

ARION BANK

INVESTOR PRESENTATION
Q3 2016



KEY INVESTMENT HIGHLIGHTS – ARION BANK

- 1 Strong Economy with Further Upsides
- 2 Leading Universal Banking Franchise in Iceland
- 3 Significant Improvement in Asset Quality and Positive Outlook
- 4 Strong Capital Position - Target Reduction of Excess Capital and Capacity for Ongoing Dividend Payment
- 5 Sound Funding Profile and Liquidity Position
- 6 Experienced Management Team



Strong Economy with Further Upsides

1



ICELAND AT GLANCE

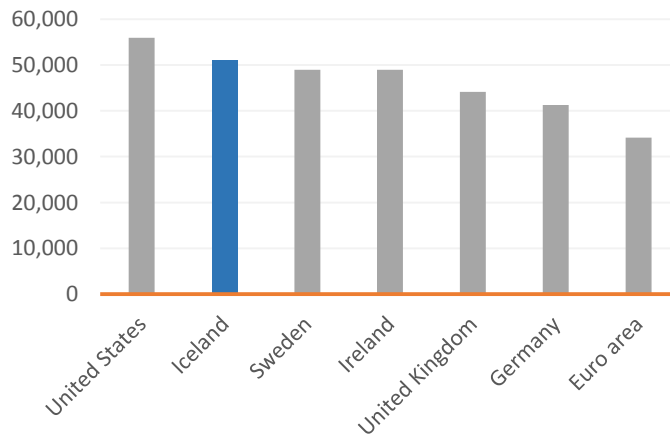
STRONG ECONOMY WITH FURTHER UPSIDES

- Full independence since 1944
- OECD founding member since 1948
- NATO founding member since 1949
- Joined EFTA in 1970
- Access to European Economic Area (EEA) since 1994
- Steady recovery since 2008 economic turmoil
- Capital controls expected to be lifted in 2016

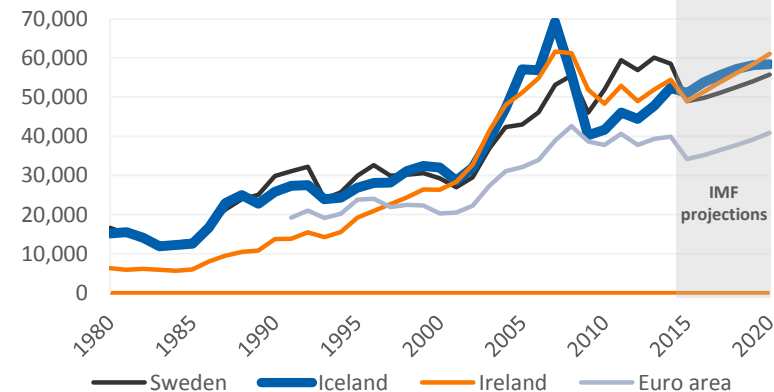
Location	Northern Europe
Population	Approx. 333,000
State	Republic
Area/size	103,000 km ² /39,756 sq. miles
Capital	Reykjavik

Gender equality world rank 2015 1

GDP per capita 2015 (USD)



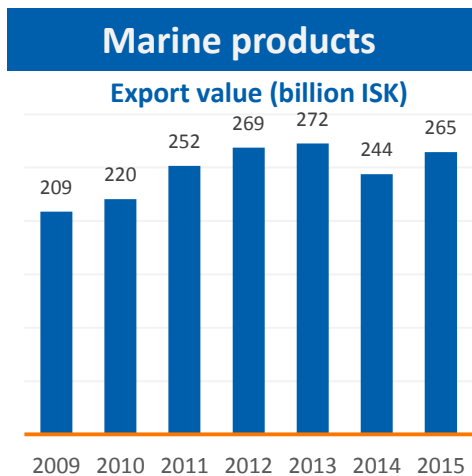
GDP per capita development (USD)



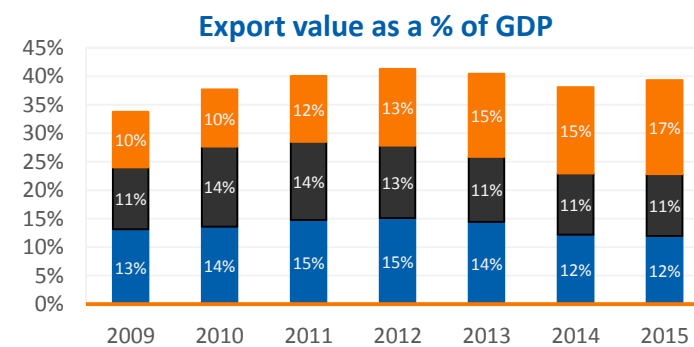
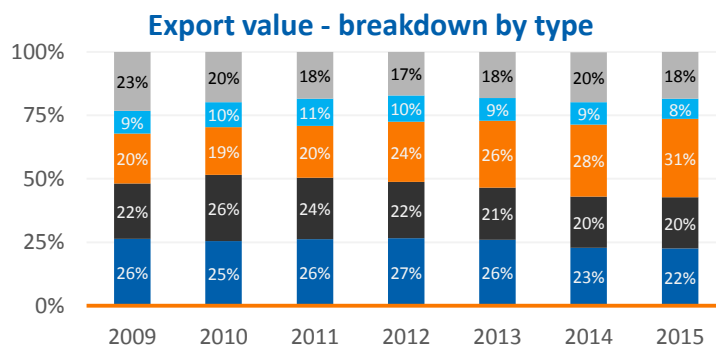
DEVELOPMENT OF KEY INDUSTRIES

STRONG ECONOMY WITH FURTHER UPSIDES

- Service exports have changed substantially in recent years
- 22% average increase in the number of tourists per year since 2011
- 2016 is set to be yet another record-breaking year in tourism



