Arion Bank
ID-No. 581008-0150

ARION BANKI HF

RULES ON VARIABLE REMUNERATION

December 2020

Name:	Rules on variable remuneration
Responsibility:	Legal and HR
Date:	4 December 2020
Review:	To be concluded before year-end 2021

1. General

1.1 These rules form a part of the remuneration policy of Arion banki hf. ("Arion" or the "Bank"), approved annually by the Bank´s AGM. These rules are approved by the Bank´s Board of Directors, following a review and assessment by the Board's Remuneration Committee and the Board's Risk Committee, in accordance with the applicable rules of procedures of these governance bodies and in line with legal and regulatory requirements.

1.2 The legal and regulatory basis of these rules are Article 57 (a) of the Act on Financial Undertakings no. 161/2002, the Rules on Remuneration Policy for Financial Undertakings, No 388/2016, prepared by the Financial Supervisory Authority of the Central Bank of Iceland ("FME rules"), and the EBA Guidelines on Sound Remuneration Policies, EBA/GL/2015/22.[1]

1.3 The Board of Directors is responsible for overseeing the implementation of these rules. The CEO is responsible for the sound execution of these rules. The CEO, in cooperation with managing directors and heads of business units or departments, shall be responsible for introducing these rules to those employees eligible to receive variable remuneration.

2. Objective

2.1 The rules reflect the Bank's objectives for good corporate governance as well as sustained and long-term value creation for all stakeholders, including customers, creditors, shareholders and employees. In addition, these rules aim to achieve the following:

a) To allow the Bank to attract, develop and retain high-performing and motivated employees in a competitive market.
b) To create a *'one team'* culture within the Bank.
c) To encourage employees to create sustainable results.
d) That employees are incentivised to comply with internal and external rules and procedures.
e) To create a link between shareholder and employee interests.

2.2 In addition to the substantial risk mitigation and regulated balance between fixed and variable components of employee remuneration, already inherent in the Icelandic legal framework for variable remuneration, as set out in Section 6, the rules further support sound and effective risk management by:

a) Establishing a transparent framework for the Bank´s overall goal settings.
b) Combining the interest of employees in different divisions.
c) Including both financial and non-financial goals.
d) Requiring the forfeit of remuneration and a claw back mechanism in specific circumstances.

[1] Terms used in these rules have the same meaning as in EBA/GL/2015/22.

3. Scope

3.1 These rules apply to all employees eligible to receive variable remuneration.

3.1.1 Eligible employees are all permanent employees of the Bank, except for employees working in risk management, internal audit and compliance.

3.1.2 These rules do not apply to members of the Board of Directors. Payment of variable remuneration to members of the Board of Directors is prohibited.

4. Variable remuneration

4.1 General

4.1.1 Variable remuneration shall be awarded in a manner which promotes sound risk management in line with the Bank´s risk policy and does not induce excessive risk-taking.

4.1.2 Variable remuneration may be paid out in cash and/or shares issued by the Bank.

4.1.3 When variable remuneration is granted, care is taken to ensure that the following is considered:

a) That the variable remuneration supports the long-term interests of the Bank.
b) That the variable remuneration does not incur conflict of interest.
c) That the variable component reflects the risk underlying the achieved result.
d) That granted variable remuneration may be forfeited in full or in part if granted on the basis of unsustainable results.

4.1.4 Employees must be employed by the Bank at the time of the granting of variable remuneration and when variable remuneration is paid out, unless the employee is a *‘Good Leaver’*, as defined in clause 5.3.

4.1.5 Employees are prohibited from engaging in any kind of trading, e.g. derivative trading, for the purpose of hedging against risk related to deferred variable remunerations.

4.2 *Annual variable remuneration pools*

Method

4.2.1 A top down approach shall be used for the setting of the bonus pool, which shall consist of one pool at the bank level. Once decided, the bonus pool shall be fully or partially distributed down to employee level, based on performance assessments and in line with the process set out in this Section.

4.2.2 Assessment of performance shall be a combination of pre-approved performance measures and prudent judgemental approaches, with objectivity, transparency and simplicity as guiding factors.

4.2.3 A main performance benchmark trigger for the bank shall be as follows:

Weighted competitive ROE = (R_L + R_I + R_K) / (E_L + E_I + E_K)

Where *R* stands for Total Net Earnings and *E* stands for Total Average Equity (average of Q4 for prior year and Q1, Q2, Q3 and Q4 for the corresponding financial year), and the subscripts refer to Landsbankinn hf. (L), Íslandsbanki hf. (I), and Kvika banki hf. (K). The figures are based on consolidated financial statements.

