Q2 results 2021

Investor presentation 28 July 2021

Key takeaways in Q2 2021

The Bank delivers outstanding results which are well above market expectations

After a good Q1 the Bank again demonstrates the ability to successfully navigate through challenges in the economic environment

- The best quarter in 6 years with ROE of 16.3%, well above the 10.0% target
- Solid core income growth of 10.5% from the same quarter in 2020
- Improved operating efficiency as OPEX remain stable from last year
- Very strong operational milestones:
  - SOPRA core system fully implemented which opens up for further efficiency going forward
  - Stock and fund trading app solution launched and an extensive integration project with Vordur commenced

Significant milestone in reducing assets held for sale

- Valitor sold for USD 100 million (subject to regulatory approval). If the sale is not completed due to the failure to obtain regulatory approval, the risk is borne by the buyer, applicable until the end of 2023
- In accordance with IFRS the approx. ISK 3.5 billion net profit from the sale is only accounted for after conditions precedent are met

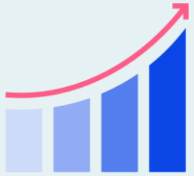
VALITOR

Strong balance sheet and dividend capacity

- ISK 2.9 billion dividend and ISK 14.9 billion in share buy-backs finalized in 6M 2021
- Capital ratios among highest in Europe and Leverage ratio significantly stronger than European peers
- ISK 42 billion of surplus capital in addition to ISK 15 billion in foreseeable dividends and buy-backs
- ISK 4 billion share buy-back program will commence from July 29, representing 50% of the authorization from the Central Bank

Market momentum

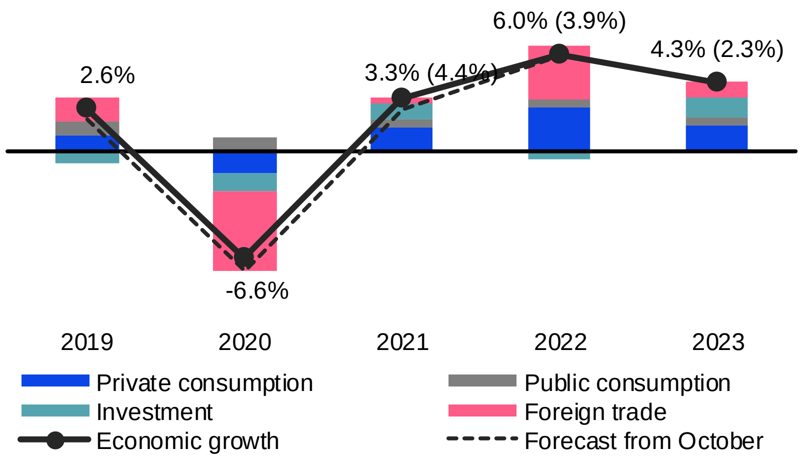
- Positive share price performance in Q2, outperforming OMX Iceland and large & mid-cap Nordic peers
- Number of shareholders grew from 8,250 to 9,700 during the quarter



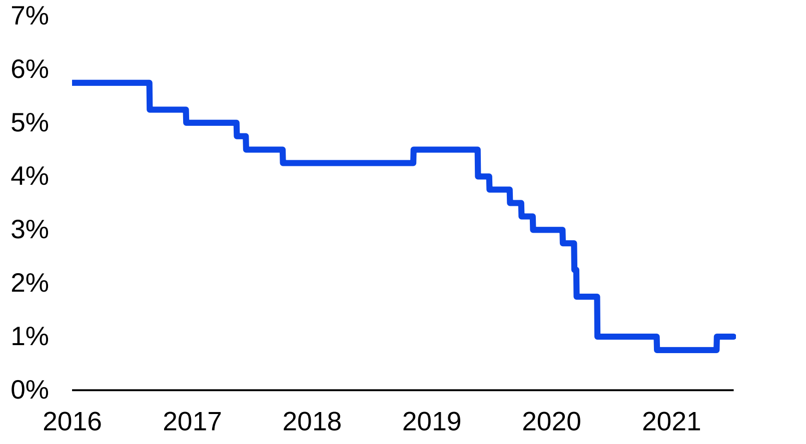
Economic rebound has started but uncertainty persists due to recent increase in Covid infections

The Central Bank of Iceland hiked interest rates by 25bp in the second quarter

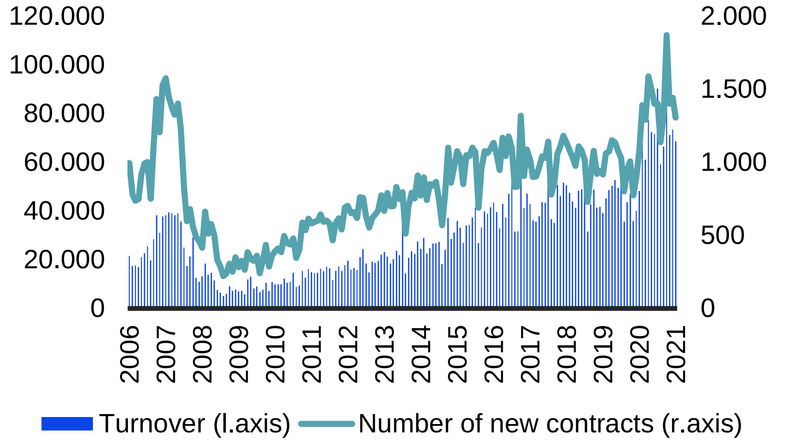
GDP growth (EU average in brackets)