Composition and development of exports of goods and services

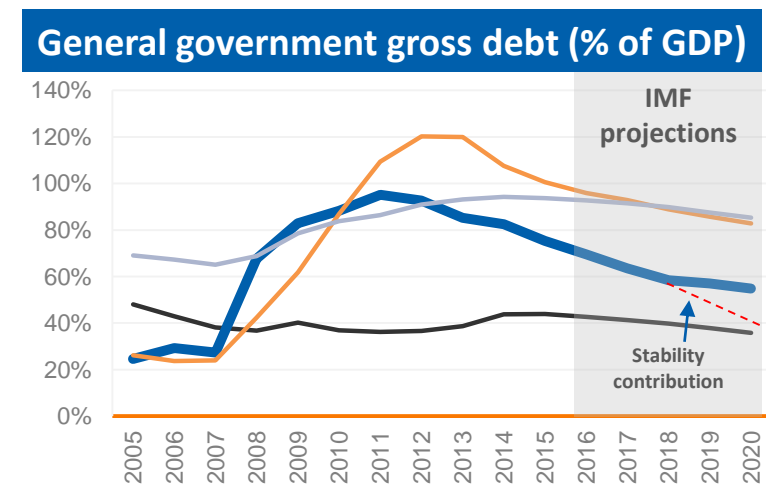
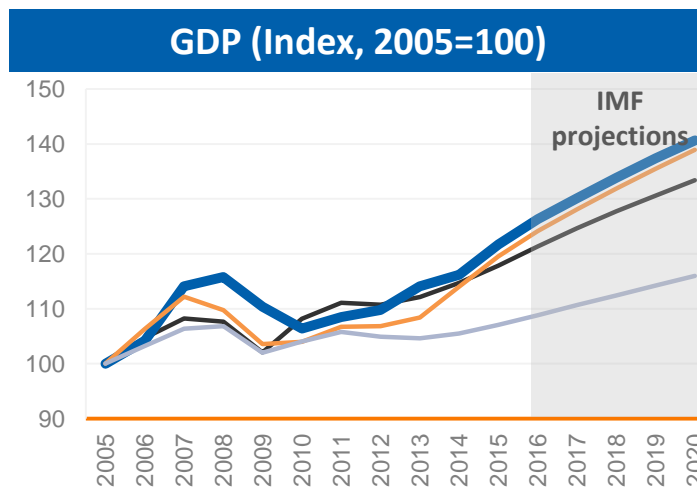
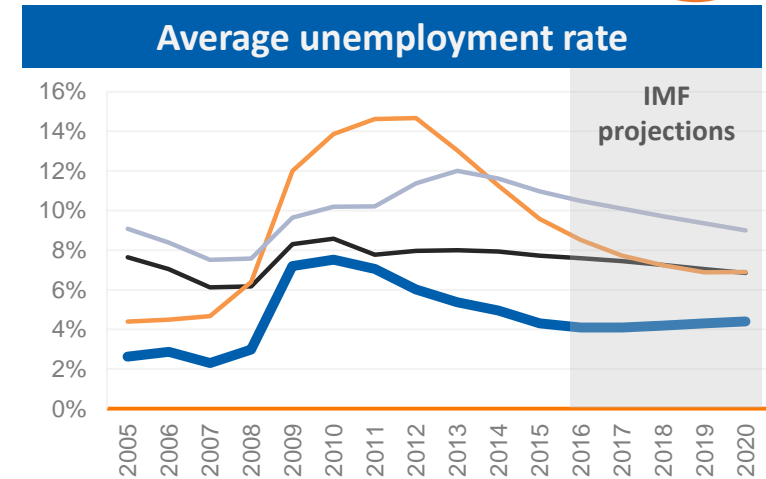
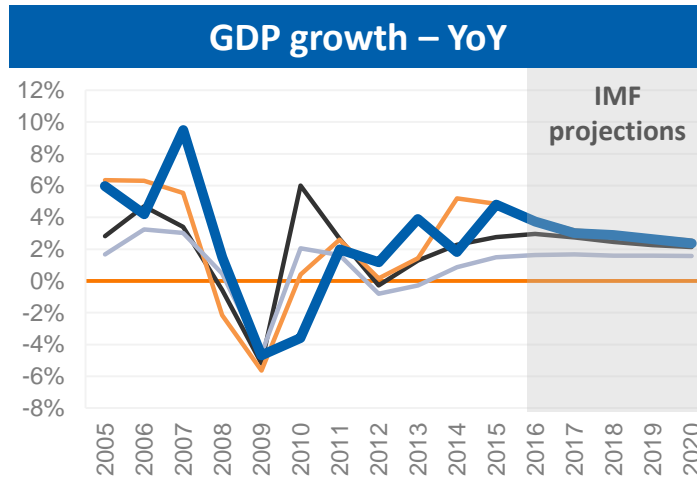


■ Marine products ■ Aluminum ■ Tourism ■ Other industrial products ■ Other goods and services

ECONOMIC PROGRESS COMPARES WELL TO OTHER EUROPEAN COUNTRIES

STRONG ECONOMY WITH FURTHER UPSIDES

- Strong economic growth in recent years
- Estimated economic growth around 5% in 2016
- Accumulated growth over 10-year period higher than in comparison countries despite 2008 turmoil
- Most economic indicators enjoy a favourable trend
- Effect of estates' contribution will have a positive effect on government debt



Leading Universal Banking Franchise in Iceland

2



STRONG LOCAL FRANCHISES

2

LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

- Arion bank provides a full range of financial services around Iceland
- Arion bank runs a one brand policy but owns few independent and important subsidiaries



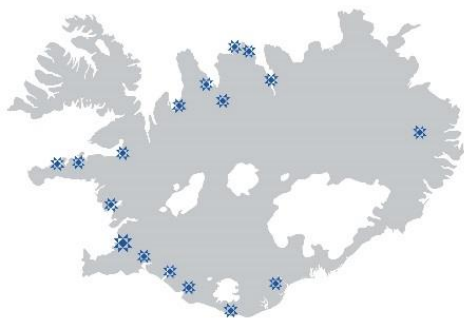
Retail banking

Corporate banking

Asset management

Investment banking

Arion branches



Key subsidiaries

VALITOR

- The largest online and e-commerce payment services company in Iceland
- Operations in Iceland, Denmark and the UK
- Member of VISA EU and MasterCard International



- Iceland's largest fund management company
- Retail and professional clients
- Range of mutual, investment and institutional investment funds



- Leading life insurance company in Iceland
- Focus on modern personal insurance services
- Sales and distribution partnerships with Arion Bank



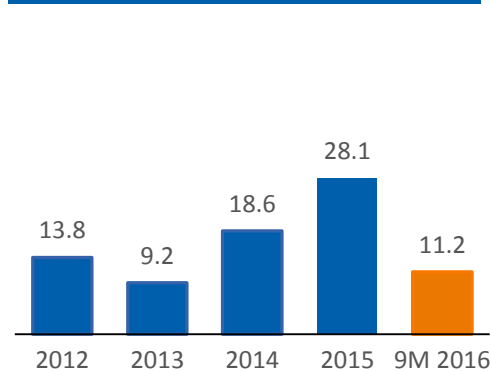
- Vörður is the 4th largest universal insurance company in Iceland
- Arion Bank has reached a deal to acquire 51% in the company

ALL KEY FINANCIAL INDICATORS PERFORMING

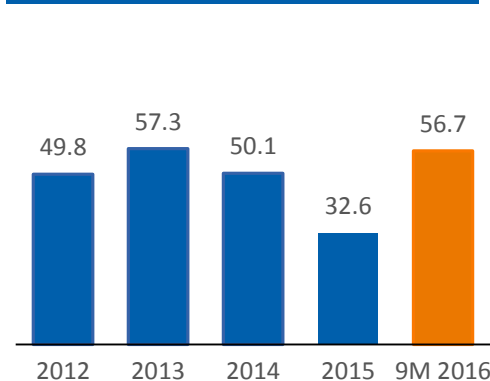
LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

