



ARION BANK

Investor Presentation

March 2018



Key Highlights

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

Macroeconomic Environment



Iceland at glance – strong and modern economy...

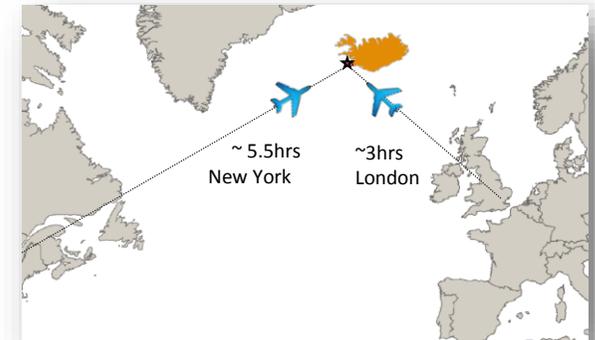
Strong economy with further upsides

- 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

State	Republic
Capital	Reykjavik
Life expectancy world rank 2017	6
Gender equality world rank 2017	1
Contribution of renewables to energy supply in OECD countries 2014	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

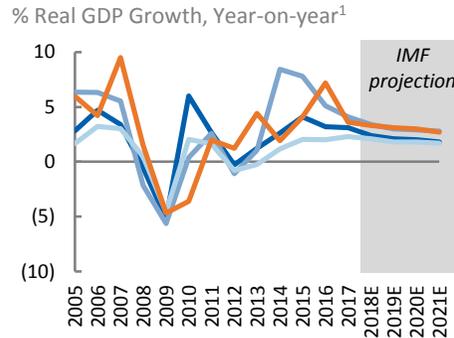
GDP per capita 2017, USD thousands¹



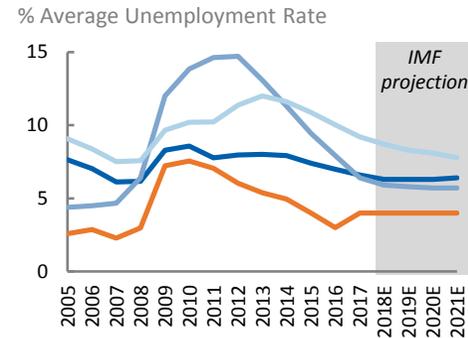
Strong and modern economy with positive economic fundamentals...

- 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:
 - Tourism³
 - Marine/Seafood industry
 - Energy
 - Knowledge

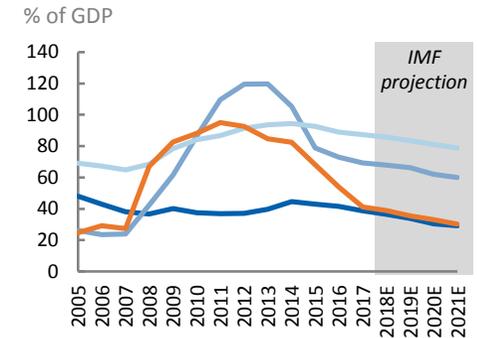
Economic recovery since 2010 with strong outlook



Unemployment rate significantly below other countries



General government gross debt (% of GDP)

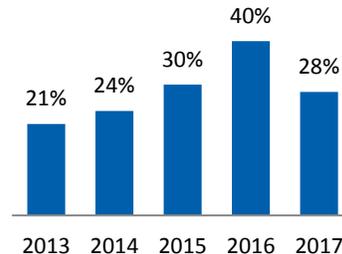


■ Sweden ■ Ireland ■ Euro Area ■ Iceland

Accelerated growth in tourism contributing to exports and strength in GDP

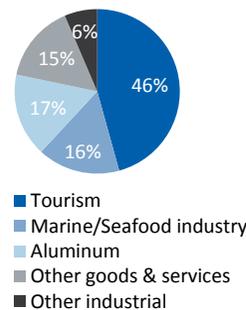
Growth in Tourism

% Change YoY in # Tourists²



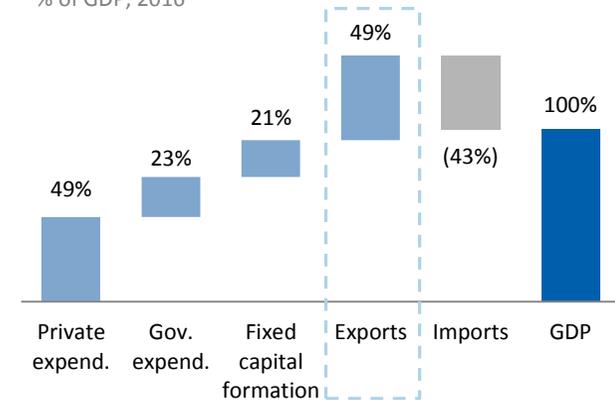
Export Contribution by Industry

% Contribution, 9M 2017



Breakdown of GDP

% of GDP, 2016



Leading Universal Banking Franchise in Iceland

2



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

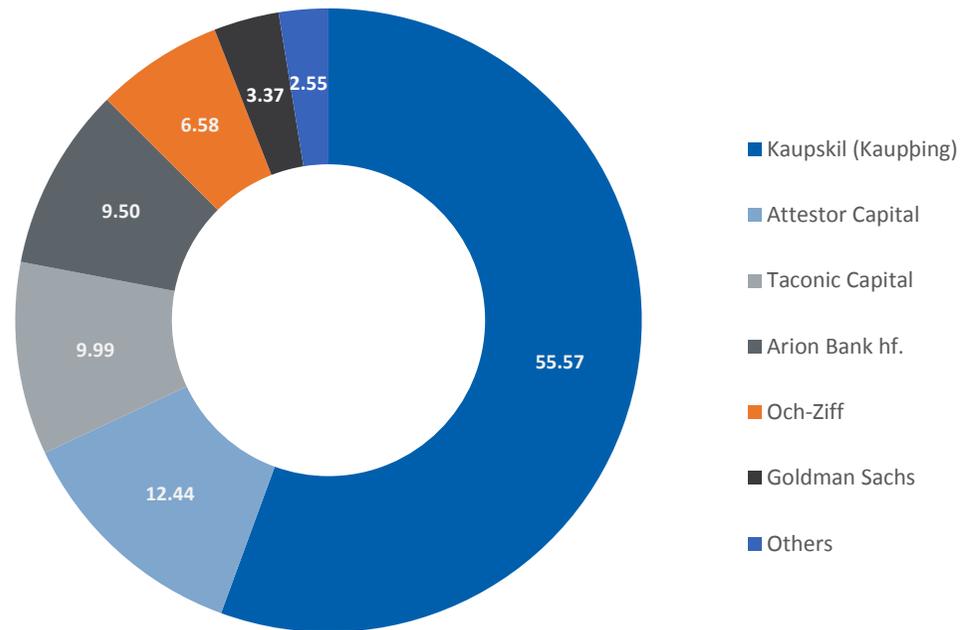
5. Based on 2016 annual accounts (Valitor, Borgun and Kortþjónustustan)

Current ownership structure

Recent changes in the ownership structure

- In early 2017, Kaupskil sold a 29% share in Arion Bank in a private placement
- In February, Kaupthing exercised a call option buying 13% stake in Arion Bank from the Icelandic government
- Arion Bank bought back 9.5% of those shares
- The remaining were bought by international and domestic investors

Ownership structure (%)



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:

