Arion Bank

Third quarter results 2019

Investor presentation

31 October 2019

Highlights of the third quarter 2019

- Core earnings of Arion Bank continue to improve
- Significant organizational changes and improvement measures launched in September
- Agreement concluded with Housing Financing Fund on the sale of a ISK 48 billion mortgage portfolio. Positive impact of ISK 1.3 billion in Q4
- Developments in businesses held for sale negatively affected Q3 results
- Sale process of Valitor continues but is taking more time than originally anticipated

Organizational changes introduced

Measures introduced as part of trajectory to reach financial targets

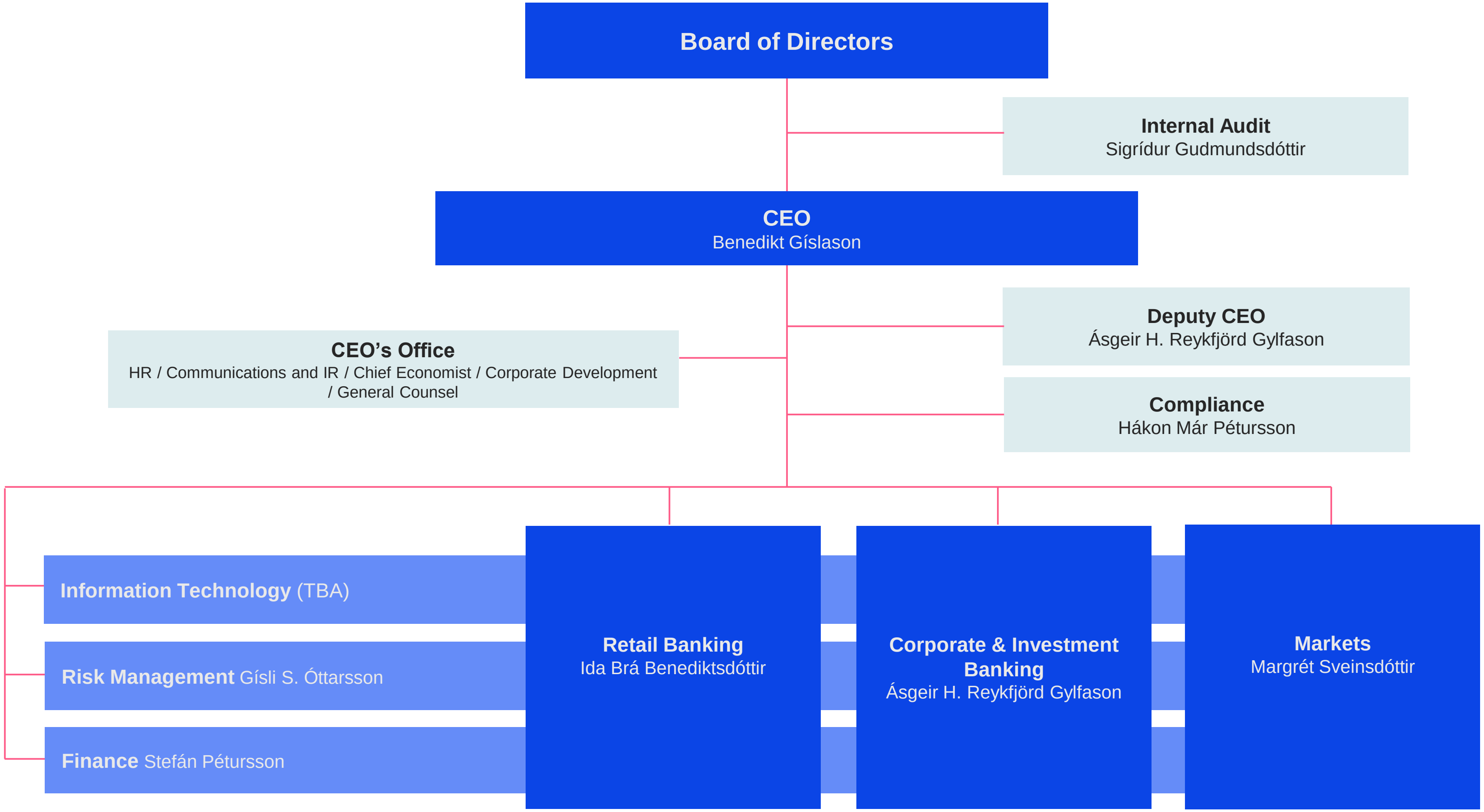
Core strategy remains unchanged – comprehensive financial services to individuals, companies and investors and to be at the forefront of digital banking

The Bank will enhance its services to customers seeking the most cost-effective financing by acting as financial intermediary with third parties such as funds and other institutional investors

Changes resulted in reduction in the number of employees by 12% in September. The cost of redundancies fully expensed in Q3 and amounts to approx. ISK 1.1 billion or ISK 0.8 billion after tax

The total impact on an annual basis of these measures is estimated at ISK 1.3 billion after tax as from Q4

New organizational structure



Arion Bank today

Fully prepared to navigate a challenging market and regulatory environment

Arion Bank

- The only listed full service bank in Iceland
- Robust capital and liquidity position
- Strong infrastructure
- Diverse revenue streams
- Leader in digital customer interface
- Market leading asset management platform
- Insurance business delivering strong results and with capacity for growth
- Rejuvenated management team and operational structure
- Recent profitability below target and sector specific one-off loan book impairments

Market drivers 2019 and onwards

- Robust but slowing Icelandic economy
- High taxation and capitalization requirements
- Diverse local competition with disproportional government involvement
- Continued growth of pension fund system and increasing involvement in diverse asset classes
- Fintech increasing role in sector innovation but banks will continue to play key role in regulated products and services
  - Partnerships between banks and Fintech increasingly an avenue of growth

Arion Bank is committed to its medium-term targets

New revenue target introduced and loan growth target amended

Return on Equity

Exceed **10%**

Revenues / RWA's

Exceed **6.5%**

Cost to Income Ratio

Reduce to **circa 50%**

Loan growth

The loan book will grow in line with economic growth. However, the corporate loan book will continue to decrease at the current rate over the next few quarters as non-core portfolio is reduced

CET 1 Ratio (Subject to regulatory requirements)

Reduce to **circa 17%**

Dividend Policy / Share buy-back

Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buy-back of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above the minimum requirements set by the regulators in addition to the Bank's management buffer

Building long-term shareholder value

Customer focus with efficient use of capital

Reduce cost of capital

- Share buy-back program
- Group capital and funding optimization
- Reduce operating leverage
- Reduce earnings volatility through long term client relationships and disciplined capital allocation
  - Increased co-investment strategy through syndication and intermediation
- Transparency around business plan and asset quality

Increase cash flows

- Enhance product / client ownership and responsibility and improve cost transparency
- Cutting costs / improve margins
- Cut assets / products that have ongoing and foreseeable sub-par returns
- Disciplined capital allocation towards higher ROE / growth products & clients
- Leveraging partnerships for infrastructure costs

Enhance equity story

- Strengthen and build on existing competitive advantages
- Reinforce long-term client relationships through best-in class products and services
- Digital solutions at the core of all activities
- Leveraging partnerships in Fintech
- Increase capital turnover
- Building a winning team
- Sustainable long-term values

The road to sustainable +10% ROE [1]

Release of CET1 plays a fundamental role

Reported 2.6% ROE 9M 2019

Underlying ~5.5% ROE

- **Discontinued operation excluded and impairments normalized to 30 bps of loans to customers [2]**

- **Exit from non-core assets, primarily on the corporate side, that are not yielding acceptable returns**

- **Capital release to the 17% CET1 target [3]**
  - Surplus capital
  - Issuance of Tier 2 and AT1
  - Share buy-back and dividend payments

- **Increased revenues from RWA's**
  - New target of 6.5% for the Bank, an increase from 5-6% in recent years
  - Result of more capital velocity, higher margins and fee generation

- **Cost to income to reach target of < 50%**
  - Structural changes to support more efficient operation and continued focus on digitalization, both in front line and support functions
  - Decrease in number of FTE's at the end of Q3 the first step on the road

>10.0% ROE

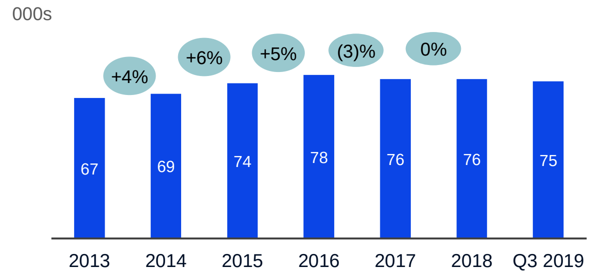
1. Bars in chart are illustrative and not to scale
2. 30 bps. impairments on loan book are based on average cost of risk from Risk models
3. Subject to regulatory approval, market conditions and other factors

Digital services are changing customer behavior

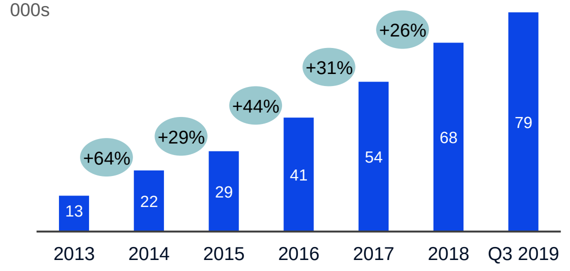
The Bank’s digital journey has produced outstanding results

- The growth in active Arion Bank app users was 16% in the first 9 months
- New digital branches continue to drive increased customer usage
- Visits to traditional branches continue to trend down – decreased by 32% since 2013
- Total branch space decreased by 45% since 2014
- Digital sales ratio 66% for core products
  - Credit cards, current accounts and savings accounts
- Overdraft applications now 84% digital
- Car loans 100% digitally processed at the car dealers
- Mortgage credit assessments more than 85% digitally processed through Arion Bank’s website

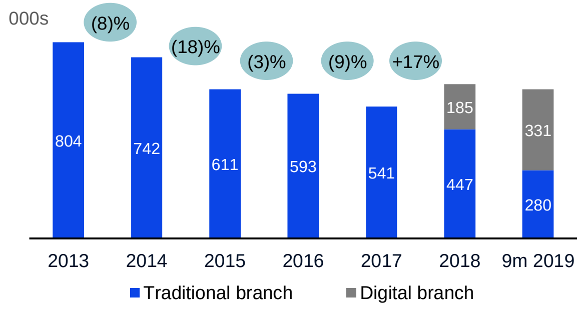
Active online bank users[1]



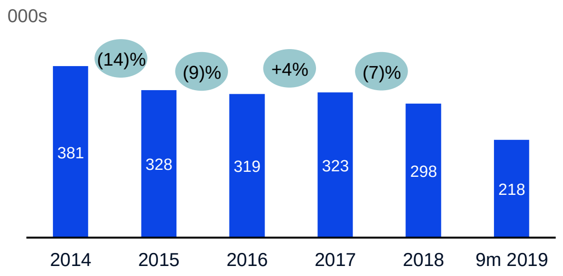
Active Arion App users[1]



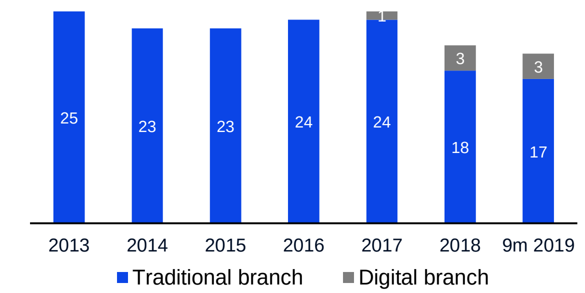
Number of visits to branches[2]



Number of calls to the call centre



Number of branches[2]



Source: Company information

1. 90 day active online users/individuals and 90 day active app users,
2. Data: Qmatic ticketing system for traditional branches and Mobotix camera counting system for digital branches. Two different methods.