4.2.4 Should this main benchmark be triggered, other KPI´s shall be taken into consideration by the CEO and the Board of Directors when determining the size of the bonus pool and final allocation down to employee level.

Process

4.2.5 Annually, before year-end, the CEO will bring a KPI proposal to the Board for approval. This must be done prior to any reference period for which variable remuneration may be granted.

4.2.6 In line with the Bank's internal procedures and the FME rules, both the BRC and BRIC will review the proposal and the system, with input submitted from Compliance and Risk Management.

4.2.7 In accordance with clause 4.3, the CEO's proposal shall include a list or a benchmark for those employees eligible for a bonus of up to 25% of annual fixed remuneration. Other employees will be capped at the 10% level. The proposal shall, furthermore, include whether employees are to be paid in cash, shares or combination of both.

4.2.8 All eligible employees will:

a) Sign an annex to their employment contract prior to inclusion into the system, outlining the applicable rules, including deferral and claw-back provisions
b) The annex will explicitly state that no variable remuneration is guaranteed, and, if granted, will be subject to a deferral period with forfeiture conditions applying during the deferral period.

4.2.9 Should the main performance benchmark set out in clause 4.2.3 be passed for a given reference period, the CEO will propose a performance-based remuneration pool to the Board of Directors for review and approval, which may then be granted to eligible employees. The total remuneration pool shall not exceed the ISK value of the outperformance from the main performance benchmark. The proposal shall, furthermore, be based on an evaluation of performance KPI approved in line with clause 4.2.5. The following shall also apply:

a) A proportional distribution to all eligible employees shall be assumed, based on their 25% and 10% caps, before taking into consideration the requirements set out in clause 4.2.10.
b) In accordance with the FME rules, the total remuneration pool must not restrict the positive development of the Bank's capital base, jeopardise liquidity ratios or financial stability of the market.
c) The number of eligible employees will in any event cap the total amount, as variable remuneration may not exceed 25% of annual fixed remuneration.

4.2.10 Once a total remuneration pool has been approved in line with clause 4.2.9, the performance of the respective division and personal circumstances of each employee shall be evaluated before the granting of variable remuneration may take place, in the following manner:

a) KPI´s linked to divisions will affect the final allocation to each division.
b) Conclusions of regular performance reviews and compliance with external and internal rules will affect the final allocation of each employee.

4.2.11 The variable remuneration allocation and allocative requirements set out in this Section shall be documented before variable remuneration is granted. Prudent judgemental assessments shall, furthermore, be reasoned and documented before variable remuneration is granted.

4.3 Granting of variable remuneration

4.3.1 All permanent employees of the Bank will be eligible to participate in the system, excluding those in compliance, internal audit and risk management, in accordance with legal requirements.

4.3.2 Annually, before year end, the CEO shall propose to the Board of Directors a list or a benchmark for employees which will be eligible to receive variable remuneration for a maximum of 25% of annual fixed salary.

a) Those eligible to receive remuneration for a maximum of 25% of annual fixed salary shall be deemed by the CEO as key performers, both in front office and support divisions.
b) All other employee shall be eligible to receive a maximum of 10% of fixed annual salary.
c) Subject to the approval of the Board of Directors, employees will be notified in writing of their eligibility, the total percentage of fixed salary they may receive, the applicable KPI, and other information required by these rules and the applicable legal framework.

4.3.3 The CEO shall consult with legal advisory and HR regarding necessary documentation, such as amendments to employment agreements.

5. Cancellation of granted variable remuneration

5.1 Granted and deferred variable remuneration shall not be paid, or only paid to a limited extent, if one of the following circumstances develops:

a) When the required performance of the employee in question is not achieved.
b) When the required performance of the business unit or department in question within the Bank is not achieved.
c) It is foreseen that the Bank will not, or is likely to not, meet capital adequacy requirements pursuant to Article 84 of the Act on Financial Undertakings, or applicable liquidity requirements.

d) When the employee does not comply with rules or internal procedures of the Bank or does not comply with laws or administrative instructions in his or her work.

5.2 If a variable remuneration is forfeited in full or part due to employee performance assessments, the grounds for that conclusion shall be clearly communicated to the employee and set forth in writing by the relevant manager and submitted to the CEO.