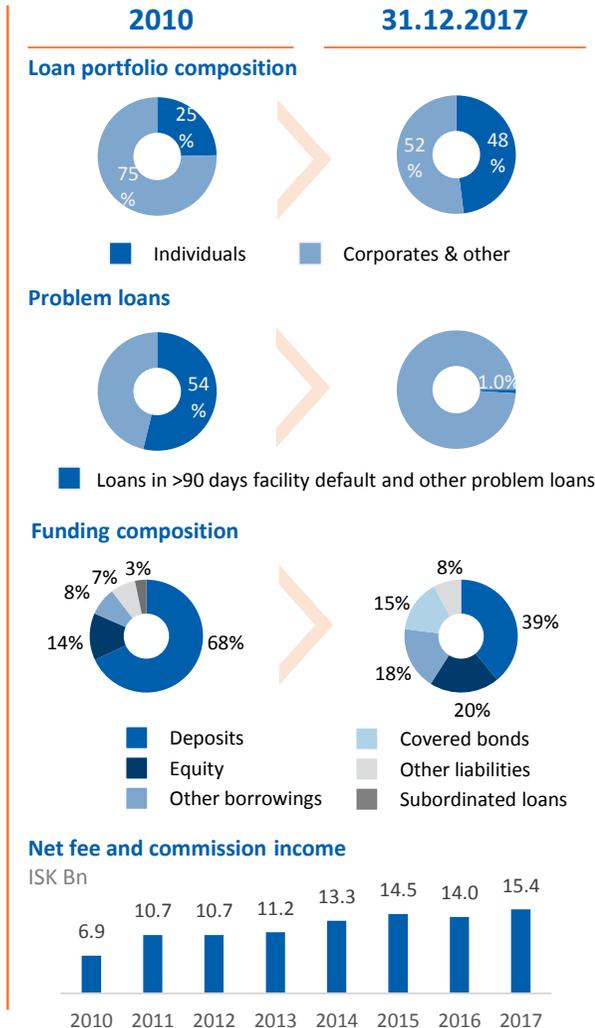
“Streamlining and building of the business”

- 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+

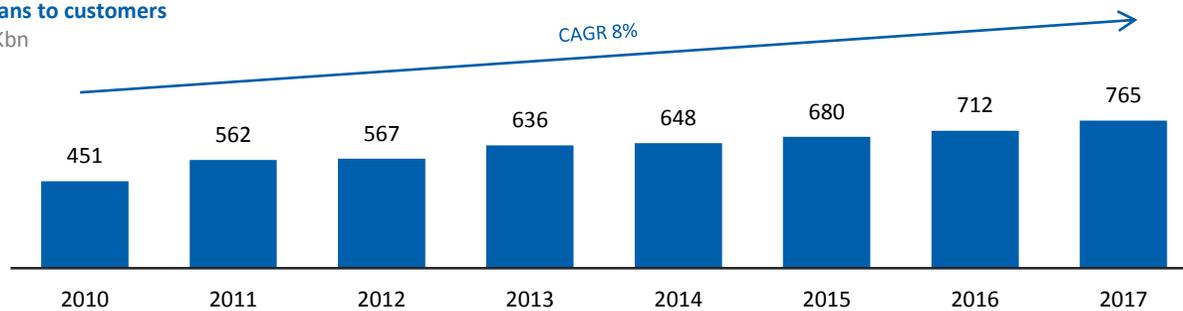
“Strengthening market leadership and harvesting full value potential”

- 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

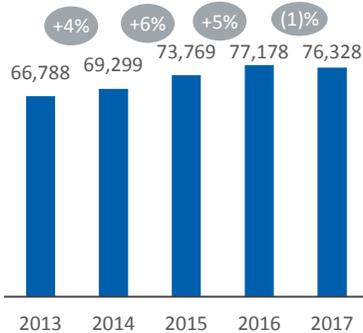


Digital strategy delivering tangible results

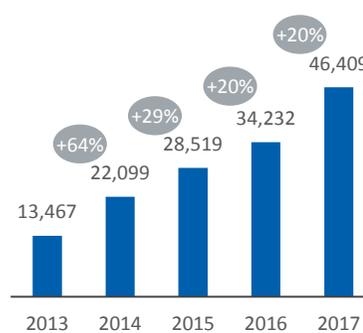
Strong customer focus

Increasing digital impact

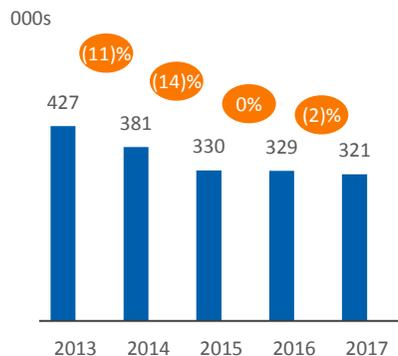
Active online bank users¹



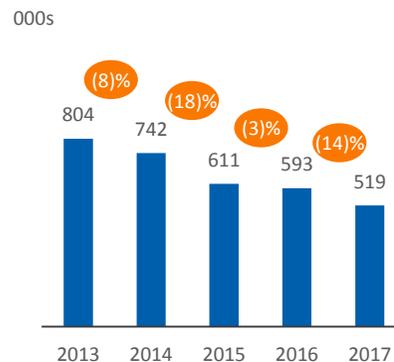
Active Arion Bank app users¹



Number of calls to the call centre²



Number of visits to branches²



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

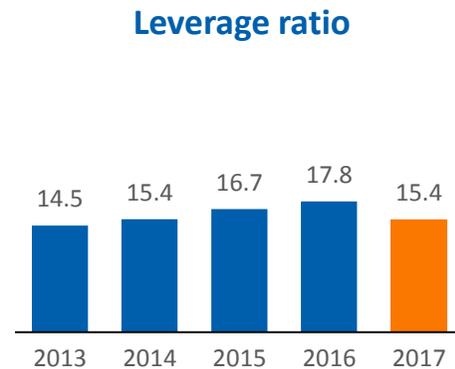
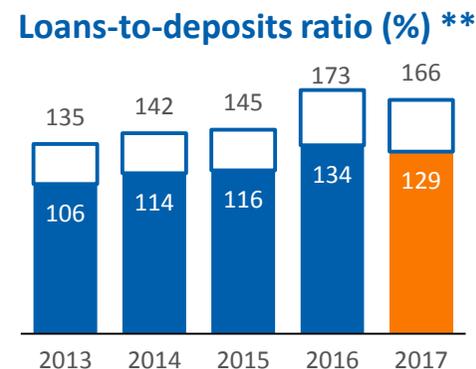
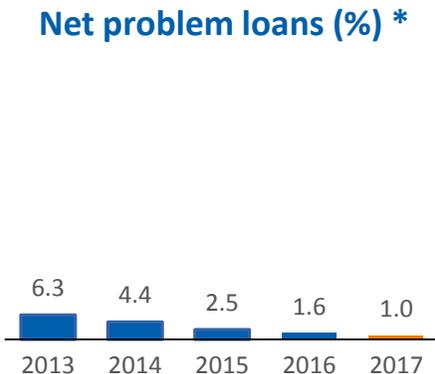
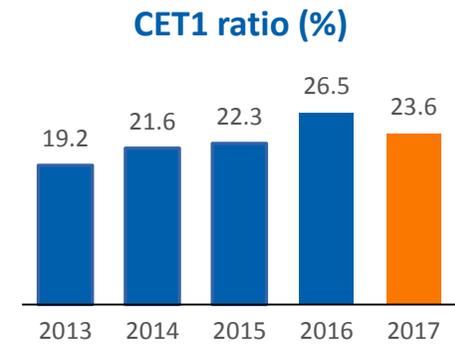
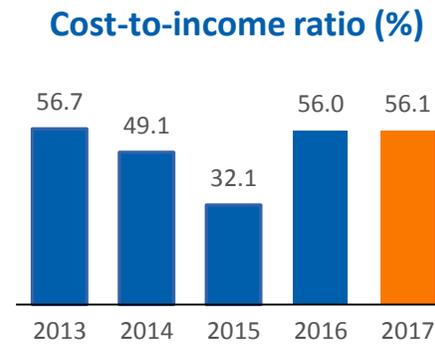
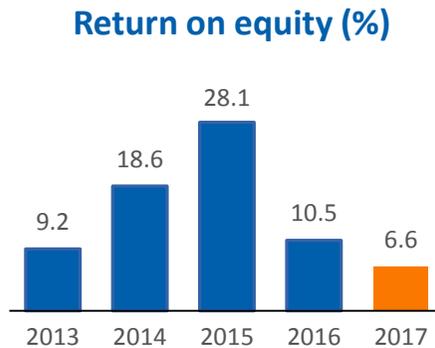
Strong Balance Sheet and Good Asset Quality