Launching 7 customers facing products in 2019

Leader in digital banking

Open App

Launched in February 2019

Everyone can use the Arion app by logging in through digital authentication, without having prior business with the Bank. The following products were made available for direct purchase in app:

Credit cards
Savings account
Debit cards
Consumer loans

Apple Pay and Mobile Wallet*

Launched in 1h 2019

Customers can link their credit and debit cards to Apple Pay or Mobile Wallet* directly through the Arion app and use their phone to pay in shops that have contactless card machines

Vördur Insurance

Launched in July 2019

Customers can get a quote for car and home insurance and complete the purchase within a few seconds in the Arion app. The insurance offering is personalized to each customer based on data & analytics

Personal Finance Management

Launched in July 2019

In the Arion app customers now have an insights option giving them an overview of their spending by period in specified categories

Aggregation of Accounts

Launched in July 2019

In partnership with Meniga you can now see your accounts and transactions at other banks in the Arion App securely and conveniently

Rós concept introduced

Launch in Q4 2019

Machine learning models are deployed to identify appropriate products and recommend to individual customers.

To make the recommendation personal and compelling we introduce a bot concept "Rós" that delivers the recommendations to our customers

*For android devices in Arion app

Sustainable and responsible banking

Arion Bank became one of the founding signatories of the UN Principles for Responsible Banking

UN Principles for Responsible Banking (PRB)

- A founding signatory of the **UN PRB** and will strategically align its business with the **Sustainable Development Goals** and the **Paris Agreement** on Climate Change
- The signing of the principles marks the beginning of the most **significant partnership** to date between the global banking industry and the UN

AllBright

- In **25th place** out of 333 listed companies in Sweden which are setting a good example in terms of **gender diversity** in management teams and at board level
- Allbright is a politically-independent, non-profit foundation that promotes **equality and diversity** on the executive business level in Sweden

Other commitments and certifications

- Festa and City of Reykjavík's **Declaration on Climate Change**
- **Equal pay** certification by the labor union VR in 2015
- Awarded Ministry of Welfare's **equal pay symbol** in 2018
- UN Women and UN Global **Compact Women's Empowerment Principles**
- **UN Global Compact**
- Recognized as a company which has achieved **excellence in corporate governance** by the Center for Corporate Governance
- United Nations' Principles for Responsible Investment, **UN PRI**

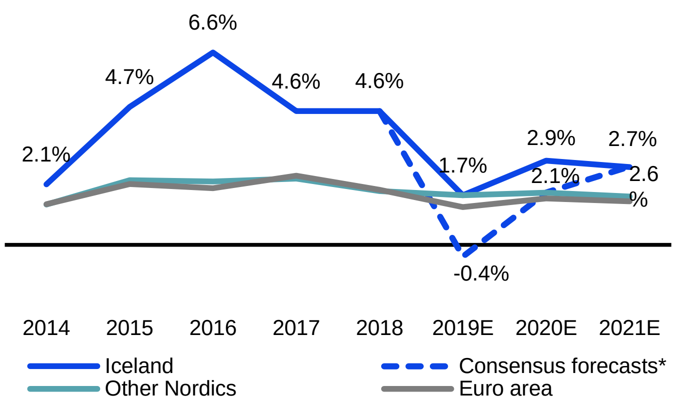
Macroeconomic environment

Outlook for negative growth in 2019 with a gradual turnaround

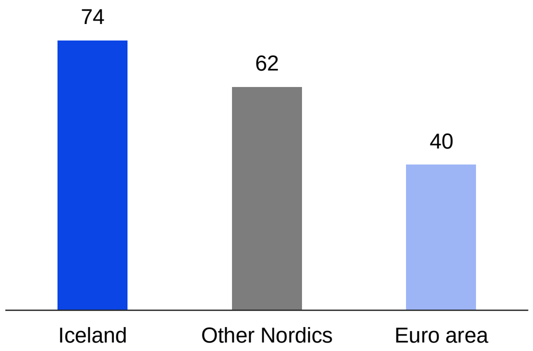
After strong 4.8% GDP growth in 2018, economic activity looks set to slow down

- Falling exports are expected to bring an end to one of the longest growth periods the Icelandic economy has experienced
- Despite a possible contraction, GDP per capita will remain high
- The tourism industry has boomed since 2011. Even though the growth period is over, for the time being, it's a welcome respite for pressured infrastructure
- The economy is well equipped to handle a short slow down, with the monetary policy having already lowered interest rates by 125 bps
- The proposed fiscal easing sides with the monetary policy, further softening the blow to the economy
- Growth in exports is expected next year as the effect of WOW air's bankruptcy and grounding of the Boeing 737 Max gradually tapers off

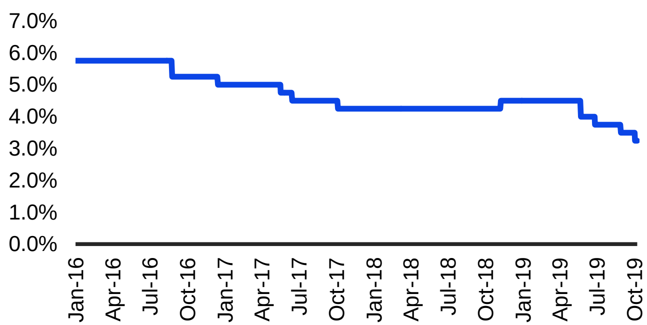
GDP growth



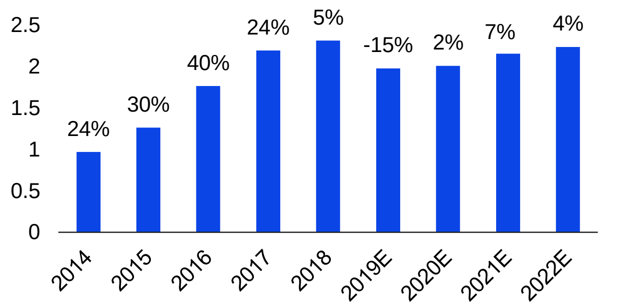
GDP per capita in 2018 (USD thousands)



Key interest rate – seven-day term deposit rate



Tourist arrivals via KEF airport (millions and YoY growth)



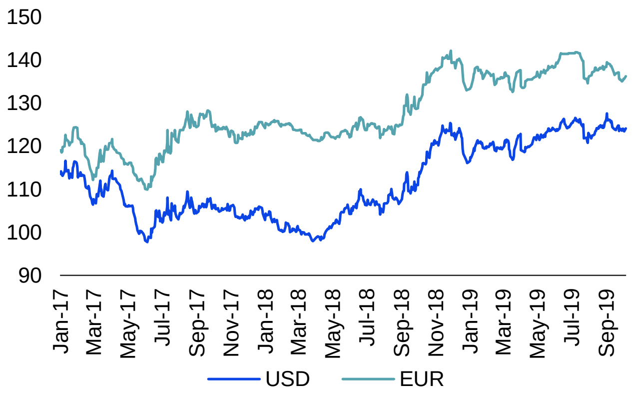
Sources: Icelandic Tourist Board, CBI, Statistics Iceland, Arion Research, IMF. * Domestic analysts

The economy is resilient

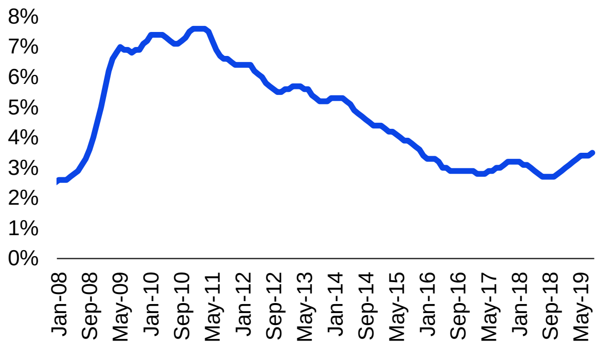
Unemployment is on the rise and household consumption is wavering, while inflation is receding

- Smaller export contraction than expected and larger drop in imports than anticipated supported the ISK in Q3, contributing to the modest appreciation
- Collective wage agreements in April coincided with a softer economic outlook and reduced uncertainty in the economy
- Inflation pressures have eased as domestic demand falters and the ISK remains relatively stable
- Unemployment has increased over the past months, a trend many expect to continue in the winter during the low season in tourism
- Rising unemployment combined with slower wage increases have been reflected in slower payment card turnover growth

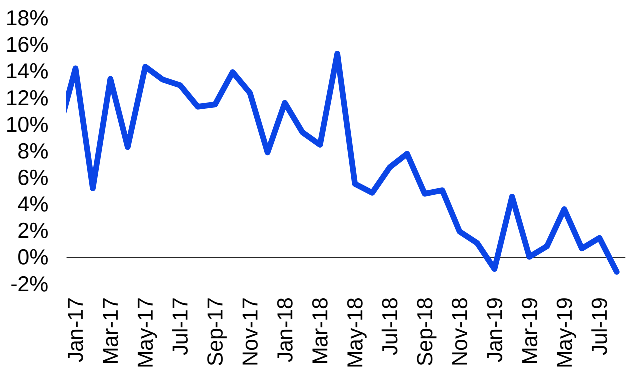
The ISK against major trade currencies



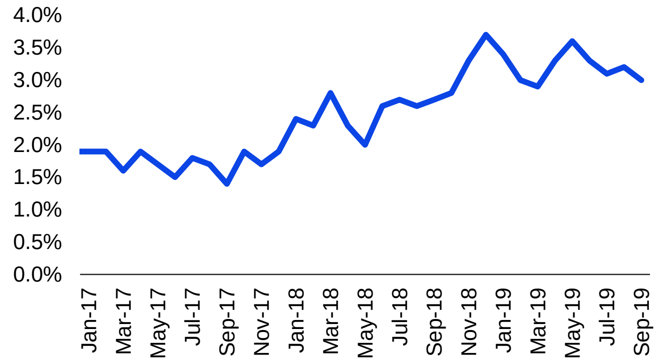
Unemployment– seasonally adjusted trend



Total payment card turnover



Inflation



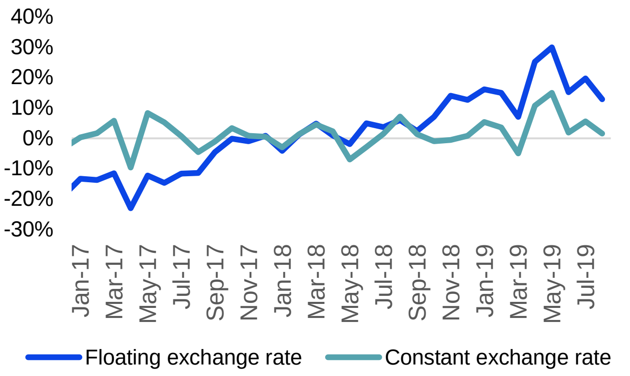
Sources: CBI, Statistics Iceland, Arion Research