- Solid level of capitalization due to strong profit generation
- Focus on cost to income ratio
- Strong return on equity over the years
- Steadily improving asset quality and further improvements expected this year
- Conservative Loans-to-deposits ratio when adjusted for those mortgages that are financed with long-term covered bonds

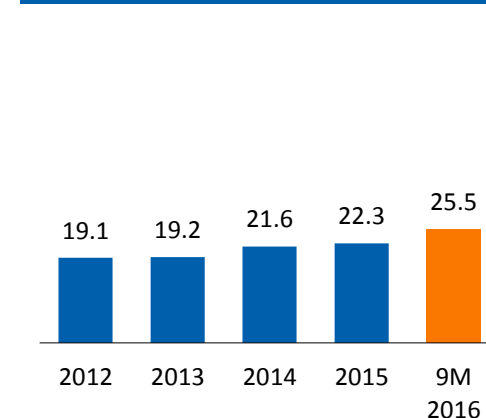
Return on equity (%)



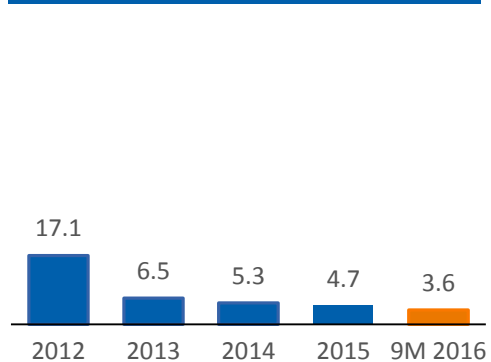
Cost-to-income ratio (%)



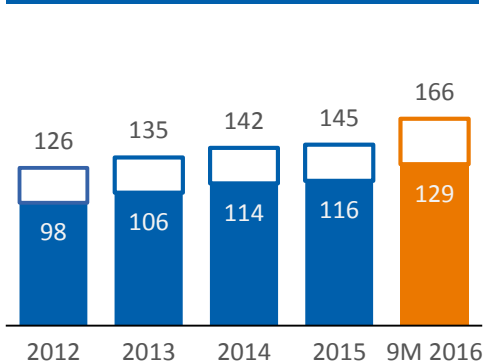
CET1 ratio* (%)



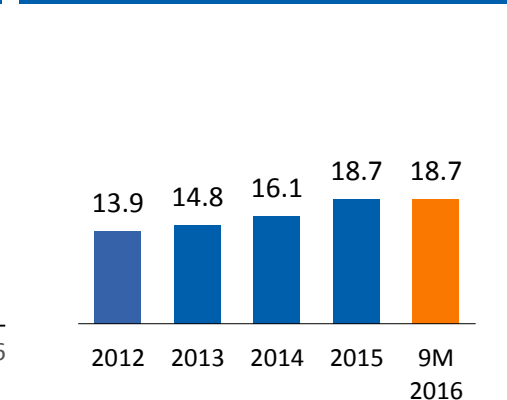
Problem loans (%)**



Loans-to-deposits ratio* (%)**



Tier 1 capital/Total assets(%)



9 * Tier 1 for 2012-2013. CET1 capital calculated according to CRR, while RWA is calculated according to Icelandic Legislation using Basel II standardised approach

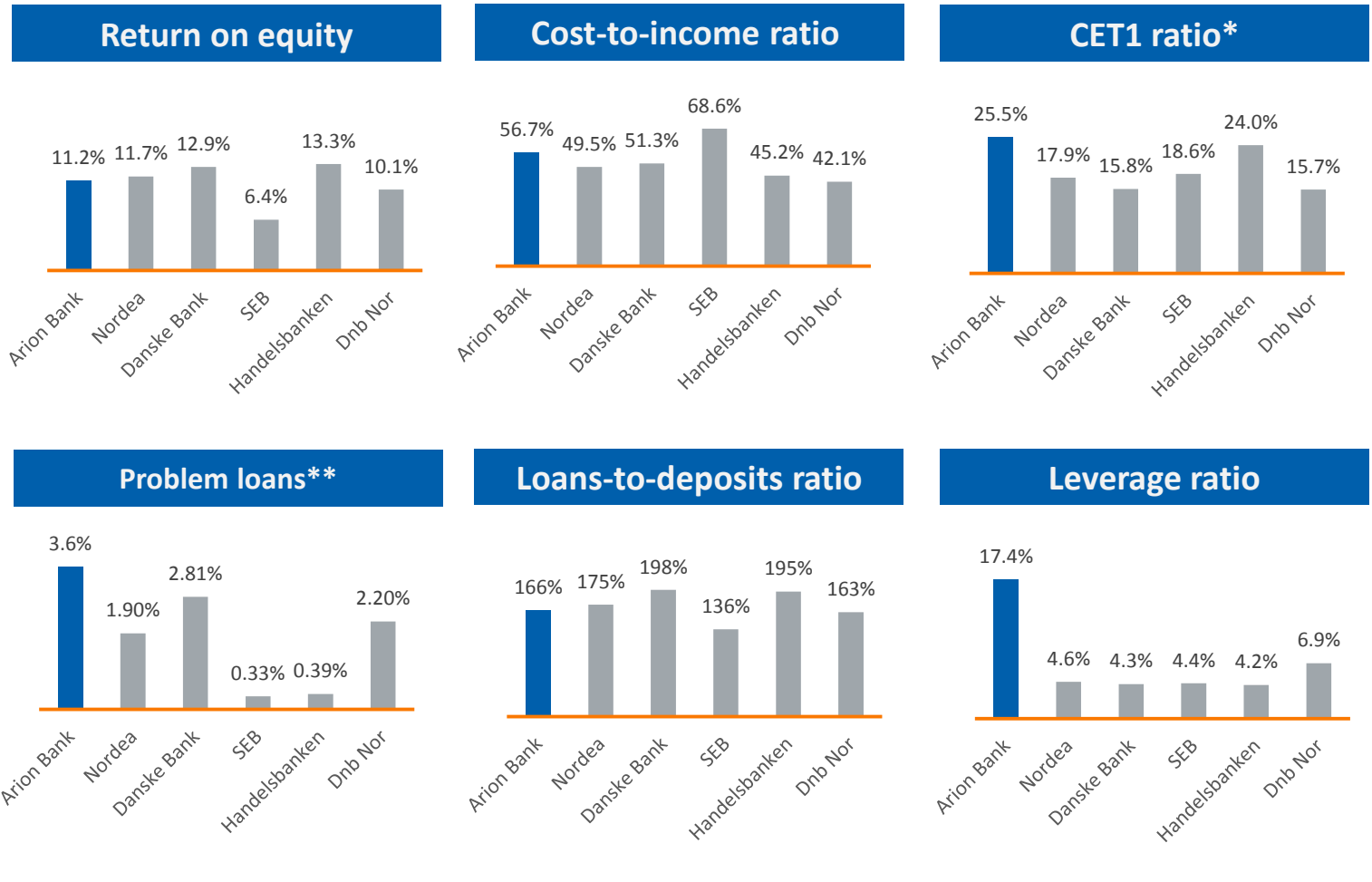
** Gross impaired loans / Gross loans

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

9M 2016: ARION BANK COMPARES WELL WITH MAJOR NORDIC BANKS

LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

- Strong capitalization and profitability
- Problem loans still relatively high but expected to continue on a downward trend