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



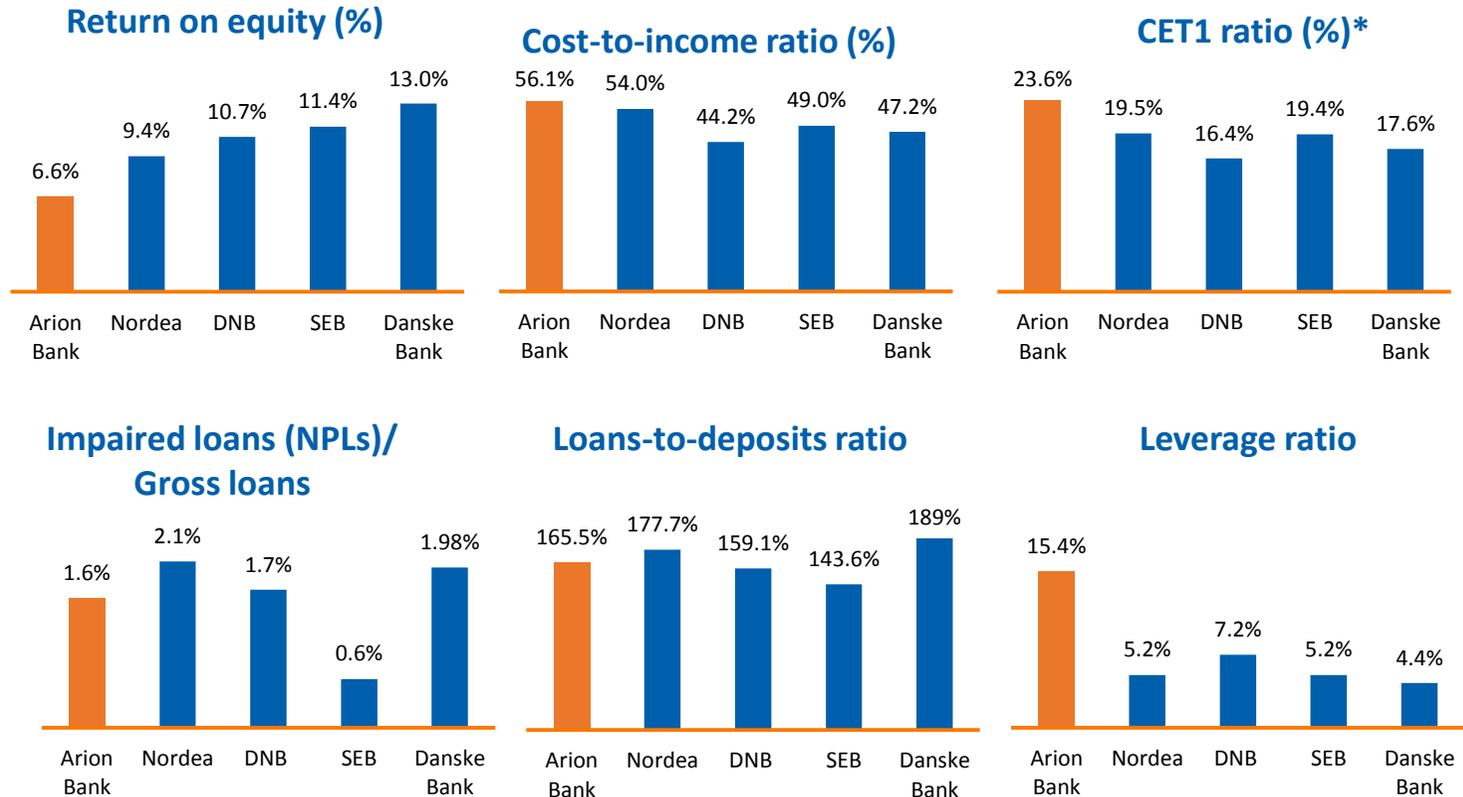
* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

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

Comparison with peer group (2017)

Arion Bank and Nordic peers

- 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



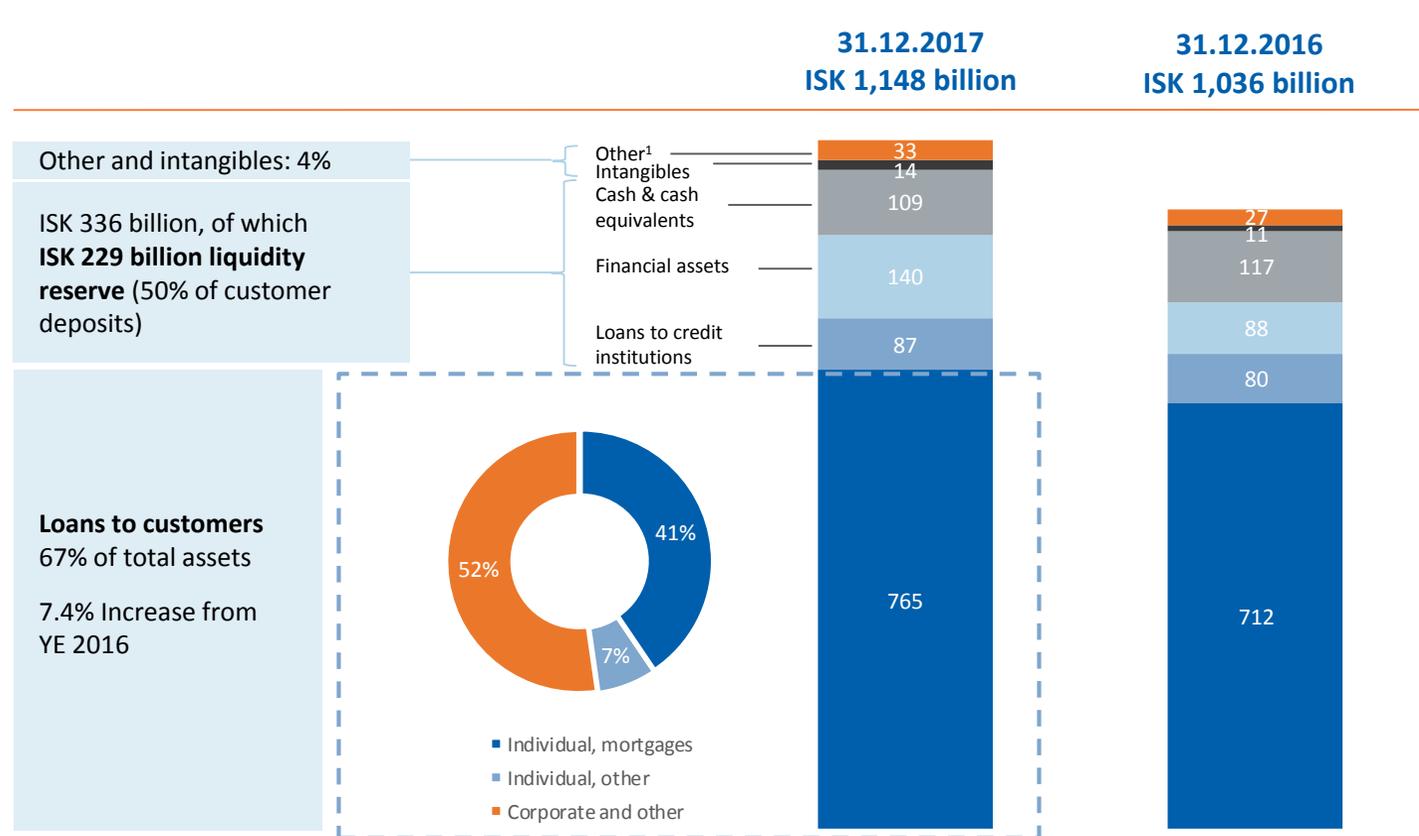
*Arion Bank uses the Standardized Approach for calculating the Credit Risk capital requirement