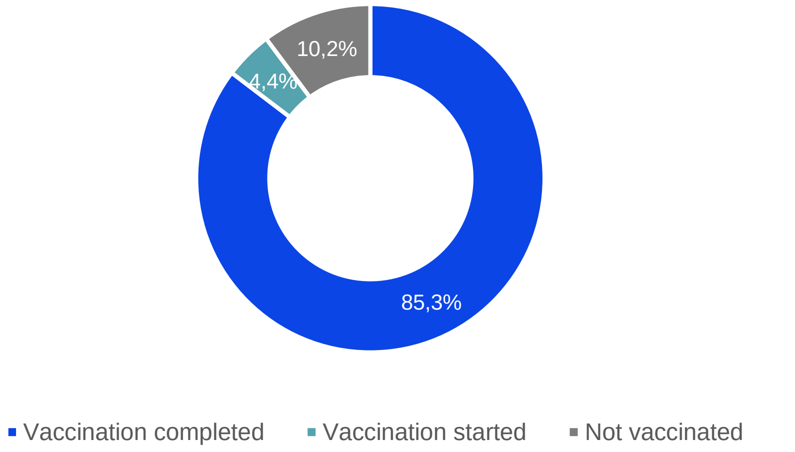
Key interest rates (seven-day term deposit rate)



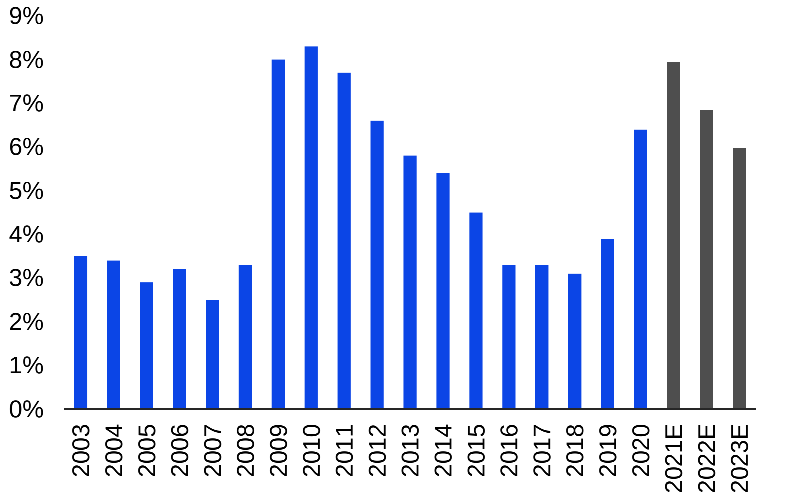
Mortgage market activity (turnover ISK millions and number of new contracts)



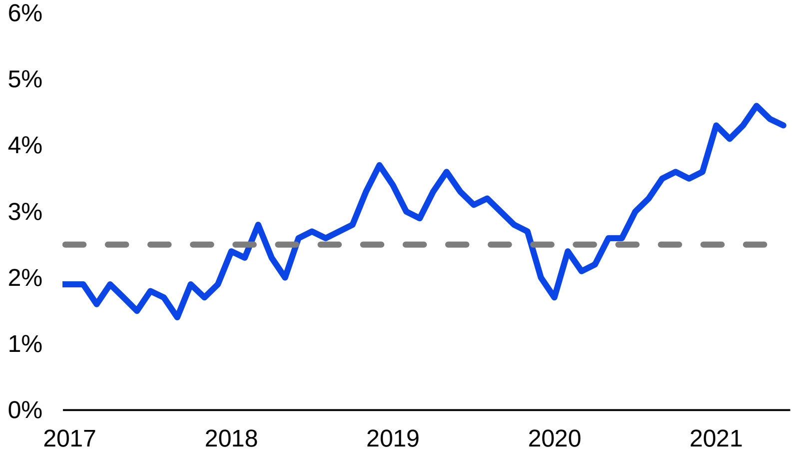
Percentage of population vaccinated (16 years and older)



Registered unemployment, excluding the reduced unemployment ratio (Arion Bank's estimates)



Inflation and inflation target



Sources: Covid.is, University of Oxford, Keflavik Airport, Central Bank of Iceland, Statistics Iceland, Arion Bank

Recent operational milestones

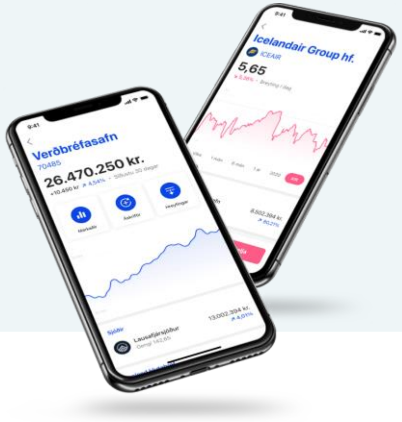
Sale of Valitor to Rapyd for USD 100 million – subject to regulatory approval

Rapyd | VALITOR

Strong activity in Corporate & Investment banking and Capital Markets

alvotech
PLAY
Íslandsbanki
AGR Dynamics
KALDALÓN
SOLIDCLOUDS
ISI ICELAND SEAFOOD
LYFSALINN

Stock and fund trading app solution launched in July



SOPRA core system went live in April

Sopra Banking Software

Implementing the bancassurance model with subsidiary Vordur to leverage attractive customer segments

The objective is to increase market share in insurance

Drivers for bancassurance from the Bank's perspective

- Fee income
- Better customer retention through Life insurance (typically long term)
- Cross selling opportunities
- Increased cost effectiveness and economies of scale (e.g. resulting from the more effective use of the branch network)
- Diversification of profits and risks

Drivers for bancassurance from an Insurer perspective

- Reduced distribution cost compared with the agency channel
- Increased market share
- Cross selling opportunities from a bank's typically transactional business (e.g. mortgages, loans)
- Enlarged customer base
- Enhanced customer retention

vörður

Drivers for bancassurance from a Customer perspective

The Bancassurance Value Proposition is very attractive:

- One stop shopping a broad range of financial and protection products under a strong brand
- Lower costs extension of the existing relationship with her/his bank.
- Extension of the digital channels – insurance, both non-life and life, also available in the Bank's app and all insurances applied for and approved by e-signing.