Indications of softer landing than anticipated

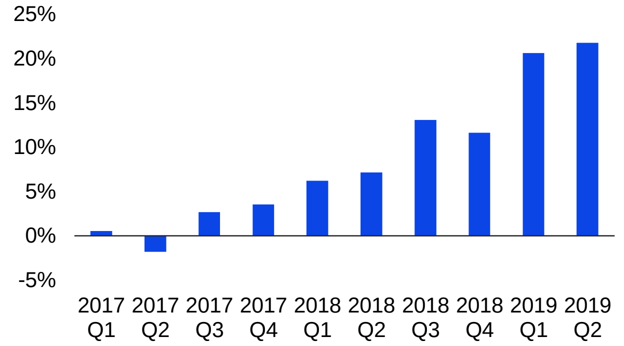
The consumption pattern of tourists has changed since WOW air's bankruptcy

- Since WOW air's bankruptcy, spending per tourist has increased significantly, both in ISK and FX
- A plausible explanation for this development is that each tourist is staying for longer, on average, than before
- The drop in total overnight stays is mainly due to unlisted accommodation while hotels have mostly held their ground
- The recent tourism figures are extremely positive for Icelandic tourism and the economy as a whole
- The economy is well equipped to handle a short recession, with a positive net external position and historically low debt levels, both in the private and public sector
- Recent economic development, coupled with monetary easing, has contributed to long-term ISK yields coming down and the Icelandic housing market holding its ground

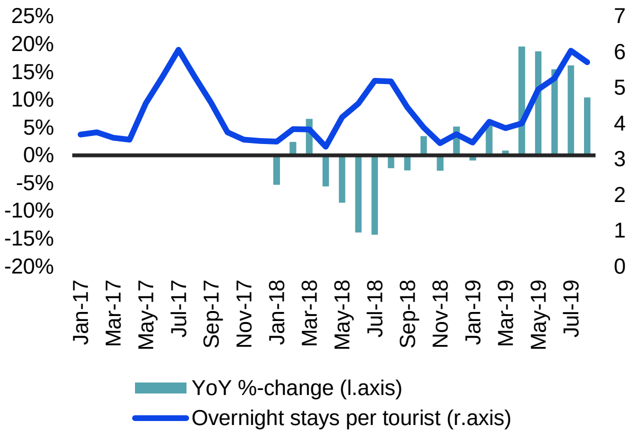
Foreign payment card turnover per tourist – YoY %-change



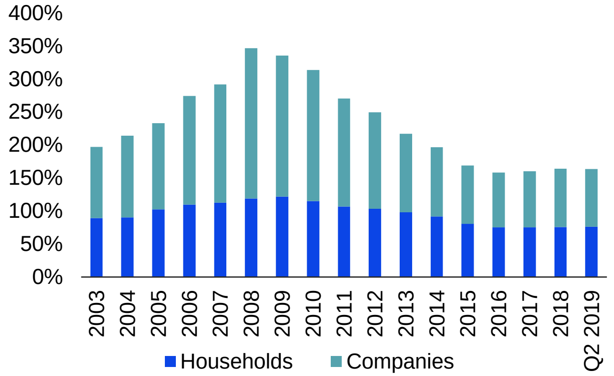
Net international investment position – % of GDP



Total overnight stays per tourist



Household and non-financial corporate debt – % of GDP



Sources: CBI, Centre for Retail Studies, Statistics Iceland, Arion Research

Headline Figures

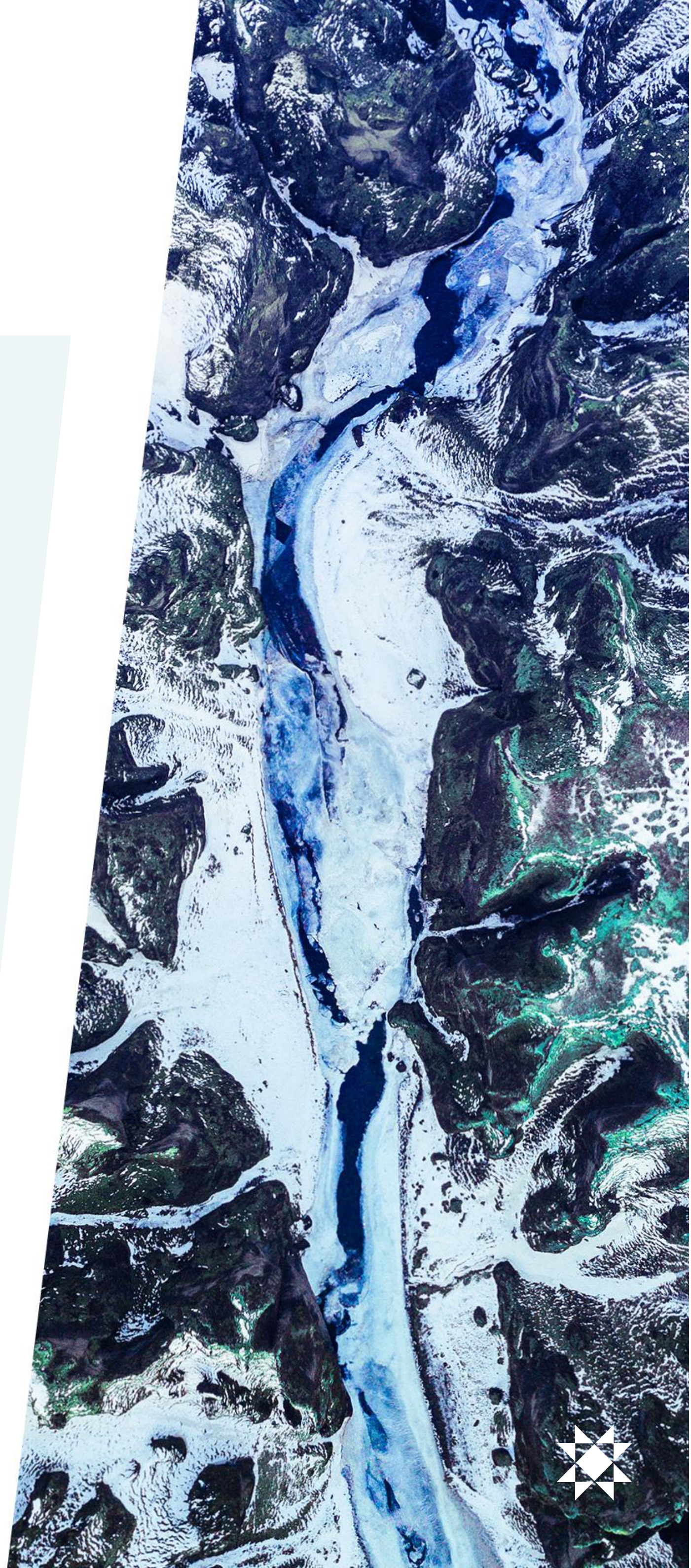
Q3 2019

Net earnings	CET 1	Cost-to-income ratio	Share of stage 3 loans, gross
ISK 0.8 bn.	**21.6%**	**56.2%**	**2.5%**
Q3 2018: **ISK 1.1 bn.**	31.12.2018: **21.2%**	Q3 2018: **50.3%**	31.12.2018: **2.6%**

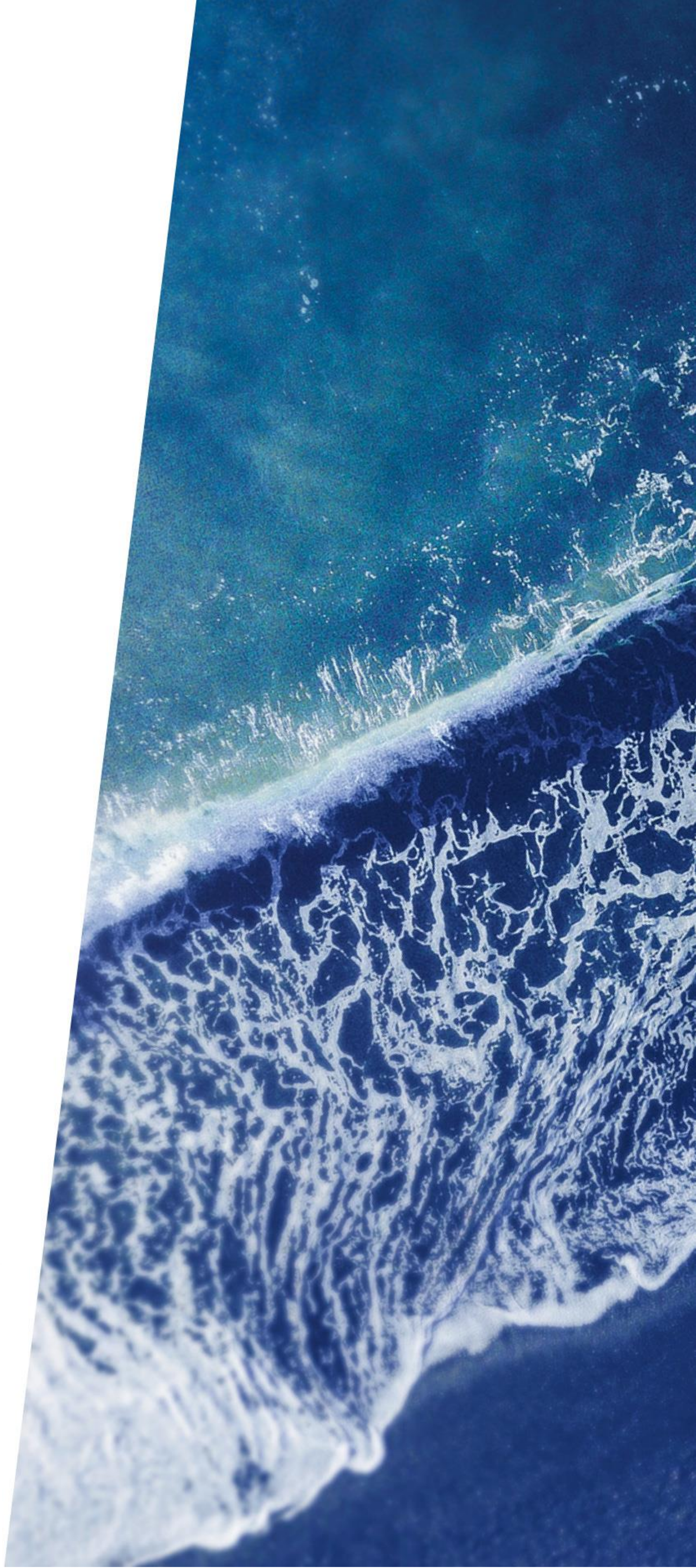
Return on equity	Leverage ratio	Number of employees	Mortgages/Total loans
1.6%	**12.8%**	**802**	**43.0%**
Q3 2018: **2.3%**	31.12.2018: **14.2%**	31.12.2018: **904**	31.12.2018: **41.1%**