Balance sheet - Assets

All amounts in ISK billion

Robust loan growth in line with economic growth

- The balance sheet grew by 10.8% in 2017
- Strong growth in loans to customers, specially in the second half of the year
- Strong liquidity position partially due to pre-financing of upcoming bond maturities



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

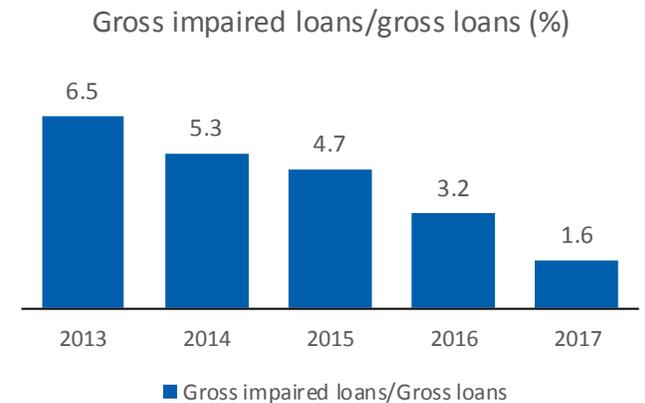
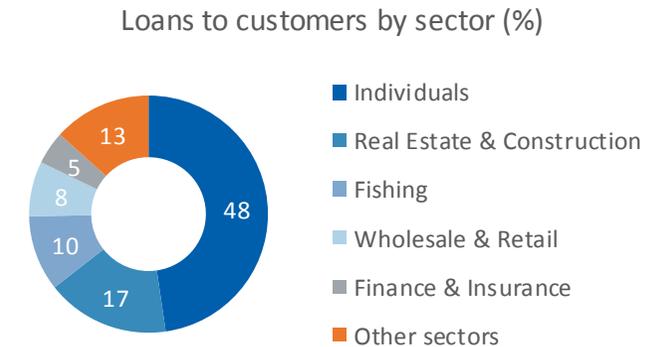
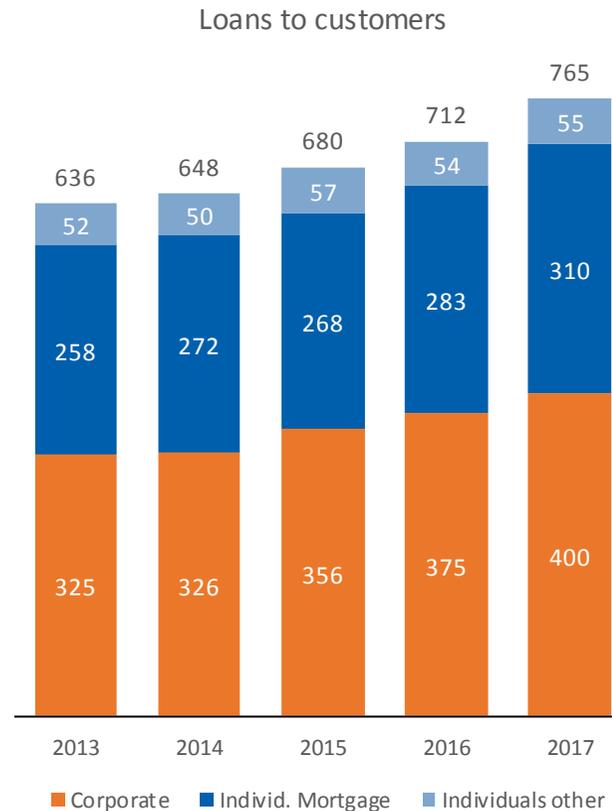
Loans to customers

All amounts in ISK billion

Well balanced loan portfolio between corporates and individuals

- Loans to customers increased by 7.4% in 2017

- The mortgage portfolio grew by 9.7%, driven by new digital solutions and a strong housing market
- The corporate loan portfolio grew by 6.6%, mainly in real estate, construction and transportation
- Good diversification in the corporate loan book
- The ratio of gross impaired loans/gross loans continues to improve
- Outlook for new lending is strong



Balance sheet – Liabilities and Equity

All amounts in ISK billion

Strong equity position and well balanced funding

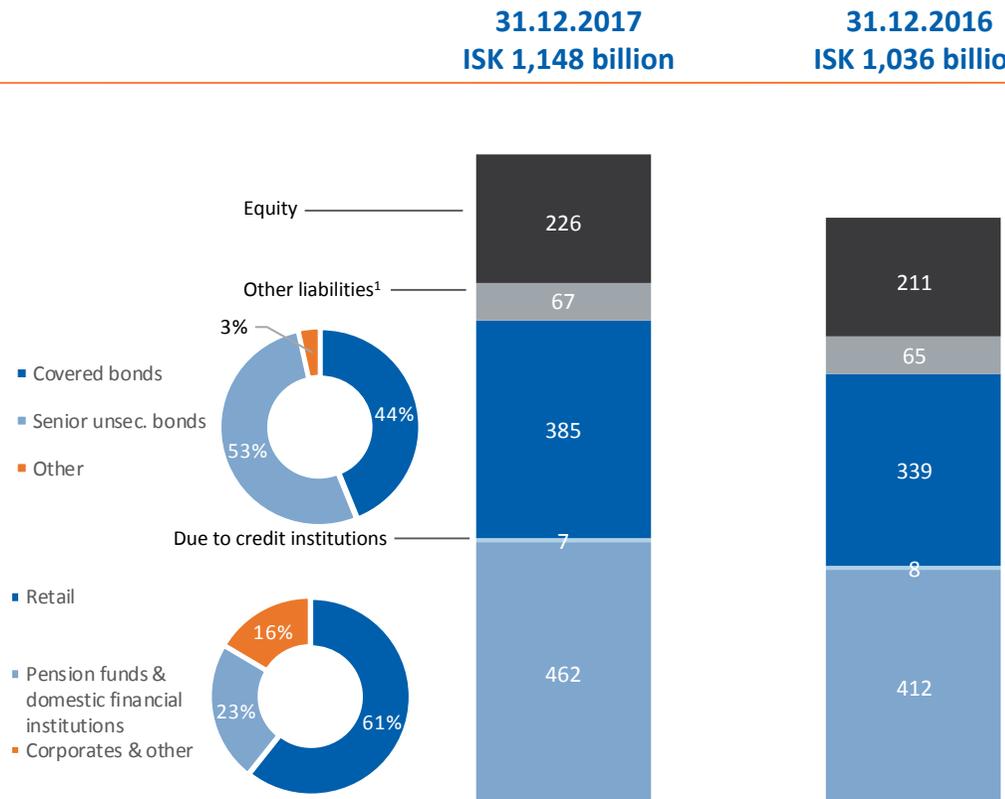
- Increase in deposits, mainly from retail customers
- Successful wholesale funding activities both in Iceland and in the international markets
- Strong equity position and a very high leverage ratio despite foreseeable dividend payment of ISK 25 billion