Arion Bank’s sustainability journey

Establishment of a Green Financing Framework is an important milestone in Arion Bank’s sustainability journey

Signatory to the **City Reykjavik and Festa’s Declaration on Climate Change** in 2015 and to the **UN Global Compact** in 2016

United Nations Global Compact

Festa

Signatory to **Principles for Responsible Investment** (UN PRI) in 2017 and to **Principles for Responsible Banking** (UNPRB) in 2019

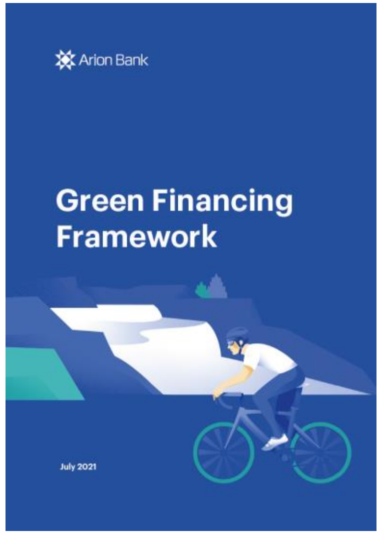
PRI Principles for Responsible Investment

UNEP Finance Initiative | Principles for Responsible Banking

Introduction of a **new environment and climate policy in 2020**, implementing a clearer focus on the Bank’s ambition to finance projects on sustainable development and green infrastructure. Specific sector policies have been designed that inform the loan origination process going forward

Kick-off for green product portfolio with a green deposit bank account for retail clients in 2020. The Bank also offers green mortgages and green car financing

Set-up of **Green Financing Framework** with SPO from Cicero. Issuance of inaugural Green Bond to finance ongoing ambition to allocate capital in a sustainable way



By the end of 2022, Arion Bank will have measured the **carbon footprint of the balance sheet** and set **targets for carbon reduction in alignment with the Paris Climate Agreement**

Arion Bank issued its inaugural 300m EUR green bond in July

Eligible categories under Arion Bank's Green Financing Framework

Green buildings

- Commercial real estate with certification (BREEAM 'Excellent' or better; LEED 'Gold' or better; Nordic Swan Ecolabel)
- Residential real estate according to methodology by engineering firm Mannvit (top 15% carbon efficient buildings from a lifecycle perspective)

Sustainable fishery and aquaculture

- Loans to the fisheries sector, which has a pivotal role for the Icelandic economy
- MSC and ASC certification needed
- Direct financing of fossil fuel equipment / vessels / infrastructure excluded
- Arion Bank to engage with clients on feed policies

Energy efficiency

- Investments aiming at reducing the use of energy for facilities, infrastructure and appliances (reduction >30%; decision on case-by-case basis; only non-fossil fuel based processes)
- Data centers with PUE < 1.25

Pollution prevention and wastewater management

- Waste prevention and separate collection sorting
- Prevention, reduction and control of maritime pollution
- Sustainable wastewater management

Renewable Energy

- Threshold of 100g CO_2e / kWh declining to 0g CO_2e/kWh by 2050 for all kinds of electricity production (e.g. geothermal, hydropower, wind or solar)
- Biogas manufacturing with Nordic Swan Ecolabel

Clean transportation

- Zero tailpipe emission vehicles (including hydrogen, fuel cell, electric)
- Infrastructure for zero tailpipe emission vehicles

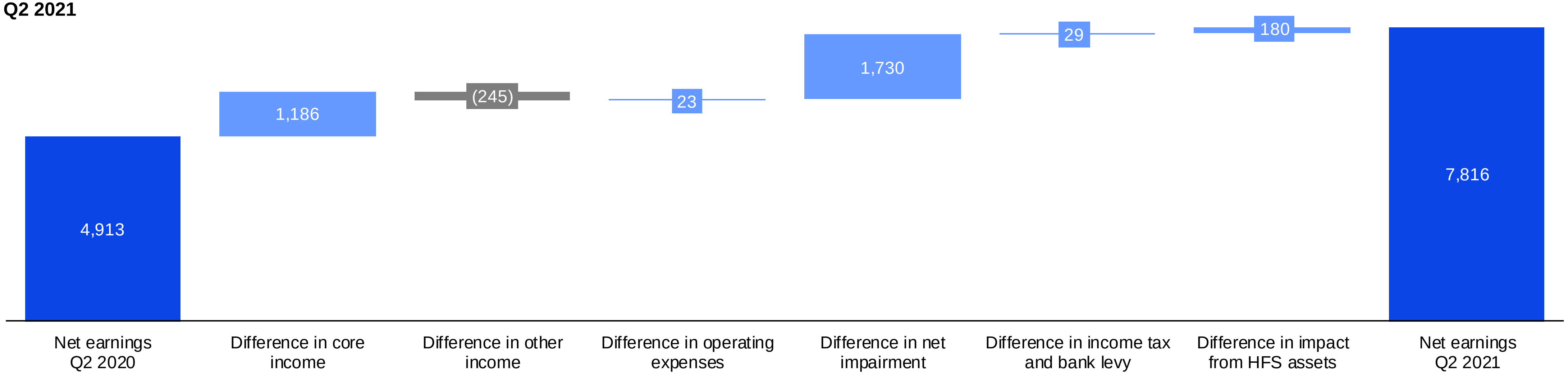
Sustainable forestry and agriculture

- Sustainable forestry and certified forest carbon projects (FSC, PEFC, Verra VCS or Gold Standard certified)
- Cross-sectoral measures, reducing GHG emissions by >30%