10

* Tier 1 for 2011-2013. CET1 capital calculated according to CRR, while RWA is calculated according to Icelandic Legislation using Basel II standardised approach

**Gross impaired loans / gross loans

Source: Bankscope



A RELATIONSHIP BANK STRATEGY

2

LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

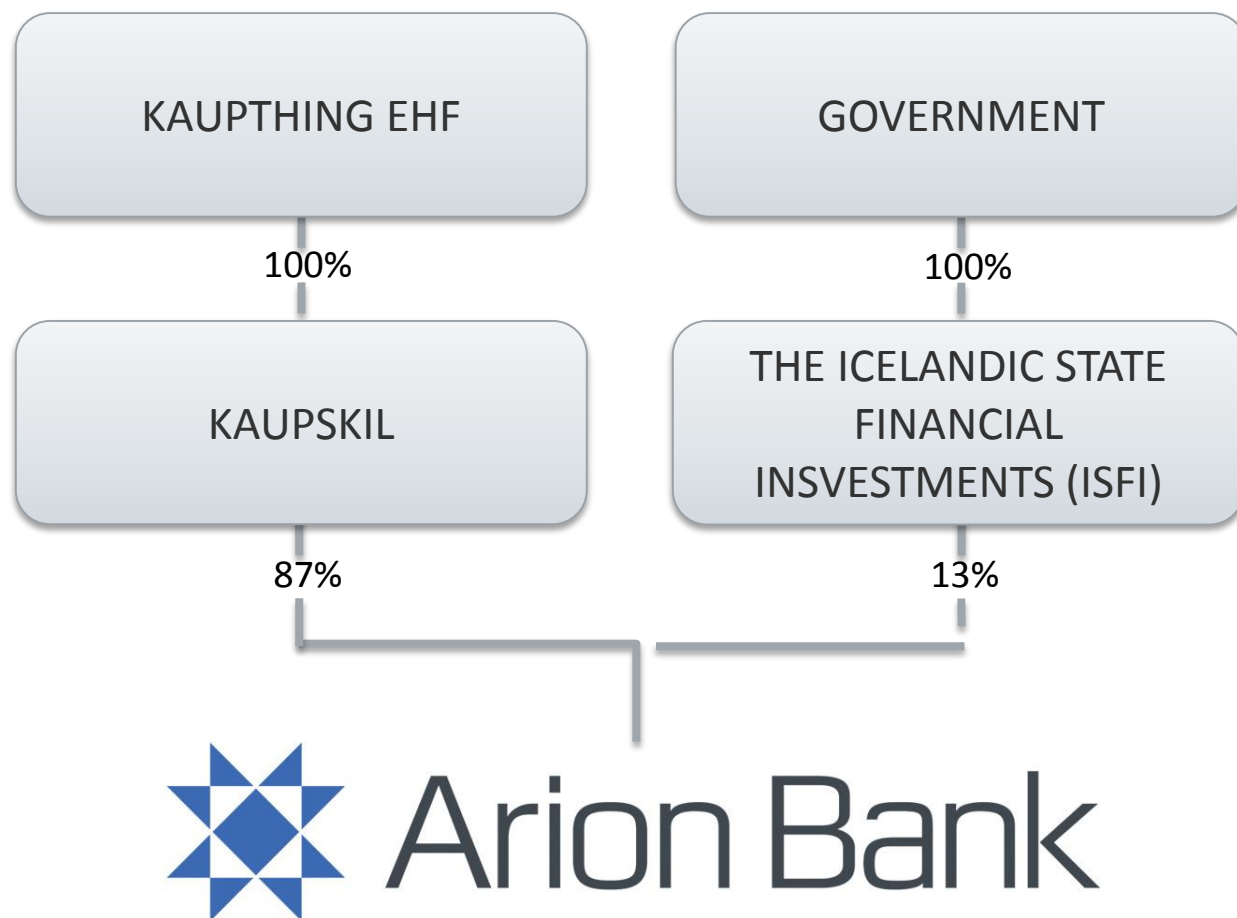
- Primary emphasis on **corporations** and **individuals** seeking a **variety of financial solutions**
- Focus on building and strengthening **long-term customer relationships** by delivering **excellent service and tailored solutions**
- Operations in the Greater Reykjavík area as well as the largest 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

LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

- Arion is owned by Kaupthing (87%) and the government of Iceland (13%)
- Kaupskil appoints seven out of eight board members of Arion Bank, the Government appoints one board member



STRONG MARKET SHARE ACROSS IMPORTANT PRODUCT AREAS

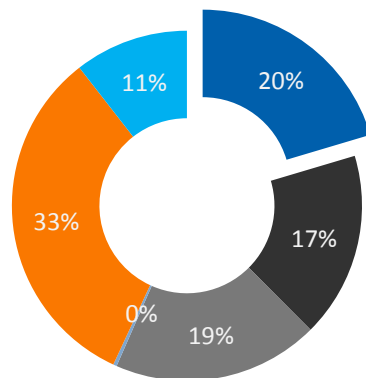
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LEADING UNIVERSAL BANKING FRANCHISE IN ICELAND WITH CONSISTENT PROFITABILITY

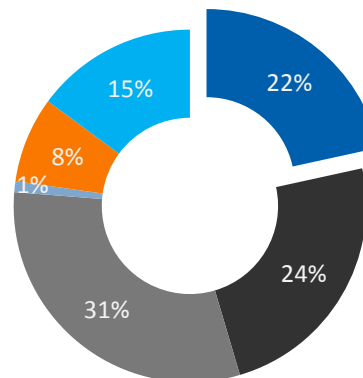
1H 2016

- Strong overall position in the retail market
- Market leader in asset management and investment banking
- Arion Bank remains the largest provider of mortgages besides government-owned HFF

Loans to households



Loans to corporates

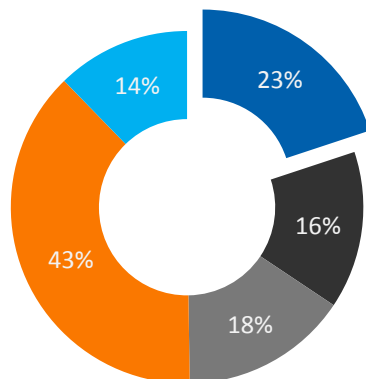


Asset Management

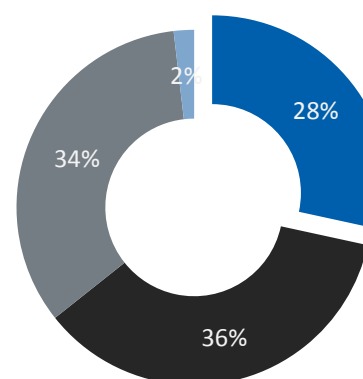
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The largest asset management operation in Iceland with AuM approx. 50% of GDP