Equity
CET1 ratio 23.6%
Leverage ratio 15.4%

Borrowings (in ISK)
ISK 182 billion
EUR 162 billion
Other currencies 41 billion

Deposits
On demand 72%
Up to 3M 18%
More than 3M 10%

12.2% increase from YE2016



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

Sound Funding Profile

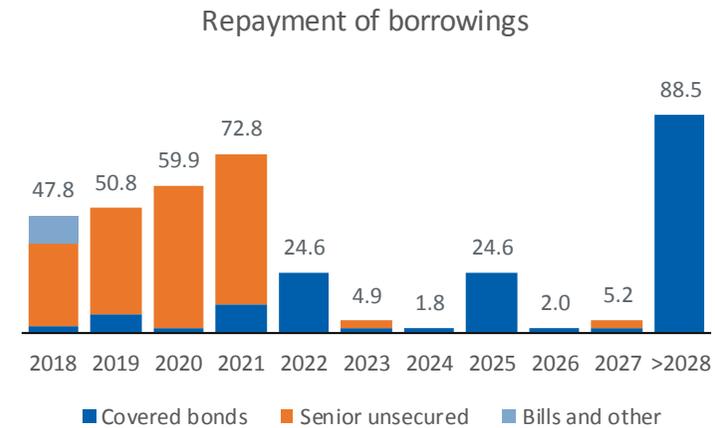
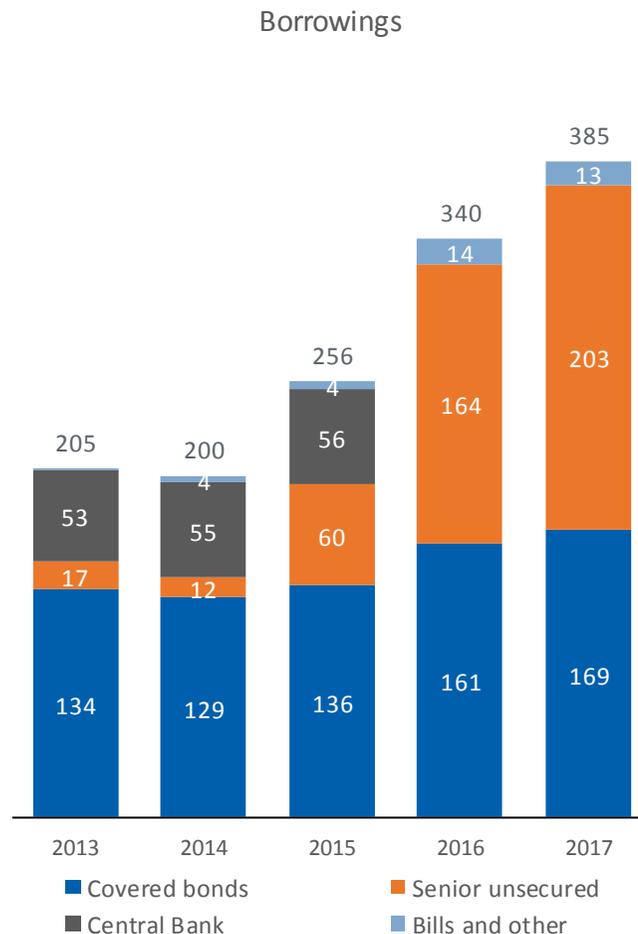


Funding

All amounts in ISK billion

Success in the international and domestic bond markets

- Regular issuer in the international bond markets
- Covered bonds issued domestically to finance mortgage lending.
- All legacy funding that was originally provided by the government and Kaupthing has now been repaid



Ratings - S&P

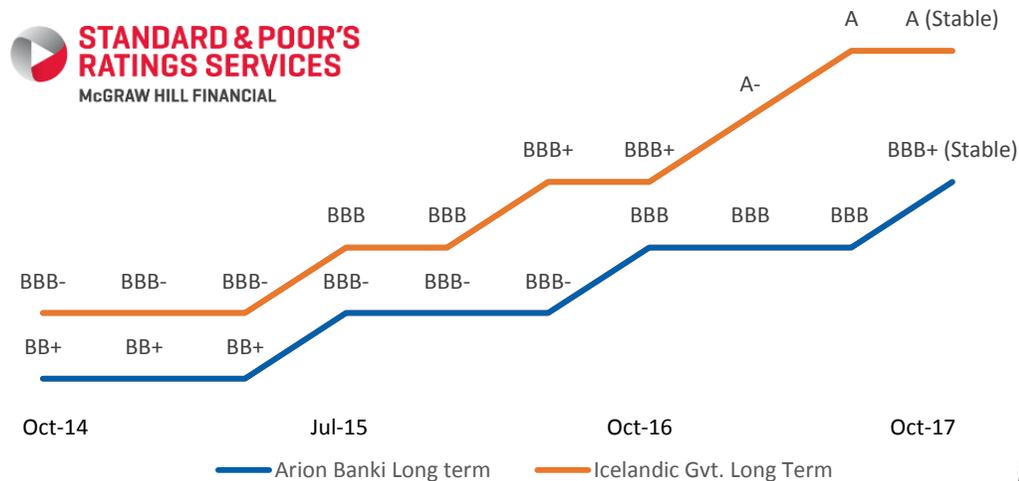
		
Senior unsecured	BBB+	A
Short term debt	A-2	A-1
Outlook	Stable	Stable



Positive rating trend

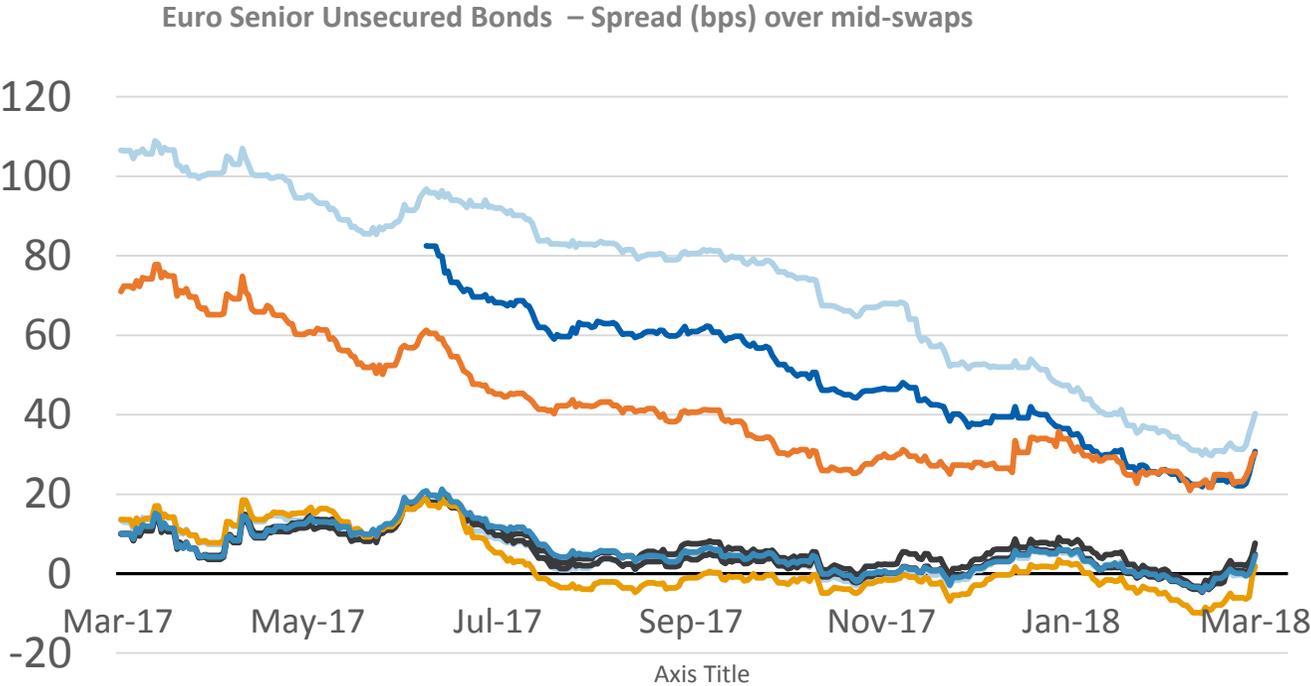
Rating fundamentals

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



Good performance in the secondary bond market

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



- ARION 06/2020
- ARION 04/2019
- ARION 12/2021
- NORDEA 02/2021
- Danske Bank 05/2021
- SEB 02/2021
- Handelsbanken 10/2021
- DNB 02/2021