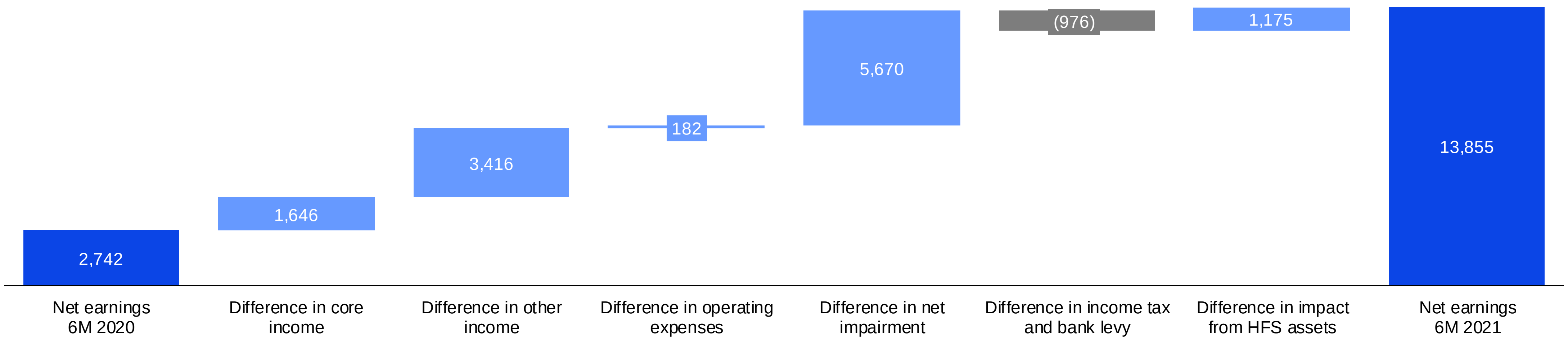
Net earnings improve significantly YoY

Core operations improve markedly but other segments also make a substantial contribution

Q2 2020 vs Q2 2021



6M 2020 vs 6M 2021



All amounts in ISK million

Financials

Operational highlights of Q2 2021

- Outstanding quarter for Arion Bank
  - All financial targets have been met
- Arion Bank's strategy results in core operations trending positively
  - Core revenues are up 10.5% YoY
  - NII to credit risk is relatively stable YoY in an extreme low interest rate environment
- Other items are favorable
  - Return from bond and equity holdings are positive
  - Impairments are being reversed
- The balance sheet increases by 3.9% from year end 2020 but mortgage lending is up 9.6%
- Surplus CET1 capital of ISK 42 billion on top of the Bank's 17% CET1 capital target

	Q2 2021	H1 2021	Target
Return on equity	16.3%	14.3%	Exceed 10%
ROE assuming 17% CET 1	21.3%	18.6%	Exceed 10%
Operating income / REA	8.0%	7.5%	Exceed 6.7%
Cost-to-income ratio	42.5%	44.2%	Below 45%
CET1 ratio	22.7%	22.7%	17.0%

Income statement Q2 2021

Outstanding quarter with all items trending positively

- Core income (NII, NCI and net insurance income) increases 10.5% YoY
  - Slight increase in net interest income YoY. The loan book increases by 8.2% from Q2 2020, mainly mortgage lending. Low interest rate environment is weighing on NII
  - Continuing strong net commission income growth across the Bank
  - Insurance income grows as a result of increased sales
- Operating expense is stable YoY
  - Additional salary expense due to general wage inflation is held back with 5% decrease in number of FTE's between years while other opex remain stable in most classes
- Impairments are positive during the quarter, partly due to change in the loan book with higher portion in mortgages instead of corporate loans and slightly less pessimistic assumptions in the IFRS models
- The main driver for low effective tax rate of 15.5% in Q2 is the positive effect of equity holdings through net financial income
- The impact of HFS assets is minimal during the quarter. Estimated positive effect from the sale of Valitor of approx. ISK 3.5 billion will not be included in the income statement until conditions precedent are met

	Q2 2021	Q2 2020	Diff%	Q1 2021	Diff%
Net interest income	8,016	7,857	2%	7,342	9%
Net commission income	3,562	2,688	33%	3,277	9%
Net insurance income	914	761	20%	671	36%
Net financial income	2,203	2,691	(18%)	1,500	47%
Share of profit (loss) of associates	25	(5)	-	1	-
Other operating income	284	71	-	306	(7%)
Operating income	**15,004**	**14,063**	**7%**	**13,097**	**15%**
Salaries and related expenses	(3,575)	(3,577)	(0%)	(3,271)	9%
Other operating expenses	(2,797)	(2,818)	(1%)	(2,777)	1%
Operating expenses	**(6,372)**	**(6,395)**	**(0%)**	**(6,048)**	**5%**
Operating profit	**8,632**	**7,668**	**13%**	**7,049**	**22%**
Bank levy	(355)	(324)	10%	(330)	8%
Net impairment	812	(918)	-	1,080	(25%)
Earnings before income tax	**9,089**	**6,426**	**41%**	**7,799**	**17%**
Income tax expense	(1,408)	(1,468)	(4%)	(1,866)	(25%)
Net earnings from continuing operations	**7,681**	**4,958**	**55%**	**5,933**	**29%**
Discontinued operations, net of tax	135	(45)	-	106	27%
Net earnings	**7,816**	**4,913**	**59%**	**6,039**	**29%**