Mortgage loans to individuals



Deposits from Customers



Investment Banking

1

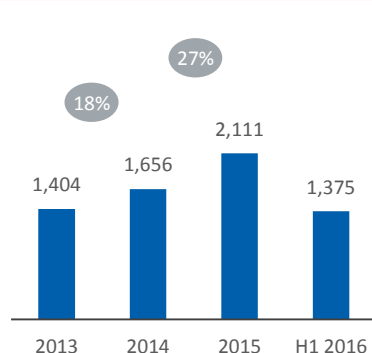
Largest Investment bank in Iceland with regards to commission income in Corporate finance and Capital markets. 60% of all IPOs in Iceland since 2011

CHANNEL DIVERSIFICATION

DIGITALISATION DRIVING EFFICIENCY

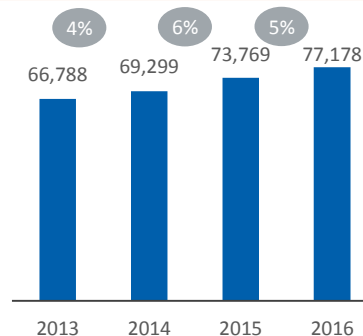
- Major changes in customer behaviour in recent years
- Full upside potential to be unlocked through changing customer mindset transitioning away from branches as the preferred channel
- The plan is to produce a steady decline in low value transactions handled in the branches
- Focus on using channels to further increase efficiency
- The new generation of ATMs is enabling customers to save time by depositing and withdrawing cash as well as paying bills themselves
- Greater emphasis on customer experience through Arion Bank app
- By focusing on digitalising processes, Arion Bank has reduced internal lead time in customer onboarding by 88%
- New digital initiatives launched in Q4 2016, i.e., mortgage process

Opening account – digital sales



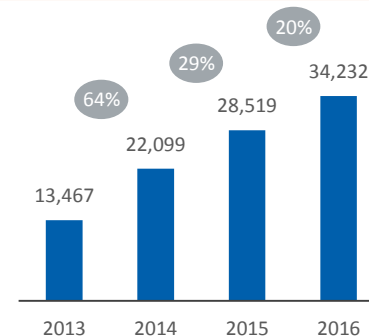
Number of interactions through ATMs

Active online bank users¹



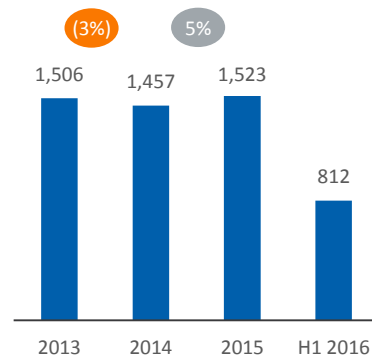
Number of calls to the call centre

Active Arion Bank app users¹

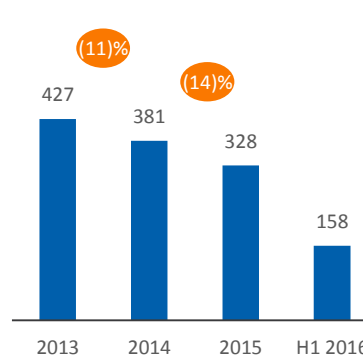


Number of visits to branches

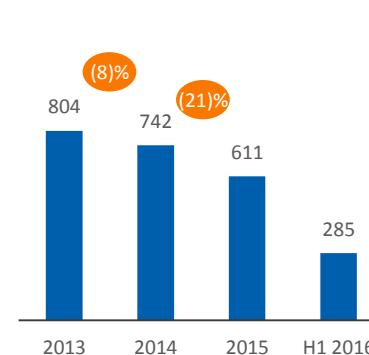
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3

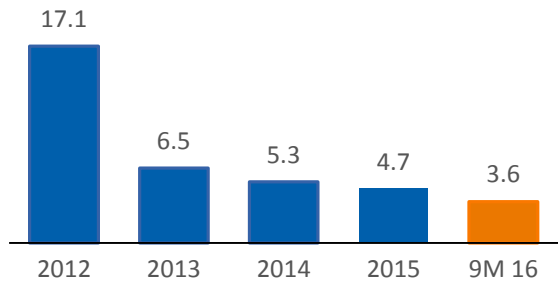
Significant Improvement in Asset Quality and Positive Outlook



LOW RISK BUSINESS MODEL - WELL DIVERSIFIED LOAN PORTFOLIO

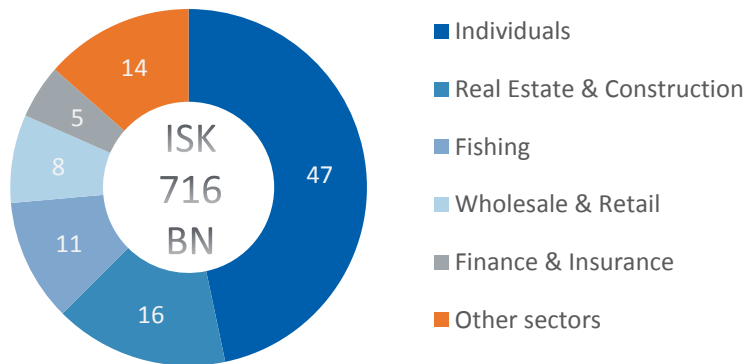
SIGNIFICANT IMPROVEMENT IN ASSET QUALITY AND POSITIVE OUTLOOK

Problem loans* %

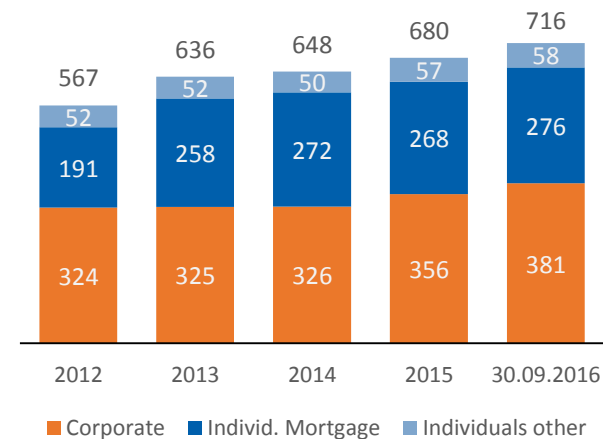


- Continued good balance in loans to corporates and individuals
- Mortgage loans decrease due to the debt forgiveness of CPI indexed mortgage loans by the Icelandic state
- 90% of total loans are collateralised, 75% real estate and 15% other collateral
- Good diversification in the corporate loan book
- Continued improvement in problem loans