Strong Capital Position

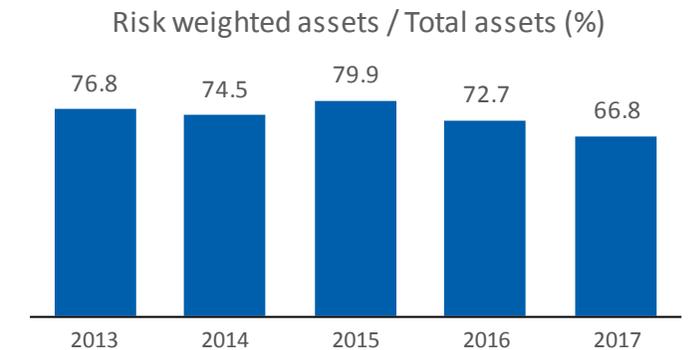
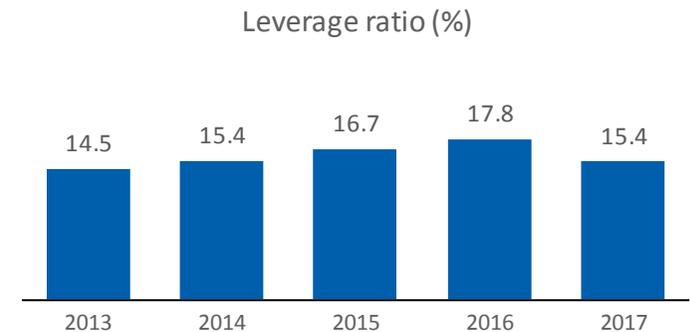
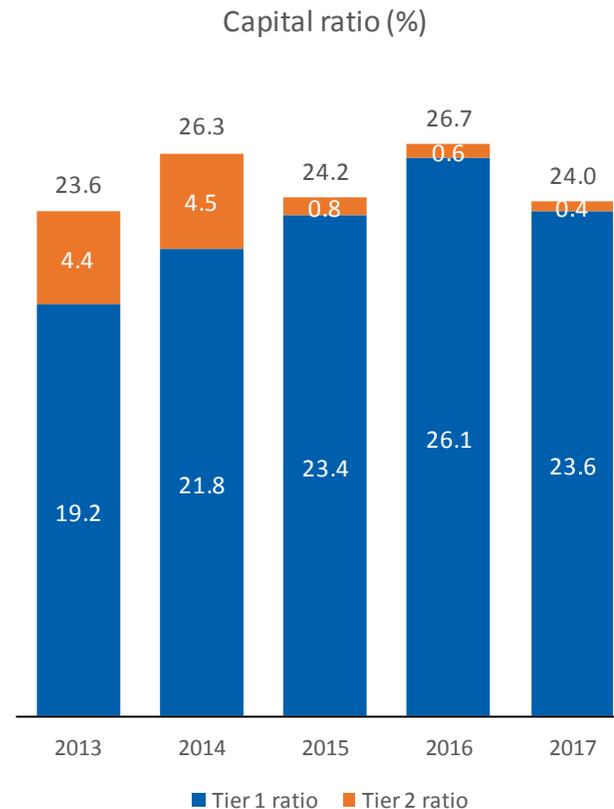


Capital base

All amounts in ISK billion

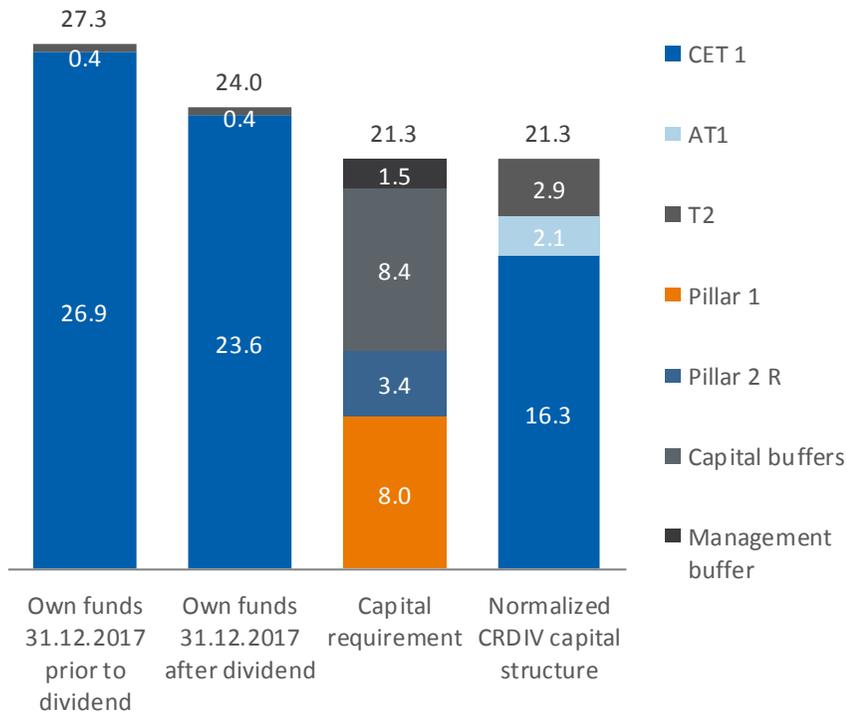
Optimizing of equity started with dividend of ISK 25 billion

- Reduction in capital base due to a dividend payment of ISK 25 billion
- Solid level of capital due to strong profit generation over recent years
- Risk-weighted assets of 66.8% are calculated on the basis of the standardized approach resulting in a leverage ratio of 15.4%
- The Bank's cash position with the Central Bank increased considerably during the year, resulting in a lower leverage ratio and lower risk-weight density
- Tier 2 capital at YE 2016 and 2017 consisted only of collective credit risk adjustment



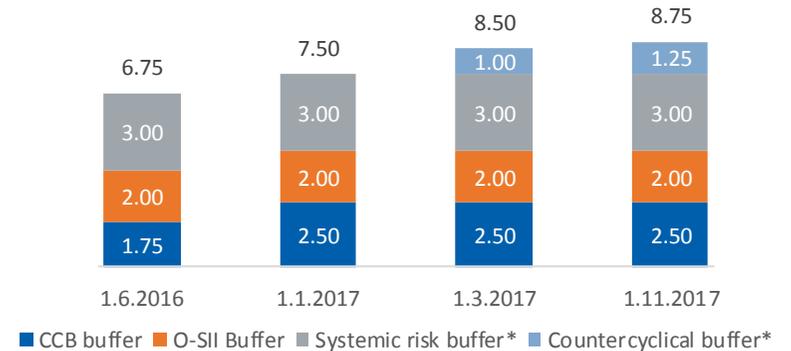
Capital adequacy

Own funds and capital requirements

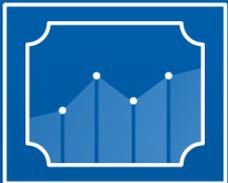


- CRD IV buffers implemented in Iceland
- All buffers at maximum levels except countercyclical buffer that can be increased to 2.5%