All amounts in ISK million

Income statement H1 2021

Turnaround in net earnings from Covid affected first half last year

- Core income increases 7.4% from last year
  - Slight increase in net interest income YoY. The loan book increases from the same period in 2020, mainly mortgage lending but lower interest rate environment is weighing in on NII.
  - Extremely strong net commission income across the Bank. Strong development in Corporate lending and Corporate finance supported by structural changes made in 2019
  - The increase in net insurance income is driven by increased volume and lower damage rate
  - Operating expenses continue to trend down and decrease by 1.4% between years and 7.9% from H1 2019
  - Salaries increase is partially due to increased redundancy payments
  - Other OPEX decreasing in line with objectives
- A complete shift in net financial income and in particular impairments from H1 last year, but both line items were hit hard by the pandemic
- HFS assets are performing in line with objectives, a substantial improvement YoY and profit from the sale of Valitor will be included at a later stage

	H1 2021	H1 2020	Diff	Diff%
Net interest income	15,358	15,110	248	2%
Net commission income	6,839	5,764	1,075	19%
Net insurance income	1,585	1,262	323	26%
Net financial income	3,703	691	3,012	436%
Share of profit (loss) of associates	26	(29)	55	-
Other operating income	590	241	349	145%
Operating income	**28,101**	**23,039**	**5,062**	**22%**
Salaries and related expenses	(6,846)	(6,707)	(139)	2%
Other operating expenses	(5,574)	(5,895)	321	(5%)
Operating expenses	**(12,420)**	**(12,602)**	**182**	**(1%)**
Operating profit	**15,681**	**10,437**	**5,244**	**50%**
Bank levy	(685)	(655)	(30)	5%
Net impairment	1,892	(3,778)	5,670	-
Net earnings before income tax	**16,888**	**6,004**	**10,884**	**181%**
Income tax expense	(3,274)	(2,328)	(946)	41%
Net earnings from continuing operations	**13,614**	**3,676**	**9,938**	**270%**
Discontinued operations, net of tax	241	(934)	1,175	-
Net earnings	**13,855**	**2,742**	**11,113**	**405%**

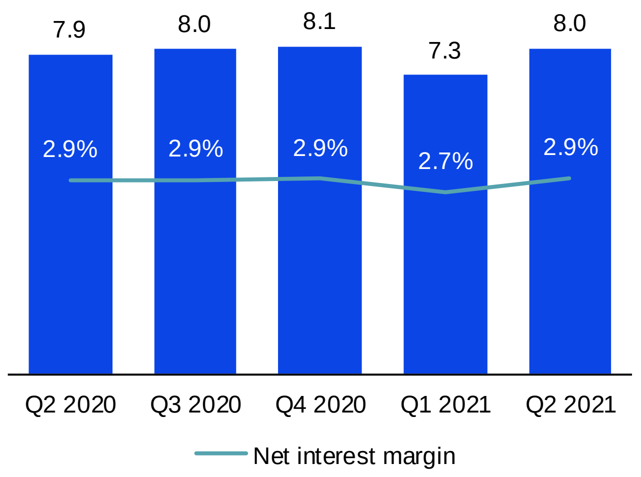
All amounts in ISK million

Net interest income

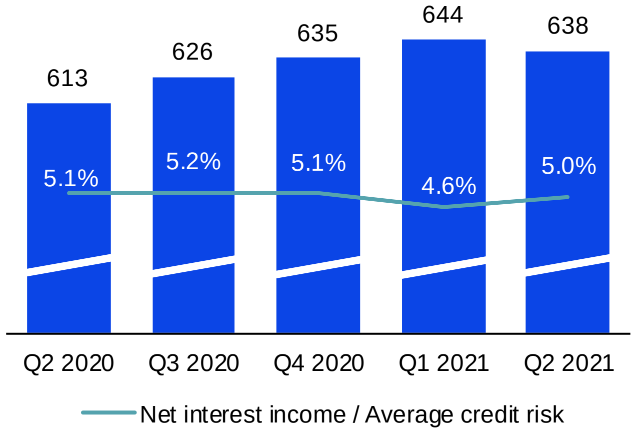
Very strong NIM in light of the record low interest rate environment – The Central Bank's hawkish tone is positive for the Bank

- Net interest income increased by 2.0% from Q2 2020 whilst average interest bearing assets increased by 1.0%, mainly mortgages
- Strong net interest margin in light of:
  - Policy rate, which was very low during the quarter, hiked from 0.75% to 1.00% in mid May
  - Surplus liquidity
- Net interest income / average credit risk continues at strong levels in the challenging environment
  - Substantial refinancing, especially in the mortgage space with the NIM in the front book slightly lower than in the back book
  - A large portion of the deposit base is at close to zero interest rate but the recent 0.25 bps base rate hike is positive
- Positive effect of 6.5% inflation is limited as the CPI imbalance decreased by ISK 65 billion from Q2 2020, thereof ISK 30 billion during the quarter. Therefore effect from inflation is ISK 625 million lower than in Q2 2020
- Increase in deposits and a corresponding reduction of wholesale funding, both maturing and buy-backs, have positive effect on NIM
- The Bank aims to maintain NIM in the range of 2.6% - 2.9% whilst the base rate remains at current levels