5.3 Variable remuneration shall not be paid if the employee has ceased to be an employee of the Bank at time of pay out unless the termination of employment is due to any of the following reasons (*'Good Leaver'*):

a) Ill health or disability which is sufficiently serious to prevent the employee from carrying out his normal duties and which is confirmed by a medical professional.
b) Death of an employee.
c) Retirement pursuant to an employment agreement or collective wage agreement (IS. *kjarasamningur*).
d) Dismissal for other reason than cause.

5.4 No variable remuneration shall be paid if the situation of the Bank has deteriorated materially or if it is probable that the situation of the Bank will deteriorate materially. The same applies if the Bank receives a loan from the Central Bank of Iceland acting in its capacity as a lender of last resort, or similar financial aid.

6. Ratios between fixed and variable remuneration and deferral

6.1 Variable remuneration to individual employees may not exceed 25% of their annual fixed salaries.

6.2 If the variable remuneration exceeds 10% of the annual fixed salaries, 40% of the variable remuneration shall be deferred for a period of at least three years.

a) The deferral can be extended beyond three years for employees with high risk-taking duties.
b) Before pay-out, the deferred amount will be subject to possible risk adjustments.

6.3 If variable remuneration does not exceed 10% of an employee's annual fixed salaries, payment can be made without any deferral.

6.4 Deferred amounts shall bear interest which shall be equal to the Central Bank of Iceland´s policy interest rate. The interest rate is calculated from the date of payment of variable remuneration to the relevant employee and until the deferred amount is released.

6.5 Cancellation, according to Section 5, and clawback, according to Section 7, shall apply to accrued and paid interest according to clause 6.4, as applicable.

7. Claw back of variable remuneration

7.1 If the basis for granting a variable remuneration turns out to have substantially deviated from the performance anticipated at the time when the decision was made, the payment can be clawed back by the Bank in part or in full.

7.2 All paid-out variable remuneration can be clawed back by the bank if certain conditions are met. These conditions are:

a) A major breach of compliance discovered after the fact.
b) Activity that constitutes a breach of law or regulations discovered after the fact.
c) An employee has participated in or was responsible for actions which caused the Bank substantial loss.

Where:

a) *Breach of compliance* means: If a breach of compliance that would have resulted in immediate dismissal (i. *riftun*) (not a warning) is discovered at any time after the fact (within the time limit for claw back), any variable remuneration paid-out can be clawed back.
b) *Breach of law* means: If an employee is subject to an administrative fine or convicted in court of breaking any law or regulation relating to his work, any variable remuneration paid-out can be clawed back.

7.3 If an employee leaves the Bank within six months from receiving a variable remuneration, the payment can be clawed back in full. This does not apply if the employee's departure is due to *'Good Leaver'* reasons, as defined in clause 5.3.

7.4 Any claw back claim has to be submitted within seven years from the date when the variable remuneration was paid to the employee.

8. Recruitment bonus

8.1 The CEO may grant a recruitment bonus to attract highly skilled and specialized individuals. A recruitment bonus is granted for a period of one year only and the combined recruitment bonus plus variable remuneration may not exceed 25% of annual fixed salaries.

8.2 A recruitment bonus is subject to deferral, pursuant to clause 6, potential cancellation, pursuant to clause 5, and claw back provisions, pursuant to clause 7.

8.3 A recruitment bonus may not be granted when an employee is rehired by the Bank or a group company within three years of leaving the Bank or a group company.

9. Process of pay-out in shares

9.1 In case of payment of variable remuneration in shares issued by the Bank, the following process shall be applied:

a. Number of shares shall be determined by dividing the allocated variable remuneration amount by share price, as per item b.

b. The share price shall be the market price of the shares at the time of formal approval by the Board of Directors of the annual report.

c. The Bank shall withhold the applicable number of shares to cover employee tax liability at pay out.

9.2 The Bank can decide to place restrictions on the shares, barring their sale by the employee for a certain time period after delivery. Such sale restrictions do not affect any other rules of the system, such as deferral.

9.3 A payment of variable remuneration in shares falls under all the same rules and restrictions as payments in cash, including claw back, deferral, cancellation etc.

10. Reviews

10.1 These rules shall be reviewed annually by the Board of Directors taking into consideration the current status of the Bank, market conditions and analyses performed according to clauses 4.1.1 and 4.1.3.

10.2 The head of risk management, internal audit and compliance shall at least annually review and analyse the Bank´s variable remuneration in accordance with Article 13 of the FME rules.

Approved by the Board of Directors of Arion bank hf. on 4 December 2020

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