Core earnings continue to improve

- Net earnings from continuing operations improve markedly
- ROE 1.6% in Q3 but approximately 8.5% from continuing operations
- Insurance becoming more important in the revenue mix
- Operating expenses down from last year when adjusted for redundancy expenses
- Impairments are positive in Q3 and asset quality remains strong
- Bank levy is decreasing in line with a smaller balance sheet
- Net earnings negatively affected by developments in discontinued operations



Income statement



Income statement Q3 2019

Core operations performing better and a substantial improvement in earnings from continuing operations

- Growth in net interest income mostly due to increase in loans to customers
  - Decreased effect of inflation due to lower CPI imbalance and lower inflation compared to last year
- Strong growth in net insurance income with combined ratio of 80.0% in Q3
- Increase in salaries mainly due to reduction of FTE's by 12% at the end of Q3 with a redundancy cost of ISK 1.1 billion
- Positive net impairments due to prepayment of loans and improved unemployment forecasts which positively affect IFRS 9 models
- Negative effects from discontinued operations due to valuation change in assets at United Silicon and TravelCo and continued investments in Valitor's international growth

	Q3 2019	Q3 2018	Diff%	Q2 2019	Diff%
Net interest income	7,382	7,209	2%	7,808	(5%)
Net commission income	2,639	2,686	(2%)	2,478	6%
Net insurance income	1,087	984	10%	823	32%
Net financial income	934	569	64%	1,023	(9%)
Share of profit of associates	30	34	(12%)	(7)	-
Other operating income	272	422	(36%)	95	186%
Operating income	**12,344**	**11,904**	**4%**	**12,220**	**1%**
Salaries and related expenses	(4,130)	(3,129)	32%	(3,805)	9%
Other operating expenses	(2,810)	(2,864)	(2%)	(2,813)	(0%)
Operating expenses	**(6,940)**	**(5,993)**	**16%**	**(6,618)**	**5%**
Bank levy	(809)	(937)	(14%)	(912)	(11%)
Net impairment	484	(2,650)	-	(988)	(149%)
Net earnings before income tax	**5,079**	**2,324**	**119%**	**3,702**	**37%**
Income tax expense	(1,278)	(973)	31%	(891)	43%
Net earnings from continuing operations	**3,801**	**1,351**	**181%**	**2,811**	**35%**
Discontinued operations, net of tax	(3,040)	(202)	-	(715)	325%
Net earnings	**761**	**1,149**	**(34%)**	**2,096**	**(64%)**

All amounts in ISK million

Income statement 9M 2019

Substantial improvement in continuing operations

- Strong growth in net interest income despite lower inflation in line with strategy
- Net commission income rather stable with Retail Banking performing well whilst Investment Banking has been subperforming
- Net insurance income continues to trend positively
- NFI down YoY, partly due to sale of Refresco in 2018. Increase in share of profit of associates in 2019 is due to the sale of Farice
- Operating expenses are under control with increase in salaries and related expenses due to redundancies
- Impairment affected by the bankruptcy of WOW air in Q1 2019. Impairments in 2018 were high due to bankruptcy of Primera Air in Q3 2018
- Discontinued operations substantially more negative than in 2018 mainly due to valuation changes of assets held for sale and continuing investment in Valitor growth

	9M 2019	9M 2018	Diff	Diff%
Net interest income	22,624	21,350	1,274	6%
Net commission income	7,335	7,603	(268)	(4%)
Net insurance income	2,163	1,885	278	15%
Net financial income	2,723	3,076	(353)	(11%)
Share of profit of associates	750	16	734	-
Other operating income	677	1,290	(613)	(48%)
Operating income	**36,272**	**35,220**	**1,052**	**3%**
Salaries and related expenses	(11,565)	(10,694)	(871)	8%
Other operating expenses	(8,855)	(8,985)	130	(1%)
Operating expenses	**(20,420)**	**(19,679)**	**(741)**	**4%**
Bank levy	(2,627)	(2,620)	(7)	0%
Net impairment	(1,585)	(2,951)	1,366	-
Net earnings before income tax	**11,640**	**9,970**	**1,670**	**17%**
Income tax expense	(2,791)	(3,165)	374	(12%)
Net earnings from continuing operations	**8,849**	**6,805**	**2,044**	**30%**
Discontinued operations, net of tax	(4,974)	(645)	(4,329)	671%
Net earnings	**3,875**	**6,160**	**(2,285)**	**(37%)**

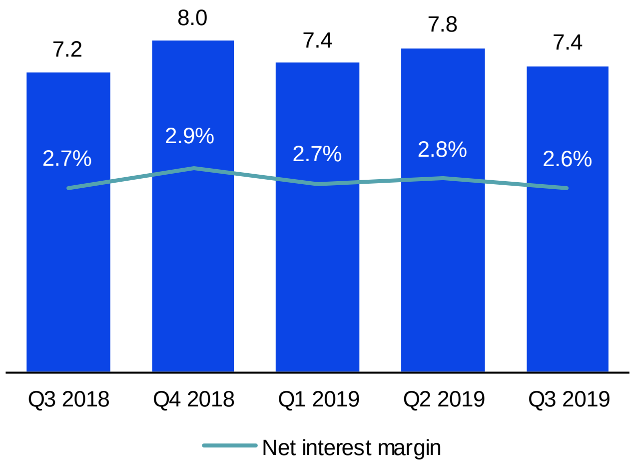
All amounts in ISK million

Net interest income

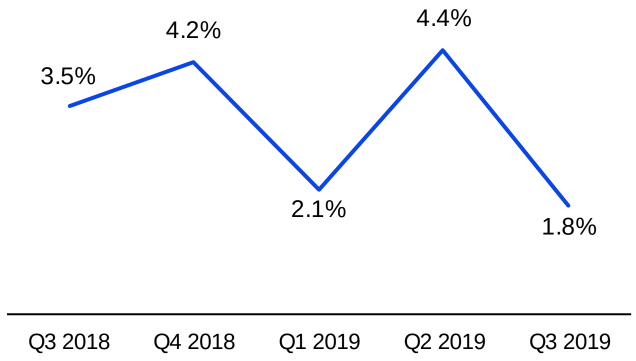
Holding up at time of base rate reduction and T2 issuance

- Net interest income increased by 2.4% from Q3 2018, mainly through funding and liquidity management
- The Bank's strategy of increased focus on returns rather than loan growth is reflected in increased income from loans to customers on a static loan book
- The NIM is strong considering that:
  - The Bank has issued ISK 10.8 billion of Tier 2 subordinated bonds in 2019
  - The policy rate has been lowered with a negative effect on NIM
  - The FX deposits with negative carry have increased from 2018
  - Net inflation effect is negative from Q3 2018 to Q3 2019 with effective inflation significantly lower, but with ISK 35 billion lower CPI imbalance the effect is less than otherwise
- The Bank has increased the proportion of ISK in its liquidity buffer, thus improving net interest income

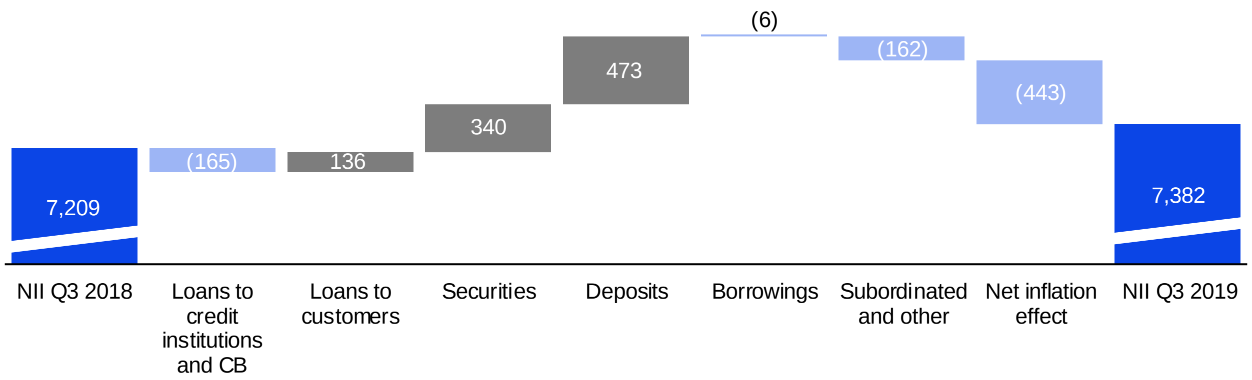
Net interest income



Effective inflation



Net interest income Q3 2018 vs Q3 2019 (ISK million)

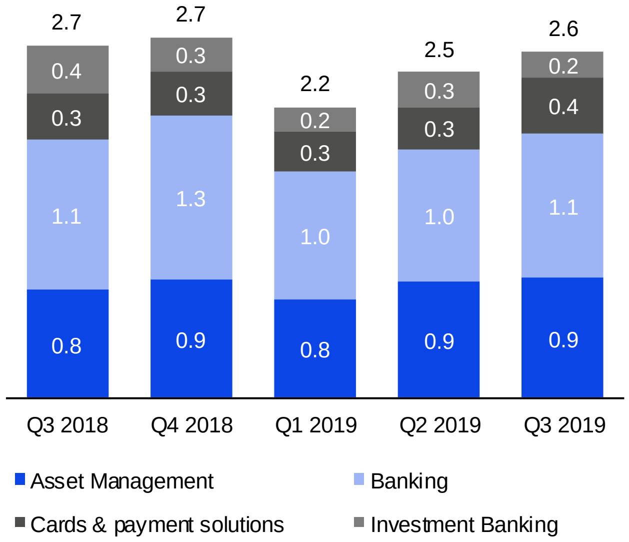


All amounts in ISK million

Net fee and commission and net insurance income

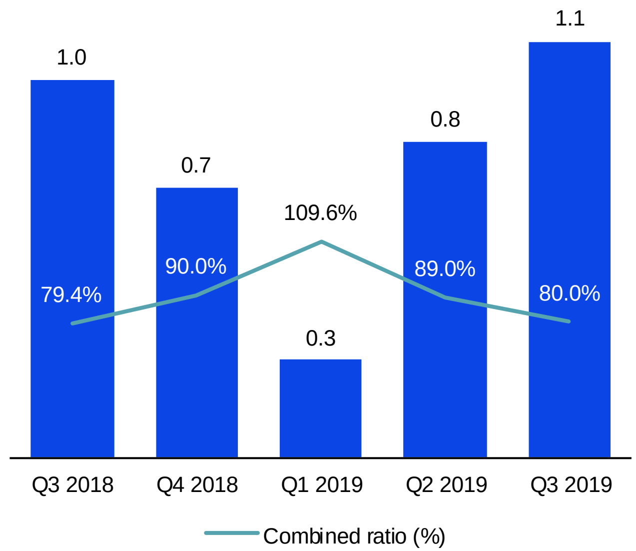
Stable net commission income – net insurance income continues to grow

Net fee and commission income



- Net fee and commission income slightly down from Q3 2018 but up from Q1 and Q2 2019
- Tourism related income from cards and banking activities supports commission income in Q3
- Income from asset management is stable. Assets under management were ISK 1,057 billion at 30 September, an increase of 9% from year end 2018