Loan portfolio diversification %



Loans to customers (bn ISK)



*Gross impaired loans / gross loans

RATINGS: POSITIVE OUTLOOK AND MORE TO COME

3

SIGNIFICANT IMPROVEMENT IN ASSET QUALITY AND POSITIVE OUTLOOK

Rating fundamentals

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

Ratings



Arion Bank

Senior Unsecured

BBB+

BBB

Short term debt

A-2

A-2

Outlook

Stable

Positive



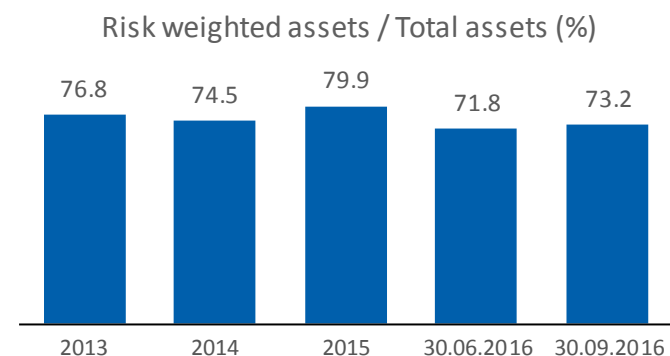
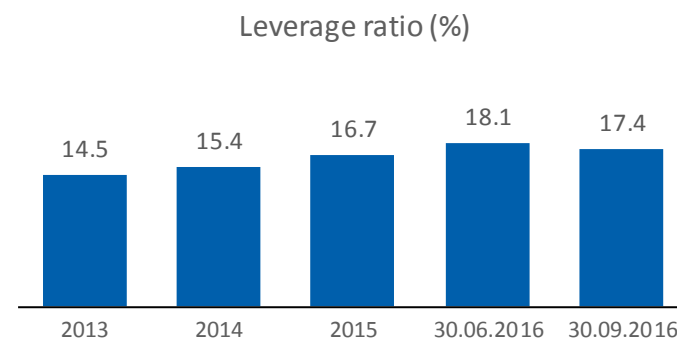
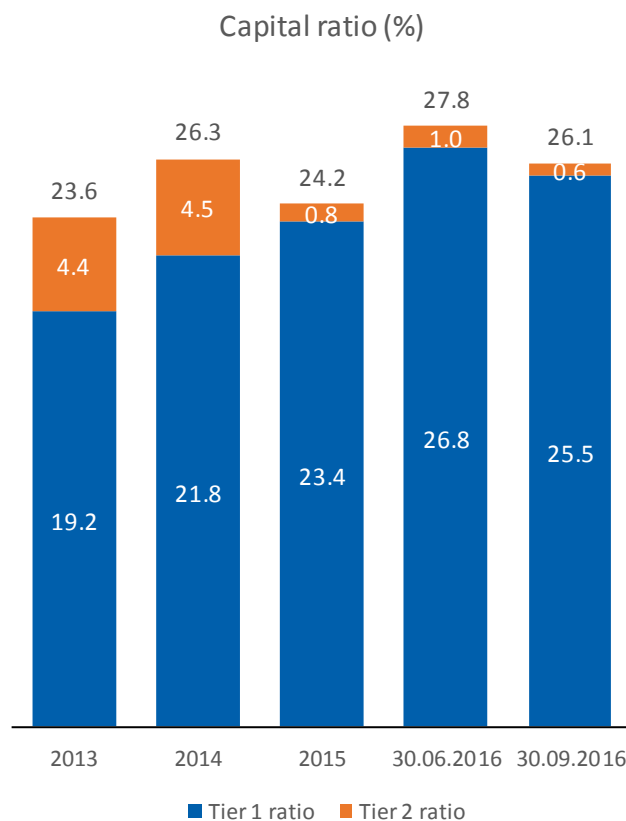
Strong Capital Position with Room for Further Optimisation

4



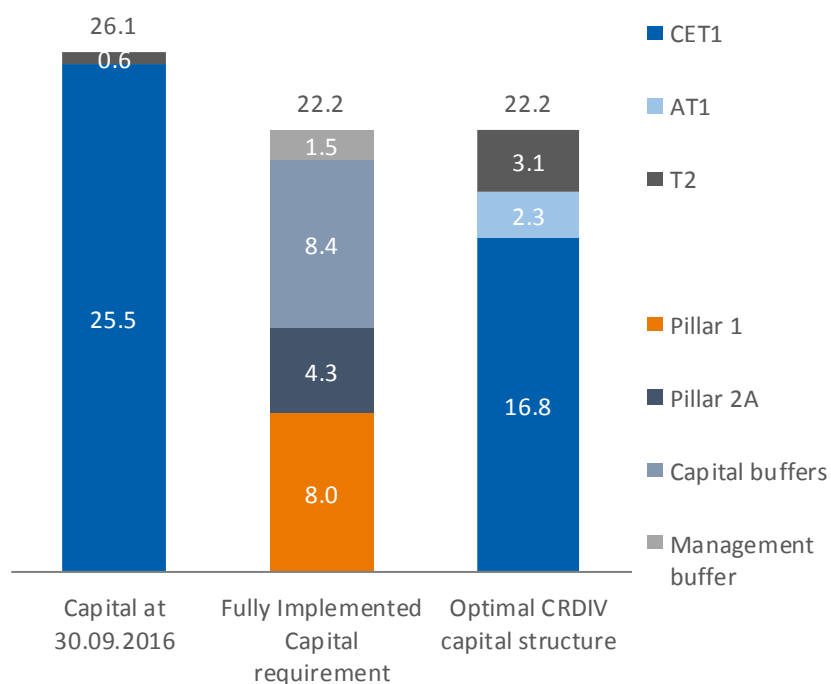
STRONG EQUITY POSITION

- Solid level of capitalization due to strong profit generation
- Decline in Tier 1 ratio due to reduction of non-controlling interest
- Reduction in risk weighted assets from year end due to decrease in loan commitments and lower FX imbalance
- Tier 2 capital consisted only of subordinated liabilities from 2013 till 30 June 2016.
- Tier 2 capital at 30 September 2016 consisted of equity holdings in financial sector entities



CAPITAL BASE

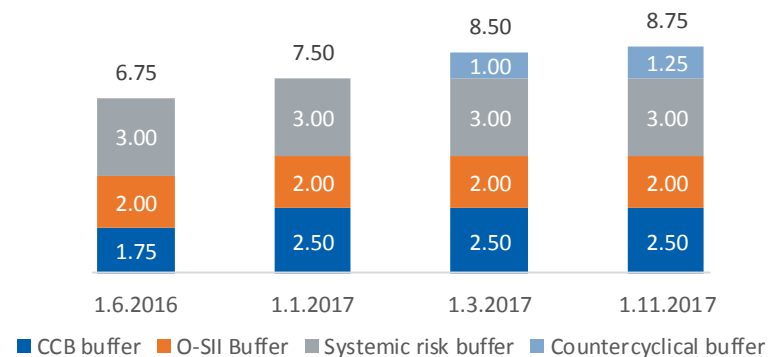
CAPITAL STRUCTURE AND CAPITAL NEEDS (%)



- The final adoption of CRDIV/CRR into Icelandic law has been finalized. The main effect is the inclusion of the Bank's general provisions as Tier 2 capital.