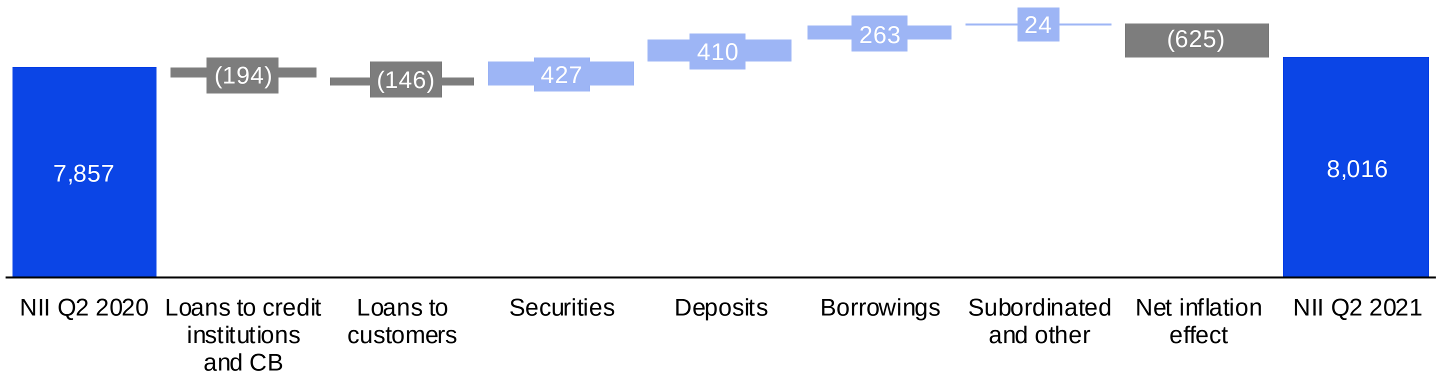
Net interest income



Credit risk



Net interest income Q2 2020 vs Q2 2021 (ISK million)

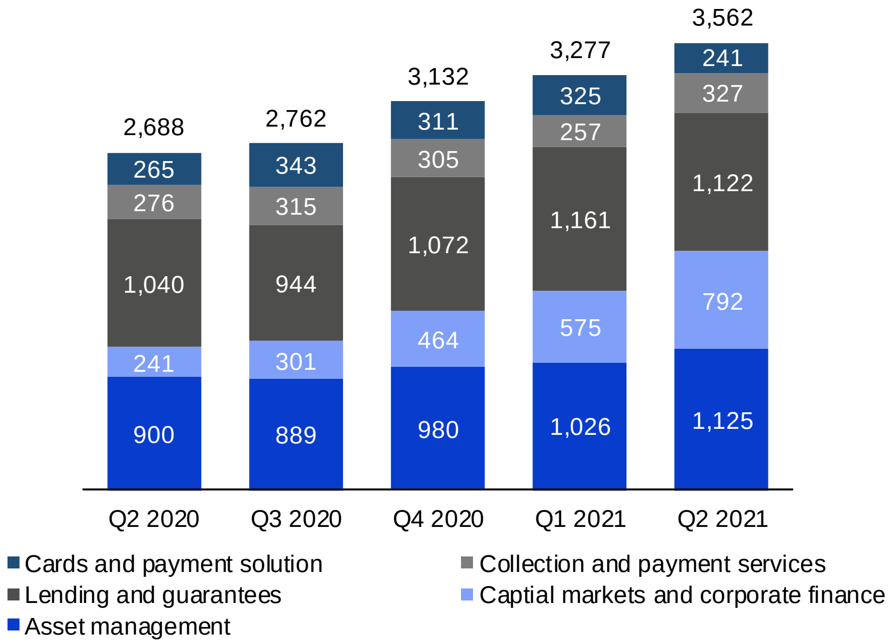


All amounts are in ISK billion

Net fee and commission income and net insurance income

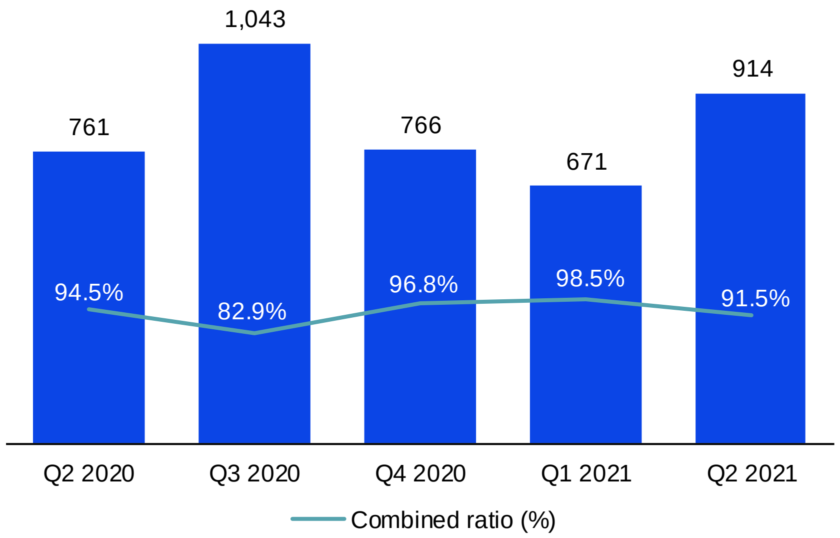
Extremely strong quarter in corporate activities, both lending and advisory

Net fee and commission income



- The forming of CIB from the previously separate Corporate Banking and Investment Banking has been successful and is supporting the business on both sides
  - CIB advised on significant transactions including two IPOs and two large bond offerings
  - Income from lending and guarantees continues to be strong, building on strategy of capital velocity
- Income from asset management increased 14% from Q1 and 5% from Q4 2020 through higher AUM and increasing flows into equity funds
- Cards and payment solutions will pick up again with increased economic activity

Net insurance income



- Very strong quarter in net insurance income, 20.1% increase YoY
  - Income was up 20.8% from Q2 2020
  - Claims increased by 21.0% from Q2 2020
  - Combined ratio of 94.9% was very strong for H1 compared with 99.4% in H1 2020
  - Constant premium growth of 6% during the last four years and favorable claim rate over the same period