Net insurance income



- Solid improvement from Q3 2018 and increase from prior quarters in 2019 mainly due to seasonality in non-life insurance
  - Earned premiums increased by 8% in Q3 YoY
- Volatility in non-life, often affected by weather conditions in Q1
- Combined ratio of 80% in Q3 is competitive in the domestic market

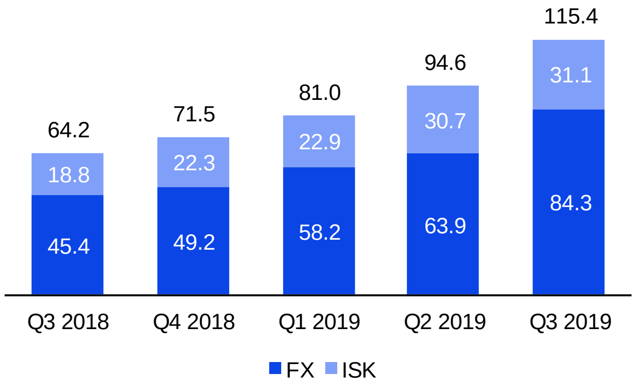
All amounts in ISK million

Net financial income

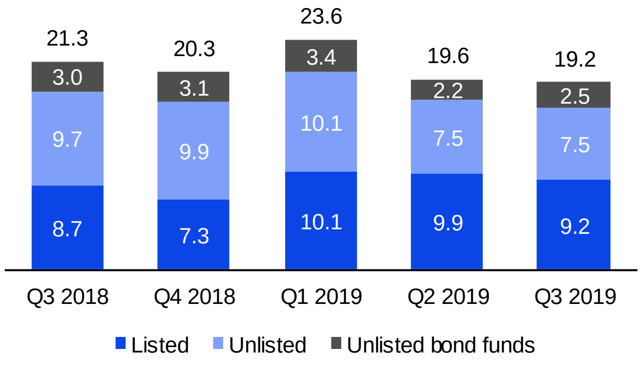
Increase in bond holdings a sign of strong liquidity position

- Net financial income in Q3 is mainly FX gain (ISK 826 million). Markets were rather bearish for equities during the quarter
- Bond holdings are mainly part of liquidity management
  - Transfer from money market to government bonds reduces RWA's
- Equity holdings are mainly strategic positions
- Total portfolio of Vördur is ISK 16.3 billion; ISK 11.3 billion of bonds and ISK 5.1 billion in equity instruments

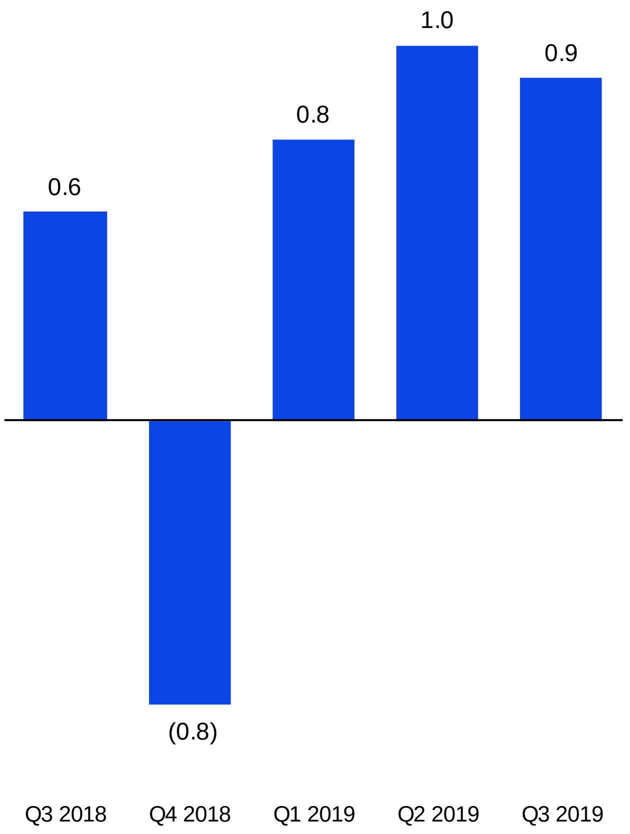
Bond holdings



Equity holdings



Net financial income



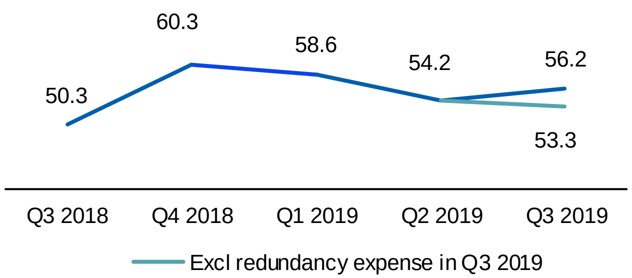
All amounts in ISK billion

Total operating expenses

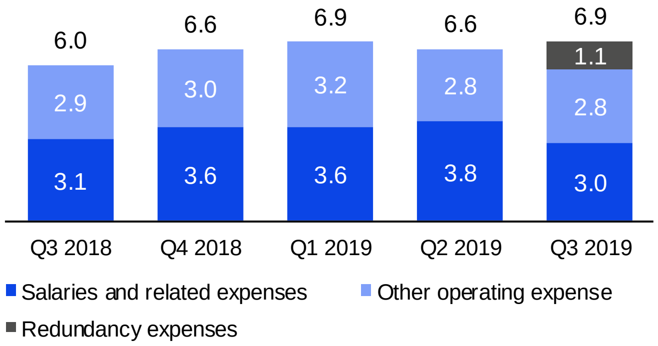
Positive development in cost-to-income excluding cost relating to redundancies at the end of third quarter

- 10.5% reduction of FTE's at the parent company from Q2 and 16.2% from Q3 2018
  - ISK 1.1 billion one-off expense in Q3 due to redundancies
  - Expected quarterly cost savings of approx. ISK 300 million going forward
- General wage inflation of 5.0% from Q3 2018 did put pressure on salary expenses. The Bank nevertheless managed to keep salary expenses stable
- Other operating expenses continue to trend positively in Q3
  - Continued investment in IT projects, such as core system SOPRA and digital solutions

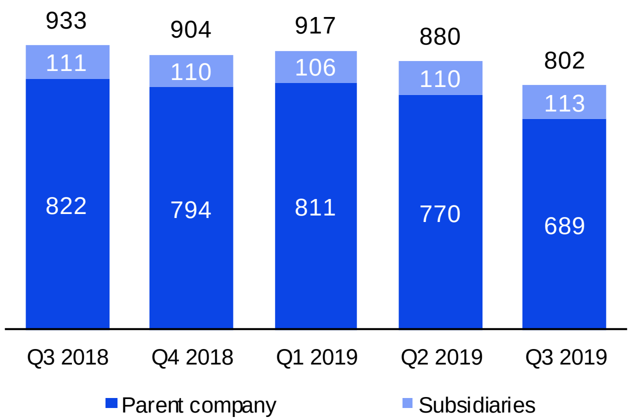
Cost-to-income ratio (%)



Total operating expenses



Number of employees



All amounts in ISK billion

Balance sheet

Balance sheet - Assets

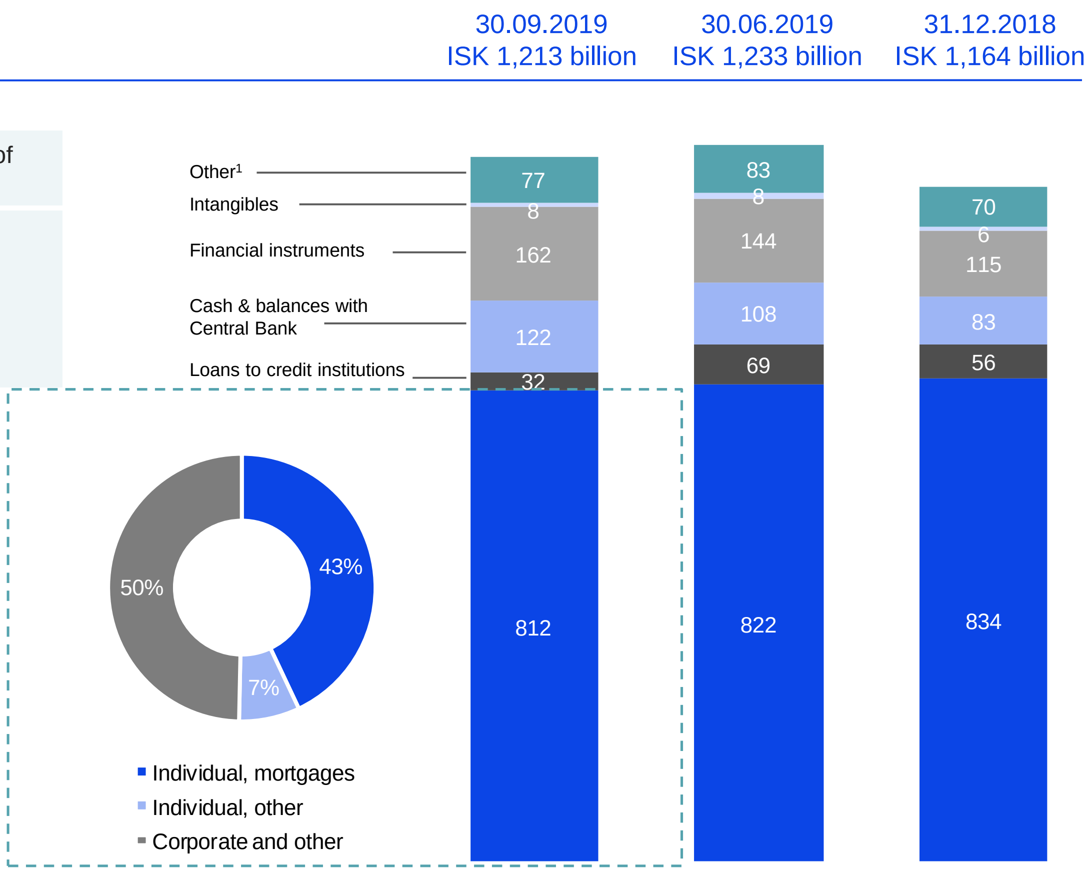
Strong liquidity position allows the Bank to prepay unfavorable wholesale funding or buy back bonds and own shares

- The Balance sheet decreases by 4.2% from 30.06.2019
- Loans to customers decrease by 2.6% from year-end 2018 and 1.2% from Q2 with continuing focus on returns over loan growth
- Very strong liquidity position despite dividend payment during Q1 2019 and prepayments of unfavorable borrowings
  - Total LCR ratio is 246% and ISK LCR ratio is 171%
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX

Other and intangibles: 7.1% of total assets

ISK 316 billion, of which **ISK 257 billion liquidity reserve** (50% of customer deposits)