- At Q4 of 2017, the combined capital buffer requirement reaches 8.4%. The Financial Stability Board has recommended to the regulator that the countercyclical capital buffer be increased from 1.00% to 1.25%, taking effect in 12 months' time
- FME's SREP results indicate a regulatory capital requirement of 20.7%, including fully-implemented buffers
- Assuming a management buffer of 1.5%, the Bank had a surplus capital of ISK 30 billion at 30 September 2016

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



Sound Funding Profile and Liquidity Position

5

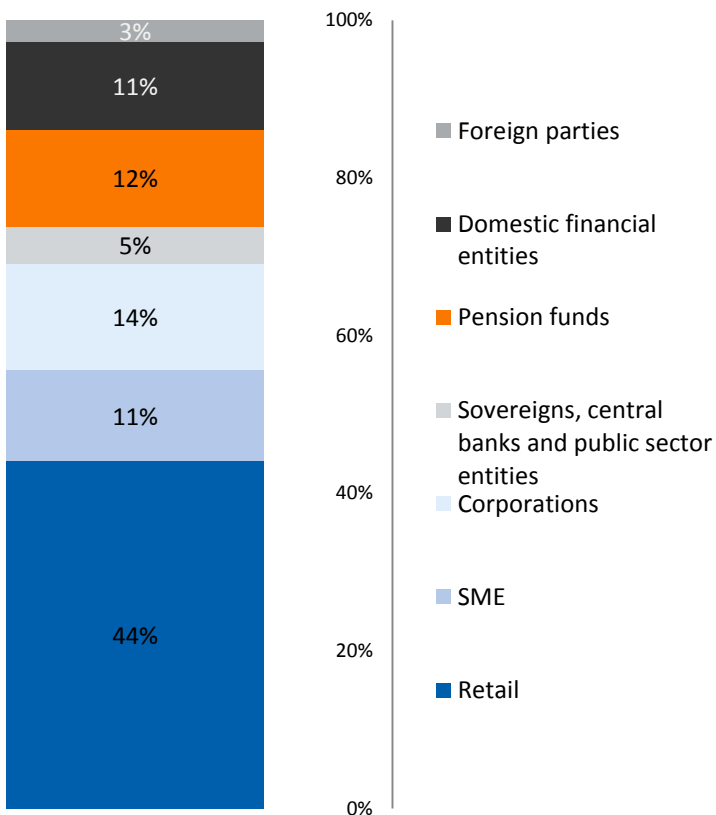


LIMITED REFINANCING NEED

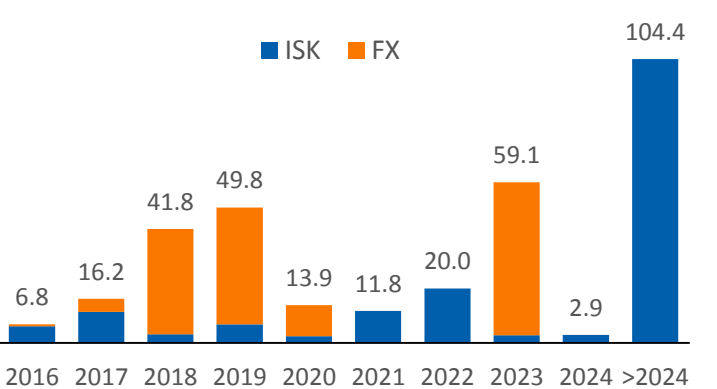
SOUND FUNDING PROFILE AND LIQUIDITY POSITION

- The Bank had a Liquidity Coverage Ratio (LCR) of 194% at Q3 2016
- Arion's liquidity position is strong, based on limited refinancing needs in coming years and a solid deposit base
- On January 11 2016 Arion Bank issued \$747 million bond to Kaupthing. The Bond offsets Kaupthing deposits in foreign currency at Arion bank and FX loan from the Central Bank of Iceland

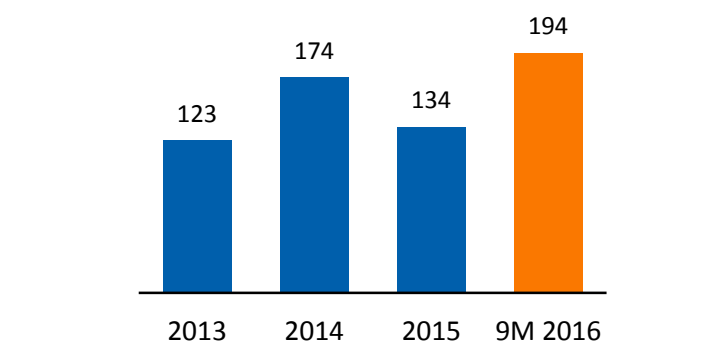
LCR outflow from deposit categories



Maturity of long term funding (ISK bn)