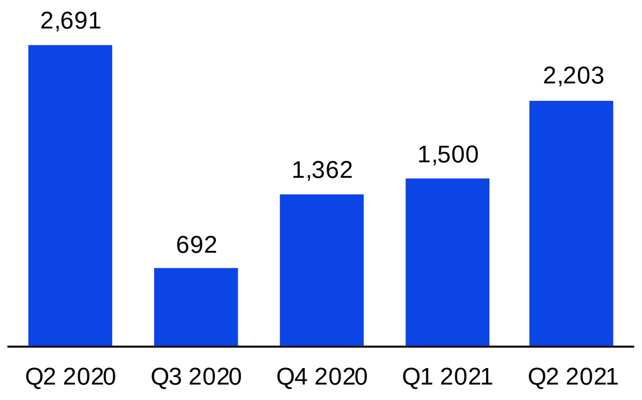
All amounts in ISK million

Net financial income

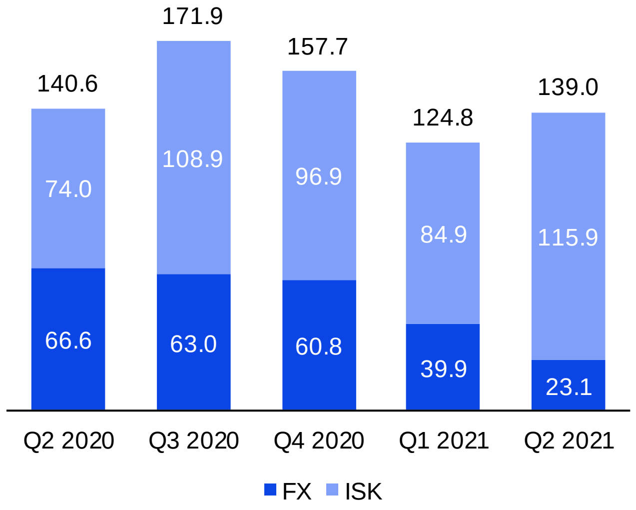
Favorable market conditions and active management deliver strong performance

- Net financial income in Q2 driven by:
  - Equity holdings measured at fair value
  - Solid performance in equities at market making
  - Performance of fixed income
- Bond holdings which are predominantly used for liquidity management decreased in Q2 but will increase again in Q3
- Equity holdings increase slightly in Q2 mainly due to increase in market value
- Total portfolio of Vördur included in the Group figures is ISK 24.1 billion; ISK 16.3 billion of bonds and ISK 7.8 billion in equity instruments, yielding ISK 946 million in the quarter

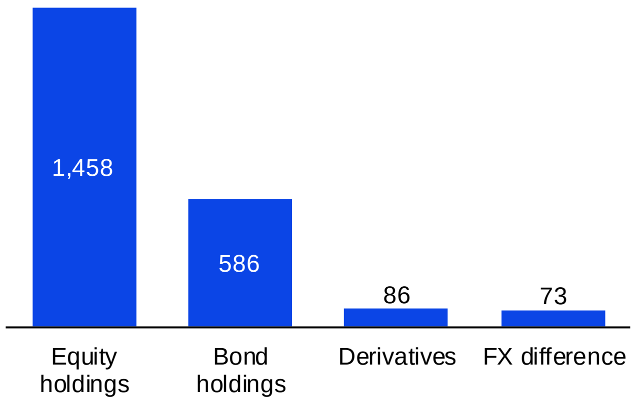
Net financial income (ISK million)



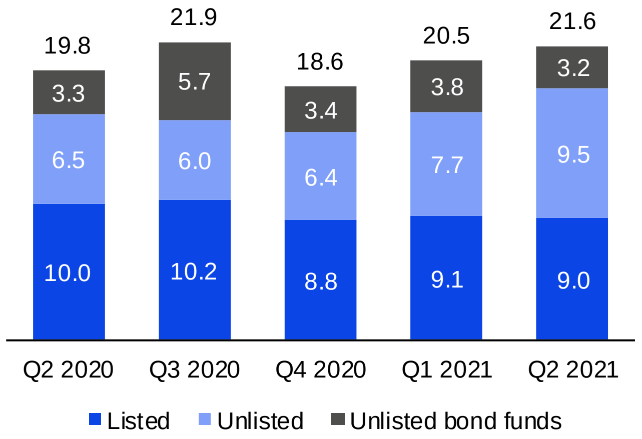
Bond holdings



Net financial income by type in Q2 2021 (ISK million)



Equity holdings



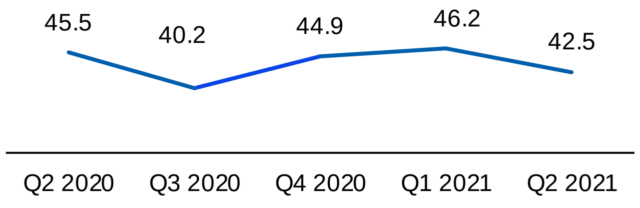
All amounts are in ISK billion

Total operating expenses

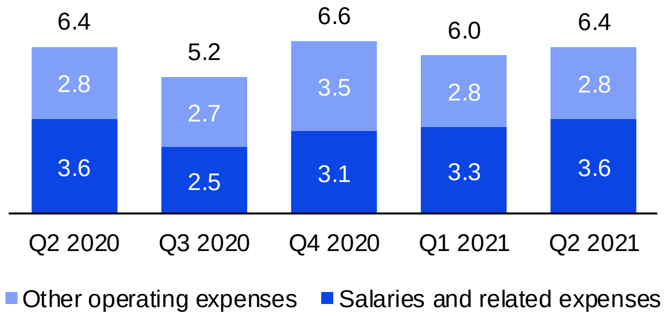
Cost-to-income ratio around the 45% target over the last five quarters