Loans to customers
67.0% of total assets



[1]Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets

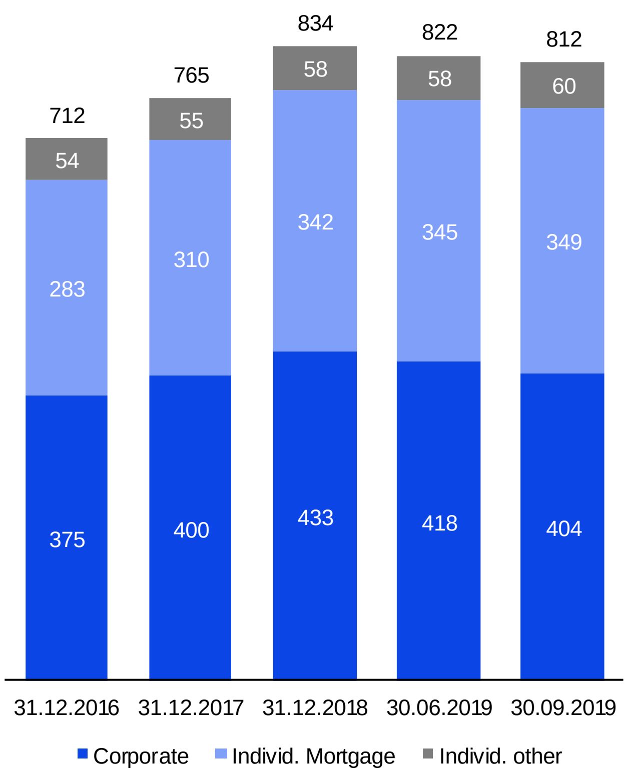
All amounts in ISK billion

Loans to customers

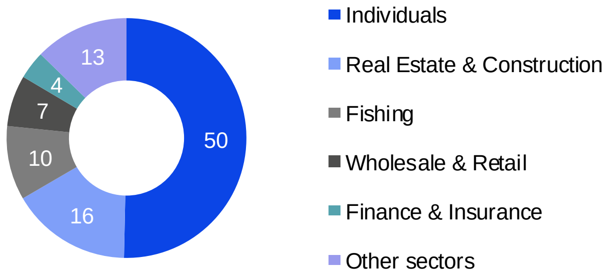
Focus on profitability results in the corporate loan book trending lower thus releasing RWA's

- Good balance between individual and corporate loans
  - Loans to individuals increase slightly from YE 2018
  - Loans to corporates decrease by 6.9% from YE 2018 and 3.5% from 30.06.2019
  - Good diversification between sectors in the corporate loan book
- The corporate loan book reduction has released approx. ISK 42 billion of RWA's since YE 2018
- Demand for new lending affected by temporary economic slowdown
  - Reflected in loan commitments, 21% decrease from 30.9.2018
- The loan book is collateralized 91.0%, compared with 90.6%, at YE 2018

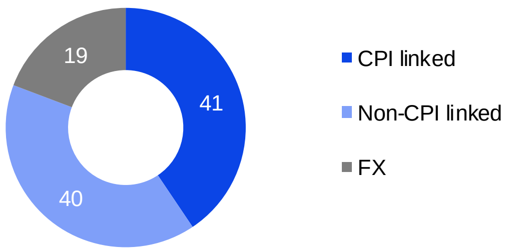
Loans to customers



Loans to customers by sector (%)



Loans to customers by currency (%)



All amounts in ISK billion

Significant assets held for sale

Assets in an active sale process but with a highly negative impact on net earnings

Valitor Holding is an international payments platform, with operations primarily in Iceland, the UK and the Nordic countries, and comprizes both card acquiring services and card issuing services. Valitor became a subsidiary of Arion Bank in 2010 when the Bank had acquired 52.94% shareholding in Valitor and following further investments Arion Bank held 100% shareholding in Valitor in Q1 2015. Valitor was categorized as held for sale in Q4 2018. At the end of September **the net value of Valitor was ISK 11.7 billion**

Stakksberg's operation comprises a silicon production plant which commenced operations in 2016In 2017 Arion Bank acquired the company, United Silicon, as a result of a loan restructuring process and at a later stage Arion Bank's subsidiary, Stakksberg, took over the operations of United Silicon. At the end of September **the net value of Stakksberg was ISK 5.5 billion (EUR 41.0 million)**

Balance sheet – Liabilities and equity

Very strong capital position – Leverage ratio of 12.8% substantially stronger than Scandinavian peers

- Strong equity position and a very high leverage ratio despite capital release
  - Dividend payments of ISK 9.1 billion in Q1 2019
  - Share-buy back up to ISK 4.5 billion from 31 October
  - 50% payout of net earnings according to dividend policy
- The funding mix is well balanced between deposits, covered bonds and senior unsecured bonds
- The Bank has been a frequent issuer of covered bonds in the domestic market and a regular issuer of senior unsecured in the international market
- Deposits increased by 9.0% from YE 2018 and 4.7% YoY – continued focus on deposits going forward
- The Bank has issued a number of Tier 2 subordinated bonds in line with its capital strategy

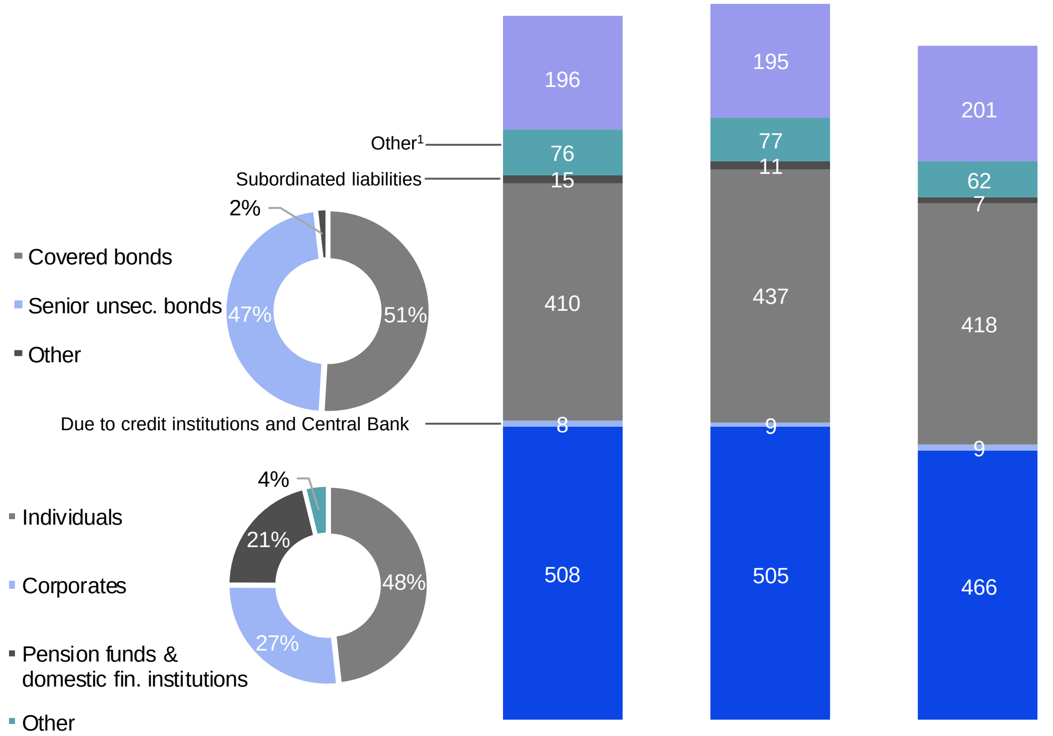
30.09.2019	30.06.2019	31.12.2018
ISK 1,213 billion	ISK 1,234 billion	ISK 1,164 billion

Equity
CET1 ratio 21.6%
Leverage ratio 12.8%

Borrowings (in ISK)
ISK 216 billion
EUR 152 billion
Other currencies 42 billion

Deposits
On demand 71%
Up to 3M 12%
More than 3M 17%

8.3% increase from YE 2018



[1] Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities

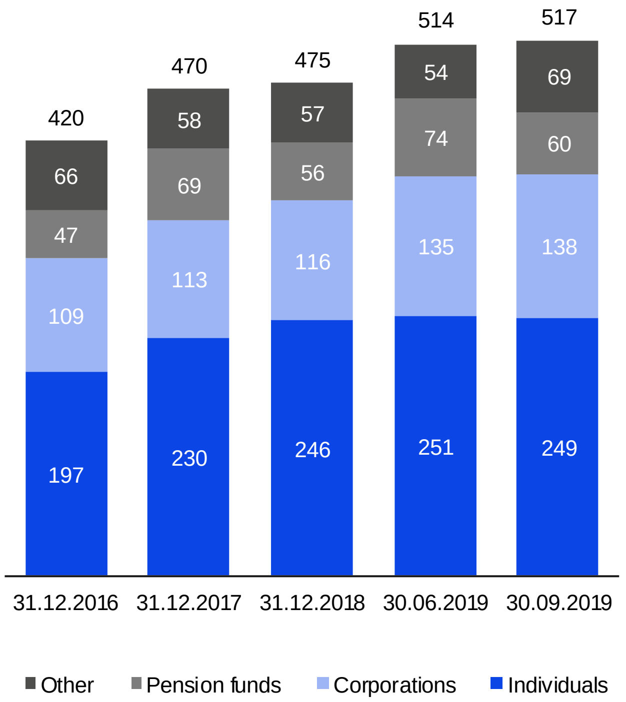
All amounts in ISK billion

Deposits

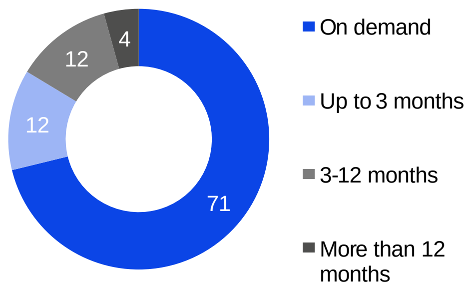
Continued focus on deposits both from individuals and corporates

- Deposits represent 42% of the Bank's funding
- Deposits from individuals have grown significantly over the last few years
  - 1.2% growth from YE 2018
- Special emphasis on corporate deposits
  - 19.0% growth from YE 2018
- FX deposits have increased significantly during 9M 2019, primarily short term
  - FX deposits are 18% of deposits, down from 20% at 30.06.2019 but up from 14% at 31.12.2018
  - The Bank is in a challenging position when it comes to short-term FX deposits as they affect NIM negatively and are subject to the bank levy
- Progress has been made with pension fund FX deposits, which have decreased markedly from Q2

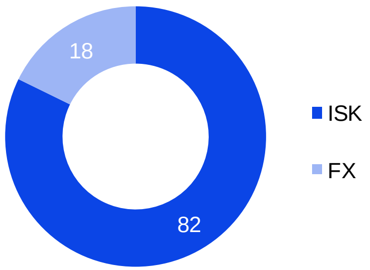
Deposits and due to credit institutions and Central Bank



Maturity of deposits (%)



Deposits by currency (%)



