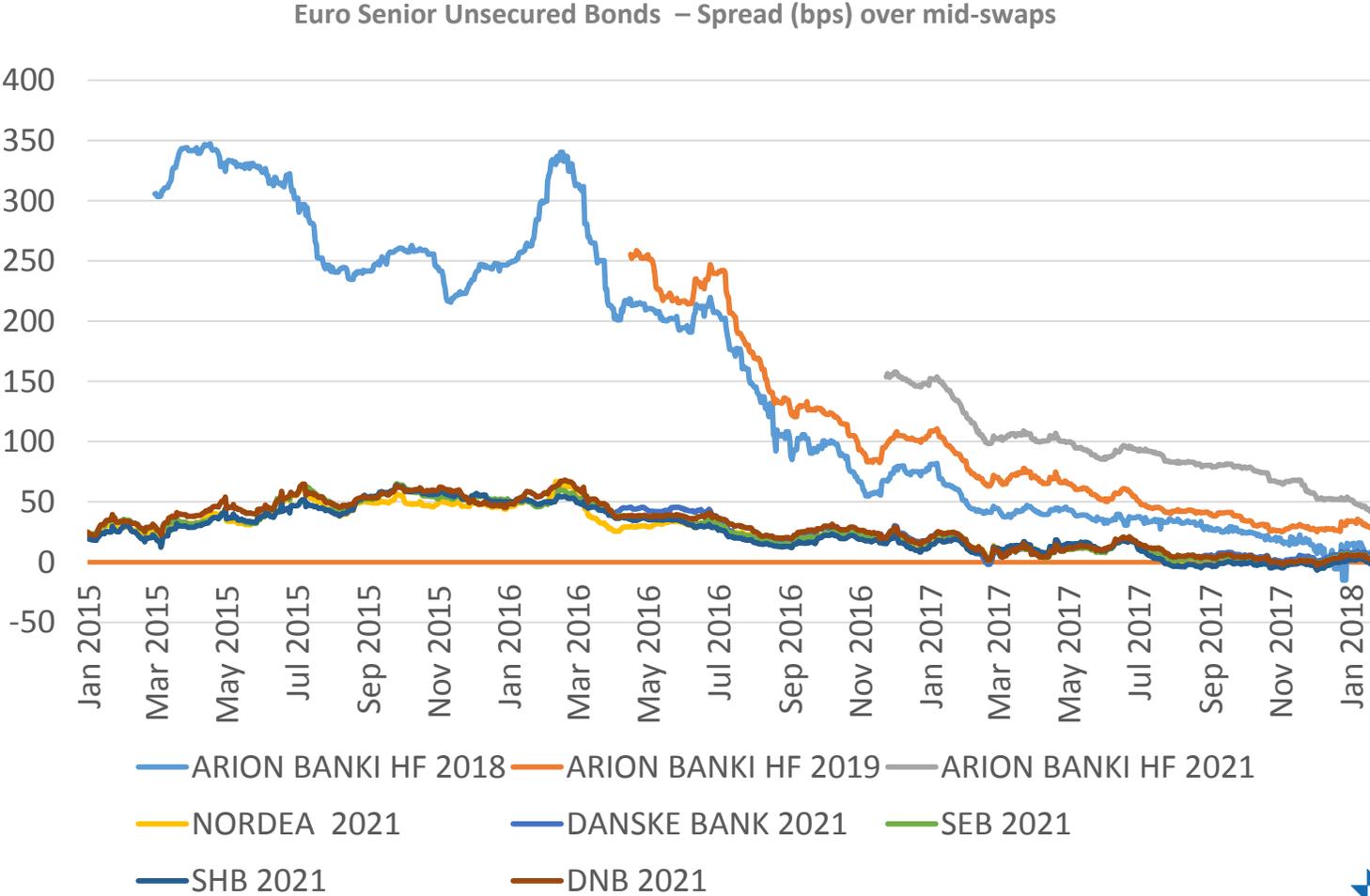


### Ratings - S&P (25 October 2017)

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

# Good performance in the secondary bond market

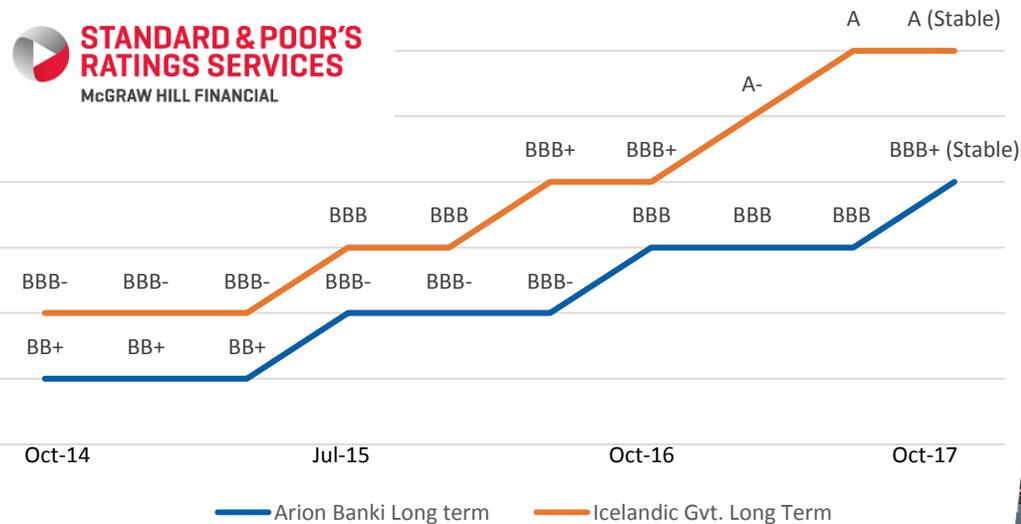
The spread between Arion Bank and large Nordic banks continues to decrease



# Improving rating and positive outlook

## Rating fundamentals

- ▶ Strong capital position
- ▶ Strong liquidity position
- ▶ Largely restructured loan book
- ▶ Strong earnings
- ▶ Improved access to foreign debt capital markets





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## Medium Term Targets

SYLVIA

## Medium term targets

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<b>CET 1 Ratio</b> (Subject to regulatory requirements)	Decrease to circa 17%
<b>Loan Growth</b>	Prudent lending to outpace economic growth in the next few years
<b>Return on Equity</b>	Reach double digit returns
<b>Dividend Policy</b>	Payout ratio of circa 50% of net earnings attributable to shareholders
<b>Cost to Income Ratio</b>	Decrease to circa 50%

# Summary

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# Q&A

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