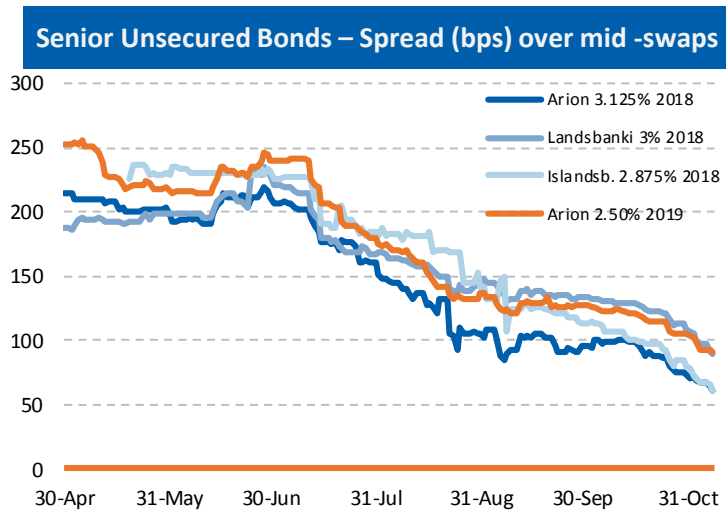
LCR ratio %



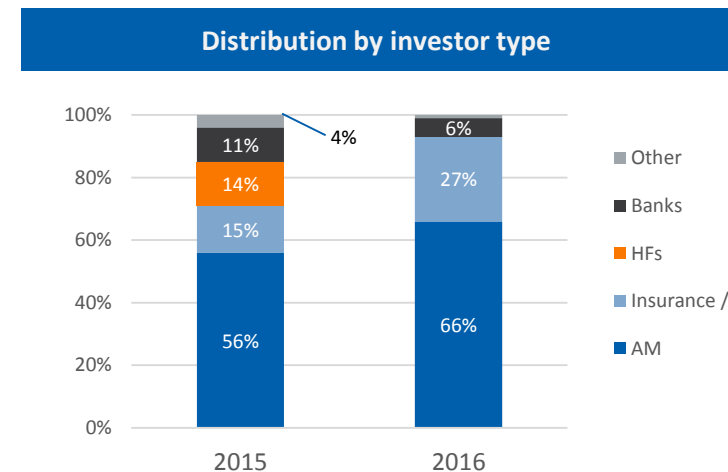
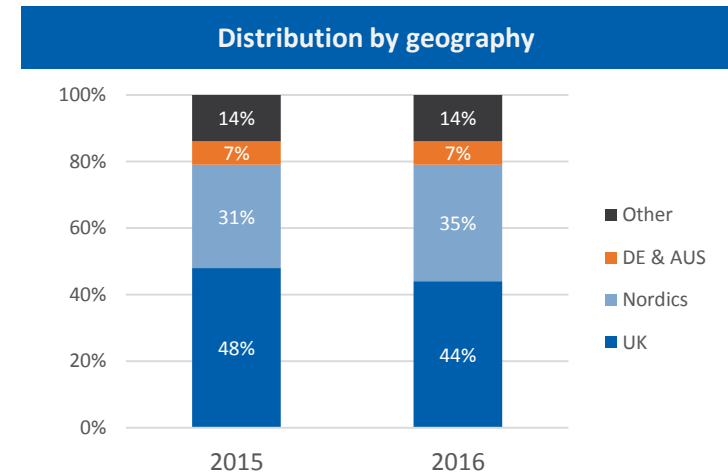
ARION BANK – SUCCESSFUL DEBUT IN THE EUROBOND MARKET

SOUND FUNDING PROFILE AND LIQUIDITY POSITION

- On 3 March 2015 Arion Bank launched its inaugural euro senior unsecured benchmark transaction, the first from an Icelandic bank since 2008
- Order book in excess of €675 million which enabled the Bank to price at MS+310 or 15bp lower than initial guidance
- In April 2016 Arion Bank issued a second 300m EUR transaction. Compared to the inaugural bond offering, Arion managed to diversify its investor base, adding new investors while also keeping a core tranche of second time investors



Issue details	2015	2016
Issue rating (S&P):	BB+ (positive)	BBB- (Positive)
Format:	Senior Unsecured	Senior Unsecured
Pricing date:	3 March 2015	19 April 2016
Settlement date:	12 March 2015	26 April 2016
Maturity date:	12 March 2018	26 April 2019
Size:	EUR 300mn	EUR 300mn
Coupon:	3.125%	2.5%
Issue price:	99.673	99.783
Initial spread guidance:	MS + 325bp area	MS + 275 bps area
Launch spread	MS + 310bp	MS + 270bp
Lead managers:	DB, Citi and Nomura	Barclays, JPM, Nomura



Experienced Management Team

6



EXPERIENCED MANAGEMENT TEAM

6

- Proven track record in strategy execution
- Low turnover rate
- Use of available incentivisation to create value
- Management and supporting team to execute on proposed strategy



Höskuldur H. Ólafsson – Chief Executive Officer

- Former CEO at Valitor hf. – Visa Iceland (2006-2010)
- Previously Deputy CEO at Eimskip (listed, Iceland) after different management positions within the group
- Served on the boards of directors of numerous institutions in Iceland and abroad
- Cand. oecon. degree in business administration (Univ. of Iceland)



Freyr Thórdarson – MD of Corporate Banking

- Senior Director Nordic Credit Portfolio at Kaupthing Bank's Resolution Committee
- Served on the boards of directors of several companies in Iceland and abroad and served on the board of directors of Arion Bank from 2012 to 2013 and was a member of the Board Credit Committee
- MBA (Reykjavik Univ.)



Stefán Pétursson – Chief Financial Officer

- Previously CFO of Landsvirkjun (listed bonds, Lux and Iceland) 2002-2010 where he worked for almost 20 years incl. as treasurer and head of funding
- Currently a member of the boards of directors of Valitor
- MBA (Babson College), Cand.oecon in business administration (Univ. of Iceland)



Ida B. Benediktsdóttir – MD of Investment Banking

- Previously Head of Private Banking, Head of Corporate Communications, Head of Department in Treasury at Arion Bank (joined in 1999)
- Served on the boards of directors of numerous companies (incl. AFL – savings bank and HB Grandi hf.)
- B.Sc. in Business Administration (Univ. of Iceland), M.Sc. in finance (Rotterdam School of Mgt.), certified stockbroker



Sigurjón Pálsson – Chief Operating Officer

- Head of the Recovery team at Arion Bank (2009-2011)
- Worked in Kaupthing Bank's Investment Banking division
- Currently a member of the boards of directors of Landey hf.
- Served on the boards of directors of various companies in Iceland and abroad
- Master's degrees in supply chain mgt. (MIT), construction mgt. (KTH Stockholm), civil engineer (Univ. of Iceland), certified stockbroker



Jónína S. Lárusdóttir – MD of Legal Division

- Previously Director of the General Office and Permanent Secretary at the Ministry of Commerce (served for 10 years)
- Currently a member of the boards of directors of Valitor
- Served on and chaired numerous committees
- Master's degree incl. European competition law (LSE), faculty of law (Univ. of Iceland), qualified district court attorney



Gísli S. Óttarsson – Chief Risk Officer

- Previously Head of Research and Dev. at Kaupthing Bank's risk mgt. division (joined in 2006)
- Formerly software designer and adviser for various engineering companies in the United States
- PhD in mechanical engineering (Univ. of Michigan), certified stockbroker



Helgi Bjarnason – MD of Retail Banking

- Managing Director of Sjóvá Almennar, Life Insurance Company (2006 - 2010)
- Currently chairman of the board of directors of Okkar Life Insurance (served as actuary for ten years), served on various boards of directors
- Cand. act. degree in actuarial mathematics (Univ. of Copenhagen)



Margrét Sveinsdóttir – MD of Asset Management

- 30+ years experience in the financial sector (various positions within banking and asset management)
- Served on a number of boards of directors
- Currently chairman of fund companies in Luxembourg
- MBA (Babson College), Cand.oecon degree in business administration (Univ. of Iceland) and certified stockbroker



Rakei Óttarsdóttir – Chief Information Officer

- Joined Kaupthing Bank in 2005 as an account manager in IT division and later head of Arion Bank's Project Office and then MD of Corporate Development and Marketing.
- Software designer and Head of Dev. at TM Software – Libra
- MBA (Duke Univ.), B.Sc. in computer science (Univ. of Iceland)

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