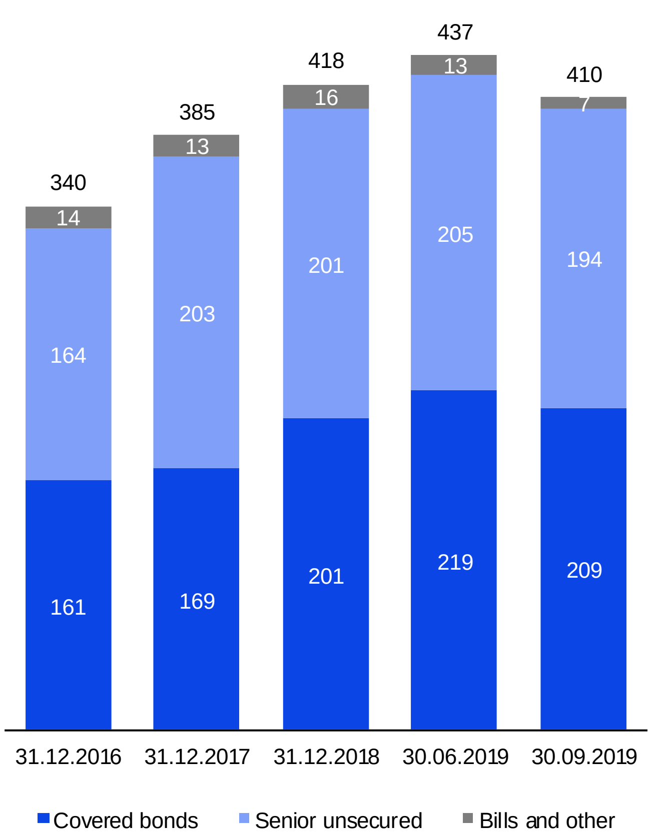
All amounts in ISK billion

Borrowings

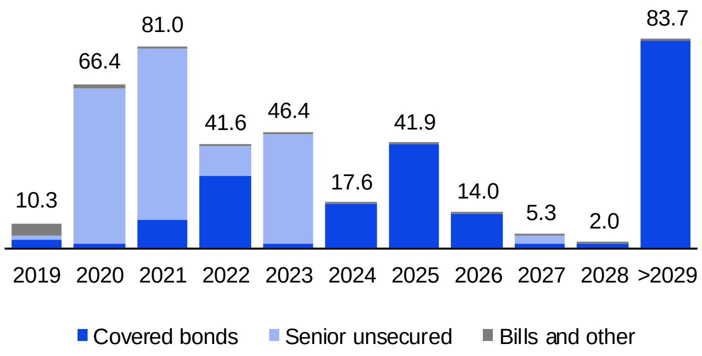
Reduced wholesale activity in line with changed focus on the asset side

- Continued emphasis on reduction of funding cost both through prepayments, buy-backs or other activities
- The Bank prepaid ISK 19 billion of its structured covered bond issuance in April and July, yielding 3.75% indexed
  - Fully prepaid in October 2019
- Strong credit rating but outlook recently changed from stable to negative across Icelandic banks
- The Bank issued covered bonds to finance mortgages in the Icelandic market, total of ISK 7.0 billion in Q3 (ISK 32.2 billion in 9M 2019)
  - In line with issuance schedule and therefore no further covered bond issuance expected in 2019
- Commercial paper issued in Q3 amounted to ISK 1.7 billion (ISK 14.5 billion in 9M 2019)
  - No further commercial paper issuance expected in 2019

Borrowings by type



Maturities of borrowings (%)



Ratings - S&P (July 2019)

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

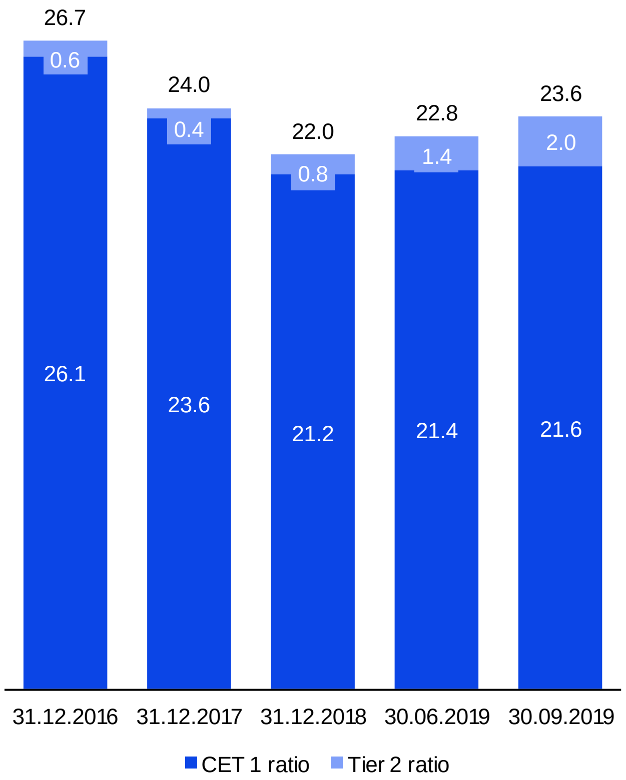
All amounts in ISK billion

Own funds

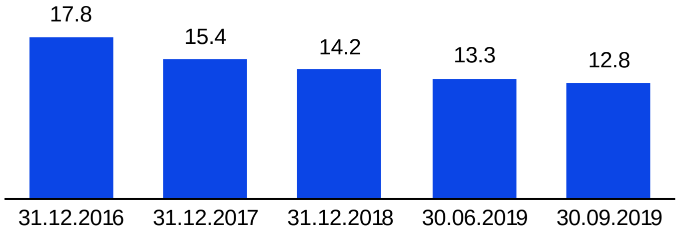
Focus on capital allocation and return on capital has increased capital ratio albeit capital release

- Capital adequacy ratio increased by 60 bps from Q2 mainly due to new Tier 2 issuance
  - In Q3 the Bank issued NOK 300 million 10NC5 and EUR 5 million 10NC5, totalling ISK 4.8 billion
- Arion Bank is considering its options regarding the issuance of Additional Tier 1 (AT1) notes
  - The process has been delayed by a negative ruling on the tax treatment of coupon payments
- The Bank is reducing risk weighted assets in its operations
- Leverage ratio remains very strong in all respects

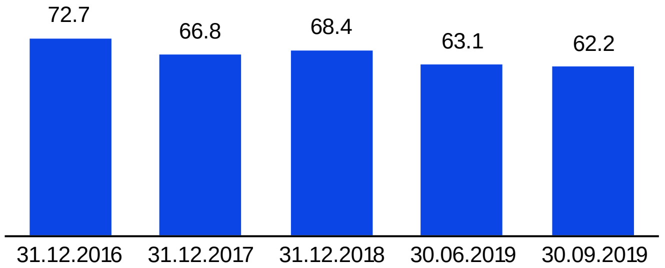
Capital ratio (%)



Leverage ratio (%)



Risk weighted assets / Total assets (%)

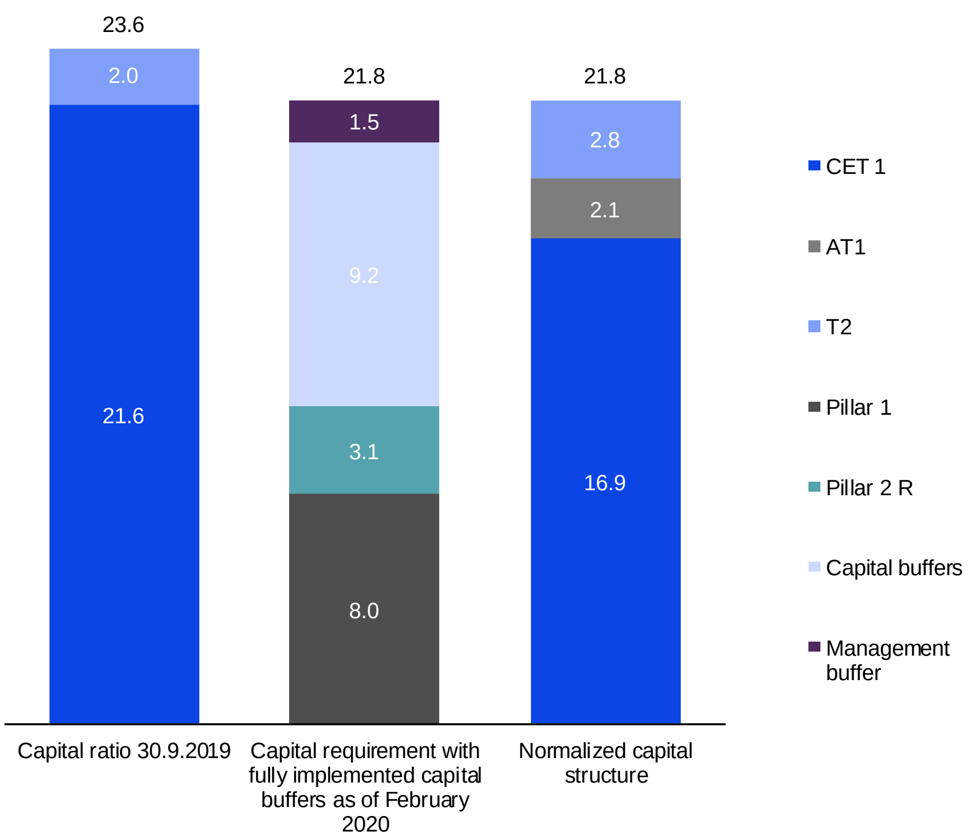


Capital adequacy

Own funds and capital requirements

- The Bank's total capital adequacy ratio was 23.6% as at 30 September 2019. The planned purchase of own shares of up to ISK 4.5 billion, to be executed in Q4 2019, is deducted from the Bank's own funds and thus reflected in the Bank's capital ratios
- The net increase in the capital ratio in the third quarter is nevertheless positive by 0.8%, primarily due to a reduction of risk-weighted assets (RWA) and new issuance of Tier 2 subordinated bonds
- In September 2019, FME concluded the annual Supervisory Review and Evaluation Process (SREP) for the Bank. The Pillar 2 additional requirement is 3.1% of RWA based on the Group's financial statement as at 31 December 2018
- The countercyclical capital buffer in Iceland increased by 0.5% in May 2019 and a further increase of 0.25% comes into effect in February 2020
- Based on the fully implemented capital buffers as at February 2020, the Group's total regulatory capital requirement is 20.3% of RWA. Taking into account the Bank's internal management buffer of 1.5%, the Bank's total capital benchmark level is 21.8%. Accordingly, the Bank's surplus capital was ISK 13.3 billion on 30 September 2019, which is in excess of foreseeable dividend distributions and purchase of own shares
- In addition the Bank can potentially distribute up to ISK 22 billion as a result of normalizing own funds by additional issuance of Tier 2 (ISK 6 billion) and successful AT1 issuance (ISK 16 billion), based on unchanged RWA's
  - The Bank is considering its options regarding issuance of AT 1 notes. The tax authorities have ruled that coupons of AT 1 notes are not tax deductible

Own funds and capital requirements (%)



Potential capital release in the near term

Distributions will be through dividends, share buy-backs or tender offers

Main levers under current RWA's, Pillar 2 and capital buffer requirements:

Share buy-back	Up to ISK 4.5 billion and will be launched 31 October in Reykjavík (Kvika Bank) and Stockholm (Nordea)
Surplus capital	Estimated ISK 13.3 billion in addition to dividend policy payout and share buy-back intention
Tier 2 issuance	The Bank has issued 2% of T2 capital but has room to issue up to an additional ISK 6 billion
AT 1 issuance	The Bank has room to issue up to 2.1% or ISK 16 billion of AT 1 and is optimistic that tax complications will be resolved in the coming months
Vördur capital	Capacity to optimize the capital structure at Vördur both in terms of absolute capital level and also scope for issuance of Solvency II qualifying subordinated capital
Valitor sale	Valitor is in a sale process and all proceeds of the sale can be distributed to shareholders without any capital dilution at Arion Bank
RWA reduction	The Bank aims to lower RWA's in the short term. This reduces the potential to issue T2 and AT 1 but increases the capital position and thus opens up for further distributions

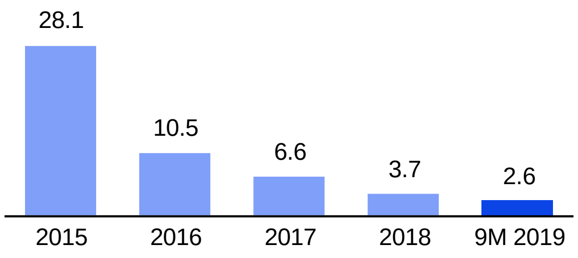
Going forward

- Greater emphasis on measures to reach financial targets
- HFF transaction will have a positive impact of ISK 1.3 billion after tax and salary expenses will decrease by ISK 0.3 billion in Q4
- Recent macroeconomic developments in Iceland have been surprisingly positive and modest growth is expected for 2020
- Sales process of Valitor continues but is taking more time than originally anticipated
- Share buy back program for up to ISK 4.5 billion will be launched 31 October

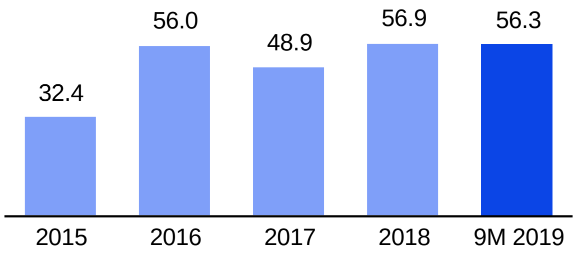
KFI’s and other information

Key financial indicators - annual

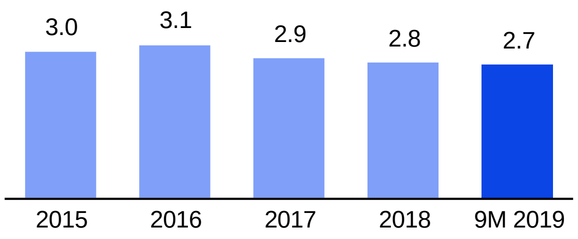
Return on equity (%)



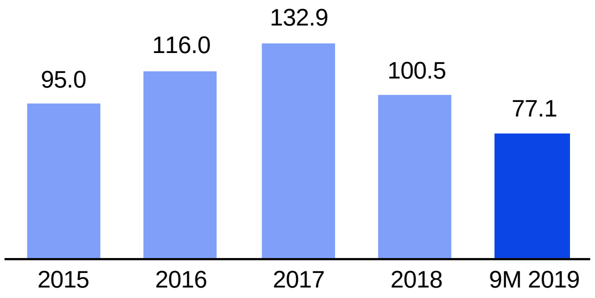
Cost-to-income ratio (%)



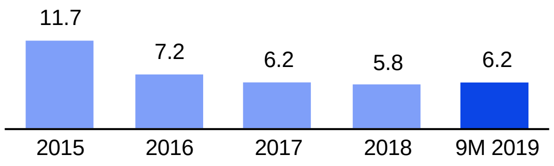
Net interest margin (%)



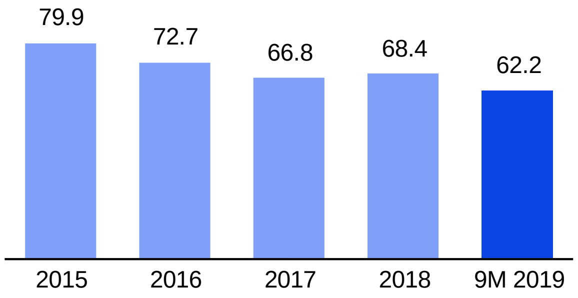
CPI imbalance (ISK billion)



Return on RWA

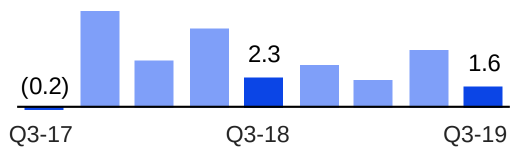


Risk weighted assets / Total assets (%)

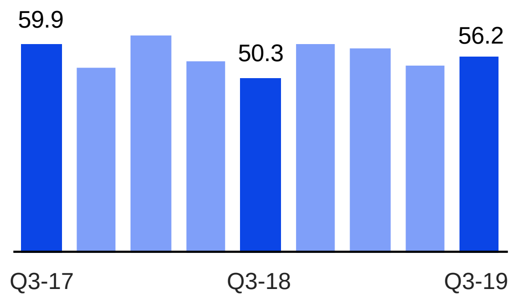


Key financial indicators - quarterly

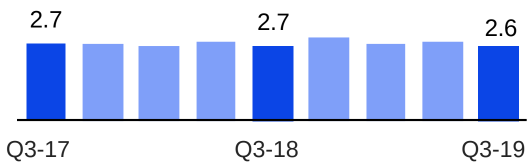
Return on equity (%)



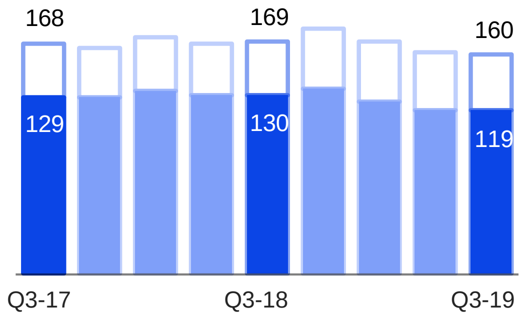
Cost-to-income ratio (%)



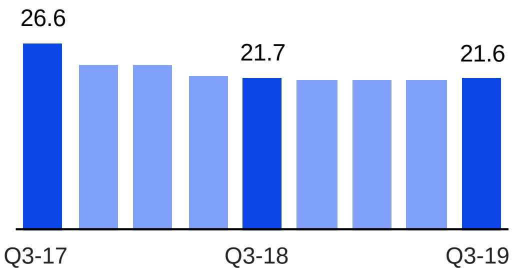
Net interest margin (%)



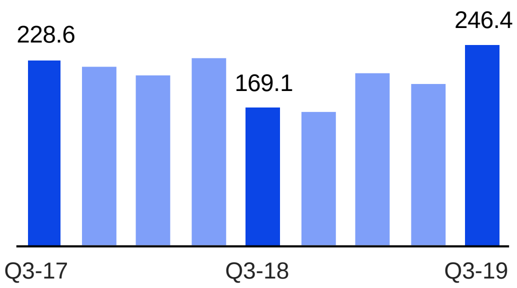
Loans-to-deposits ratio (%)
(without loans financed by covered bonds)



Tier 1 ratio (%)



Liquidity coverage ratio (LCR) (%)



Key figures

Operations	9M 2019	9M 2018	9M 2017	9M 2016	9M 2015	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018
Net interest income	22,624	21,350	21,857	22,058	20,287	7,382	7,808	7,434	7,969	7,209
Net commission income	7,335	7,603	7,087	10,213	10,727	2,639	2,478	2,218	2,746	2,686
Operating income	36,272	35,219	34,717	40,361	50,773	12,344	12,220	11,708	10,950	11,904
Operating expenses	20,420	19,679	16,450	22,330	19,387	6,940	6,618	6,862	6,599	5,993
Net earnings	3,875	6,160	10,356	17,263	25,394	761	2,096	1,018	1,616	1,149
Return on equity	2.6%	3.9%	6.3%	11.2%	19.8%	1.6%	4.3%	2.1%	3.2%	2.3%
Net interest margin	2.7%	2.7%	2.9%	3.1%	3.0%	2.6%	2.8%	2.7%	2.9%	2.7%
Return on assets	0.4%	0.7%	1.2%	2.2%	3.5%	0.2%	0.7%	0.3%	0.5%	0.4%
Cost-to-income ratio	56.3%	55.9%	47.4%	55.3%	38.2%	56.2%	54.2%	58.6%	60.3%	50.3%
Cost-to-total assets	2.3%	2.2%	2.0%	2.9%	2.6%	2.3%	2.2%	2.3%	2.2%	2.0%
Balance Sheet										
Total assets	1,213,155	1,219,529	1,144,853	1,038,479	1,009,475	1,213,155	1,233,419	1,222,695	1,164,326	1,219,529
Loans to customers	812,481	819,965	750,947	715,907	678,807	812,481	821,731	829,246	833,826	819,965
Mortgages	372,938	359,960	318,403	294,954	190,008	372,938	369,583	366,381	365,820	359,960
Share of stage 3 loans, gross	2.5%	2.9%	-	-	-	2.5%	2.4%	2.5%	2.6%	2.9%
Problem loans	-	-	1.4%	2.0%	3.2%	-	-	-	-	-
RWA/ Total assets	62.2%	66.2%	68.4%	73.2%	73.3%	62.2%	63.1%	64.4%	68.4%	66.2%
Tier 1 ratio	21.6%	21.7%	26.6%	25.5%	22.2%	21.6%	21.4%	21.3%	21.2%	21.7%
Leverage ratio	12.8%	13.8%	16.8%	0.0%	0.0%	12.8%	13.3%	13.5%	14.2%	13.8%
Liquidity coverage ratio	246.4%	169.1%	228.6%	194.1%	145.0%	246.4%	198.0%	213.0%	164.4%	169.1%
Loans to deposits ratio	159.9%	169.2%	168.4%	165.7%	134.9%	159.9%	162.8%	169.1%	178.9%	169.2%

All amounts in ISK million

Balance sheet

Assets	30.09.2019	30.06.2019	2018	2017	2016	2015
Cash & balances with CB	122	108	83	140	88	48
Loans to credit institutions	32	69	56	87	80	87
Loans to customers	812	822	834	765	712	680
Financial assets	162	144	115	109	117	133
Investment property	7	7	7	7	5	8
Investments in associates	1	1	1	1	1	27
Other assets	78	83	69	39	32	27
Total Assets	**1,213**	**1,233**	**1,164**	**1,148**	**1,036**	**1,011**

Liabilities and Equity						
Due to credit institutions & CB	8	9	9	7	8	11
Deposits from customers	508	505	466	462	412	469
Other liabilities	76	77	64	67	65	62
Borrowings	410	437	418	385	339	256
Subordinated liabilities	15	11	7	-	-	10
Shareholders Equity	196	195	201	226	211	193
Non-controlling interest	0	0	0	0	0	9
Total Liabilities and Equity	**1,213**	**1,233**	**1,164**	**1,148**	**1,036**	**1,011**

All amounts in ISK billion

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