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



Medium Term Targets



CET 1 Ratio

(Subject to regulatory requirements)
Decrease to circa **17%**



Loan Growth

Prudent lending to
outpace economic growth



Return on Equity

Exceed **10%**



Dividend Policy

Payout ratio of circa
50% of net earnings
attributable to
shareholders



Cost to Income Ratio

Decrease to circa **50%**

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Appendix

United Silicon

All amounts in ISK million

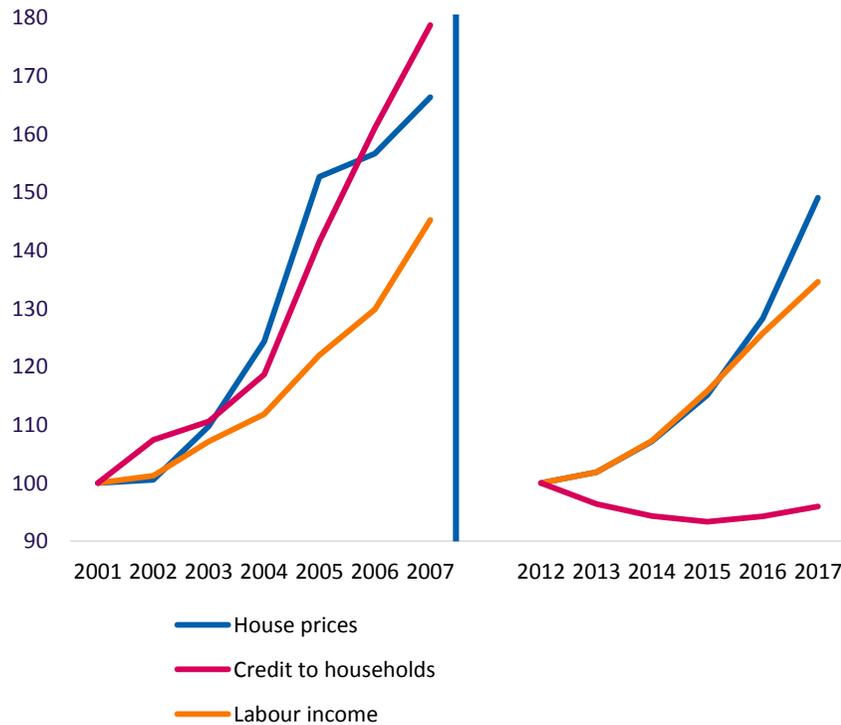
Effects of United Silicon (USi) on 2017 figures

- Arion Bank has fully provisioned for ISK 1,164 million in equity investments in USi and ISK 708 million in bonds related to USi operation. Net impairment on loans and receivables to USi amounted to ISK 2,962 million
- Further investment is needed for the factory to be fully operational and meet environmental requirements to the maximum extent
- Total exposure remaining at year end amounted to approx. ISK 6.3 billion, including loan commitments and guarantees or 0.5% of the Banks balance sheet
- USi is a recovery case that the Bank aims to conclude in the near term

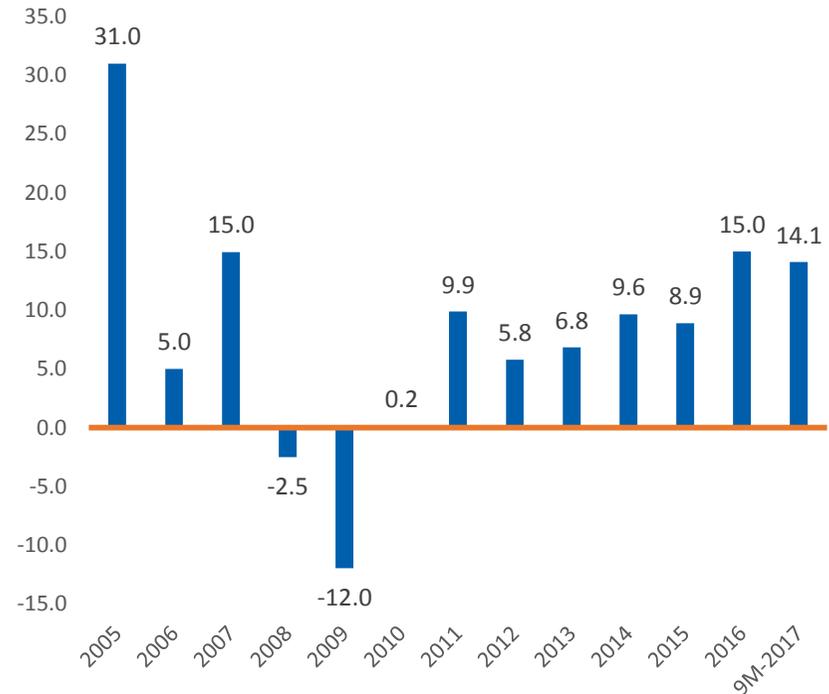
	2017	Effects of United Silicon	2017 without USi
Net interest income	29,835	-	29,835
Net commission income	15,357	-	15,357
Net financial income	4,091	(965)	5,056
Net insurance income	2,093	-	2,093
Share of profit of associates	(925)	(907)	(18)
Other operating income	2,927	-	2,927
Operating income	53,378	(1,872)	55,250
Salaries and related expense	(17,189)	-	(17,189)
Other operating expenses	(12,772)	-	(12,772)
Bank levy	(3,172)	-	(3,172)
Net impairment	186	(2,962)	3,148
Net earnings before taxes	20,431	(4,834)	25,265
Income tax expense	(5,806)	954	(6,760)
Discontinued operations, net of tax	(206)	(206)	0
Net earnings	14,419	(4,086)	18,505

Strong housing market driven by solid fundamentals

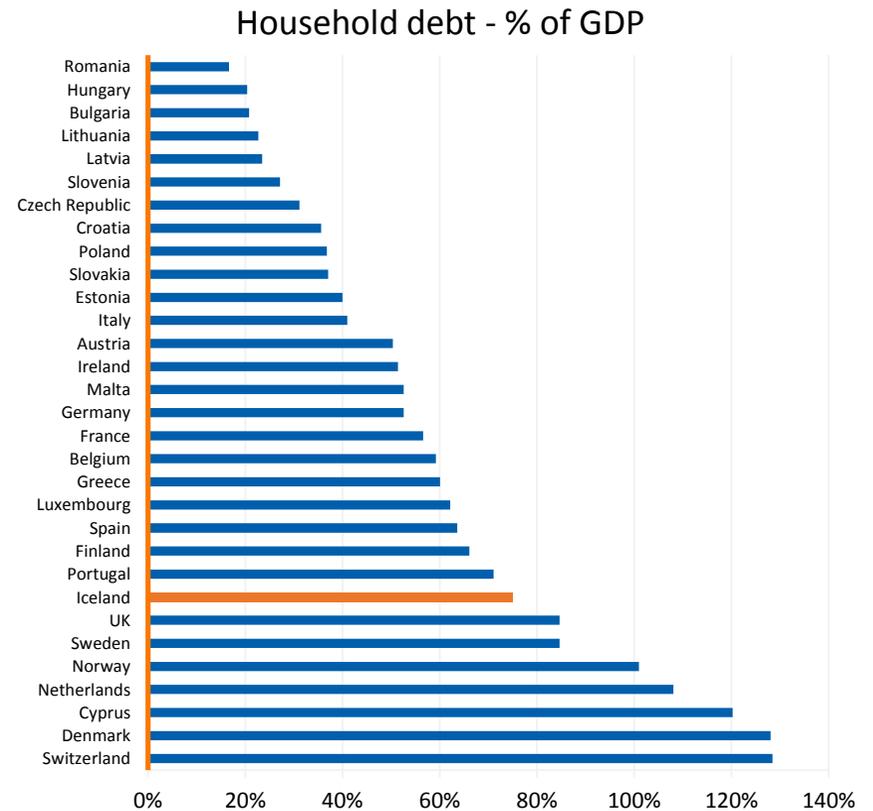
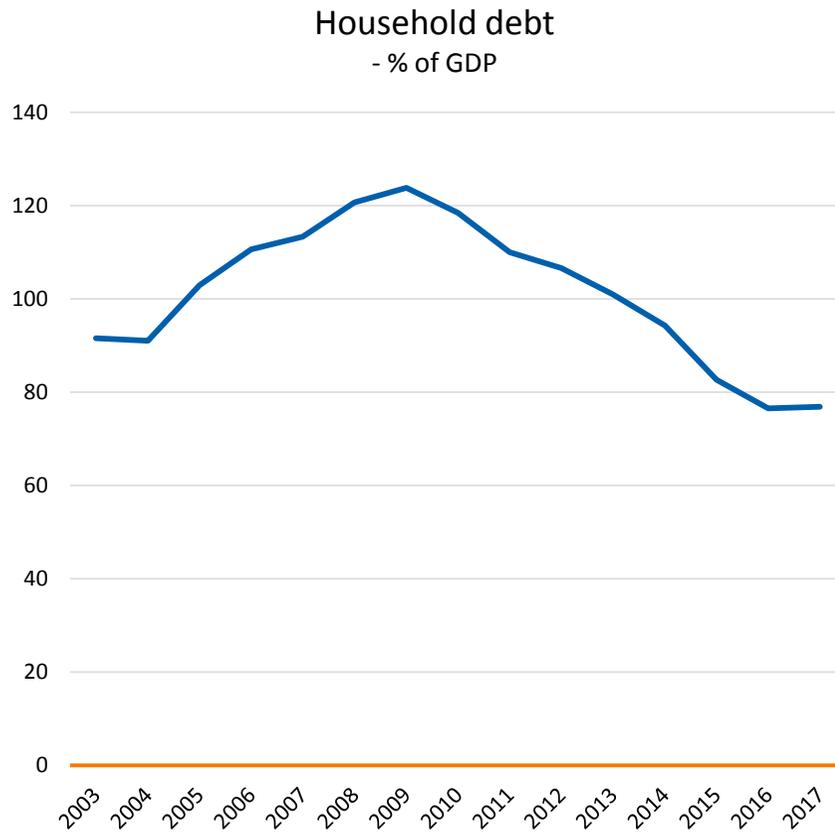
House prices, income and credit in two house price cycles - Index



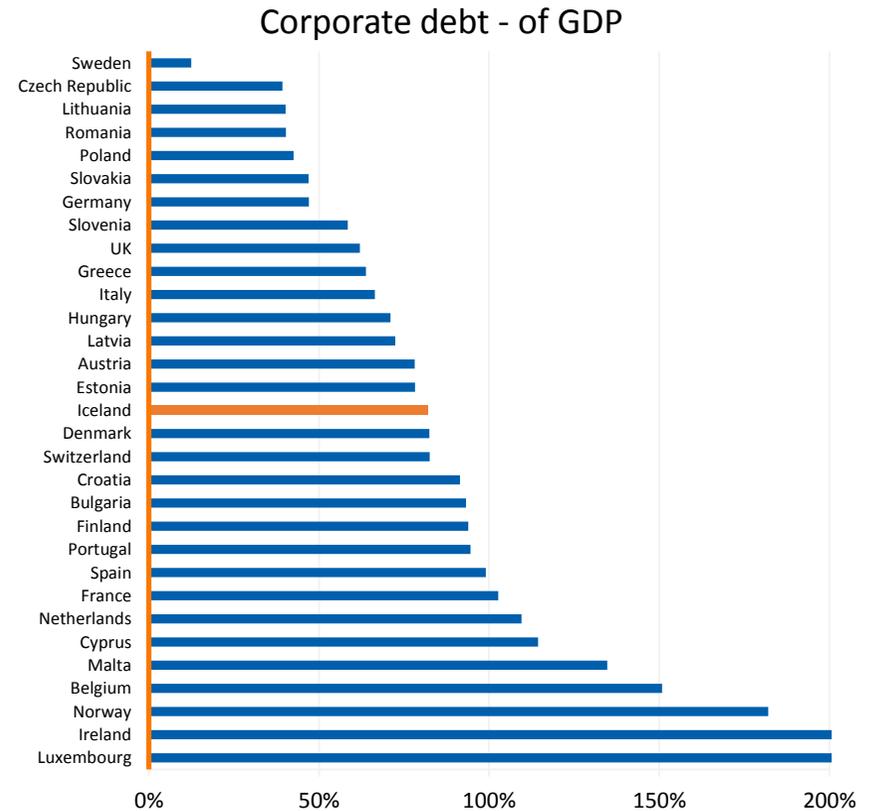
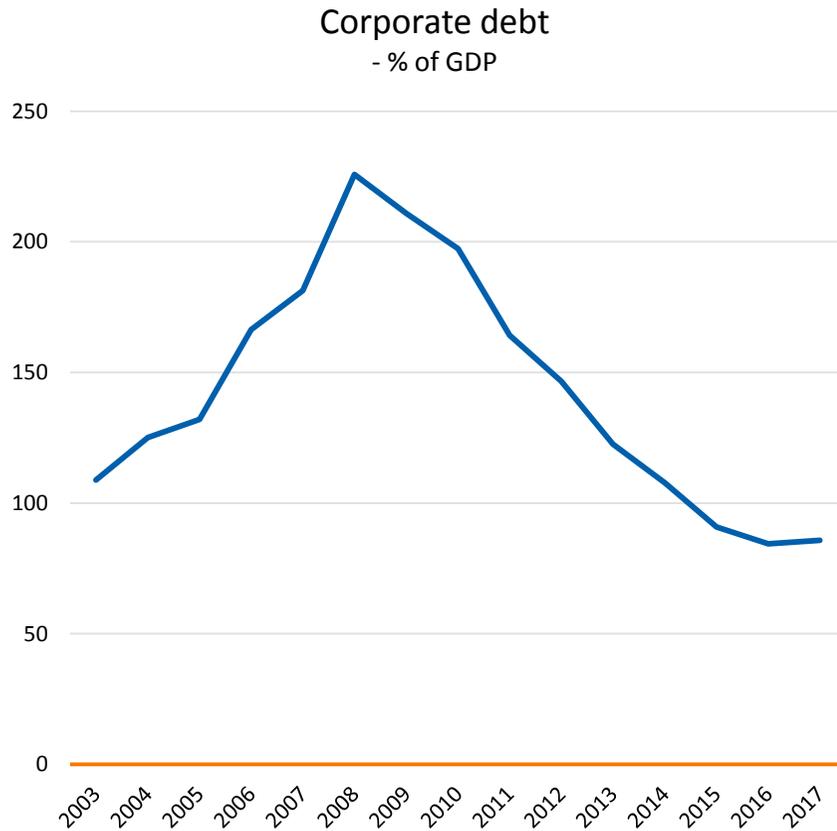
Housing prices in the greater Reykjavík Area (YoY change %)



Household debt at historically low levels



Rapidly decreasing corporate debt



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Q&A