- Number of FTEs continues to trend down
  - 5% YoY (7% at the parent company)
- Salary expense remains at the same level as in Q2 2020 due to wage inflation and changed staff composition
  - Salaries and related expenses were slightly affected by capitalized salaries which amounted to ISK 28 million in Q2 (ISK 150 million in Q2 2020) relating to investment in the Sopra core system
- Other OPEX is stable YoY
  - IT expenses decreases as planned
  - Amortization of intangible assets increased by approx. ISK 100 million per quarter following the launch of Sopra core system in April 2021 which can serve as the basis for rationalizing the Bank's system setup

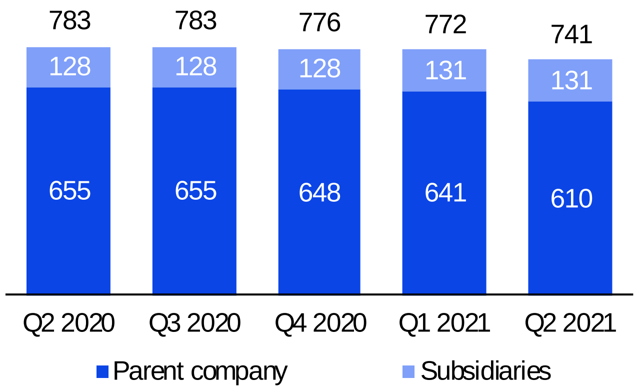
Cost-to-income ratio (%)



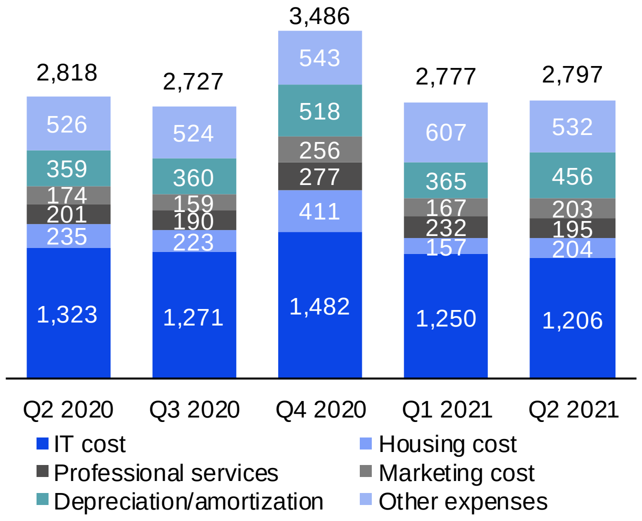
Total operating expenses



Number of employees



Other operating expenses (ISK million)



All amounts are in ISK billion

Balance sheet – assets

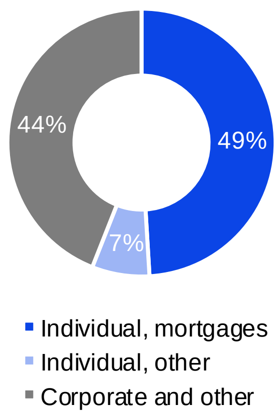
Retail mortgages drive loan growth during the quarter

- Loans to customers increased by 0.8% in Q2 and 2.6% from YE 2020
  - Mortgage lending was up 5.7% in Q2 (up 9.6% from YE 2020)
  - Corporate lending decreased by 4.7% in Q2 (4.8% decrease from YE 2020)
- Liquidity position remains very strong despite ISK 14.8 billion capital distribution
  - Total LCR ratio is 215% and ISK LCR ratio is 195%
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX and to distribute surplus capital

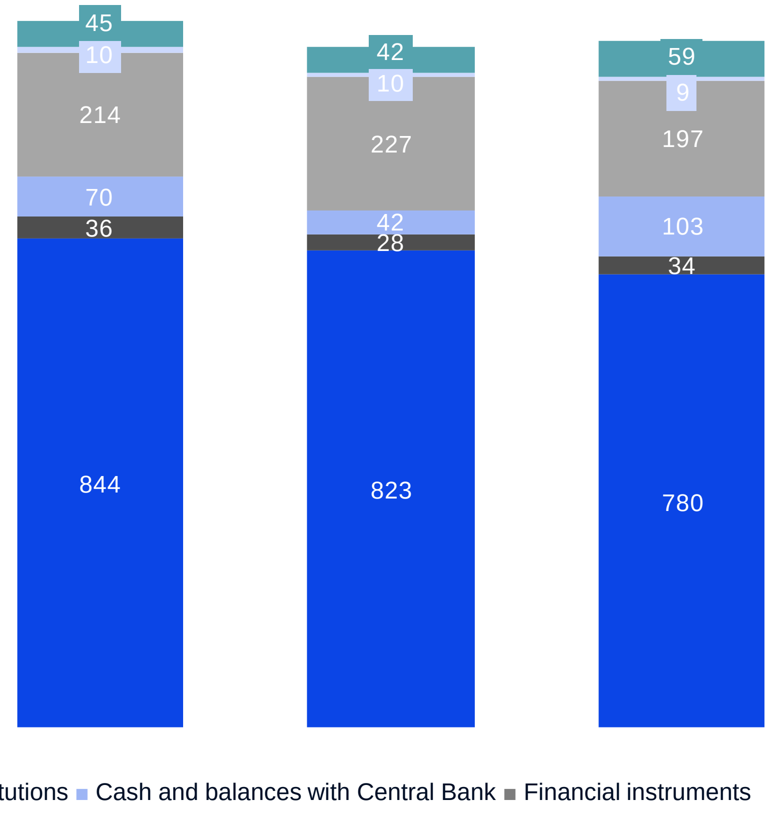
Other and intangibles:
4.5% of total assets

ISK 319 billion, of which **ISK 208 billion liquidity reserve** (34% of customer deposits)

Loans to customers
69.3% of total assets



30.06.2021	31.12.2020	30.06.2020
ISK 1,218 billion	ISK 1,173 billion	ISK 1,182 billion



All amounts in ISK billion

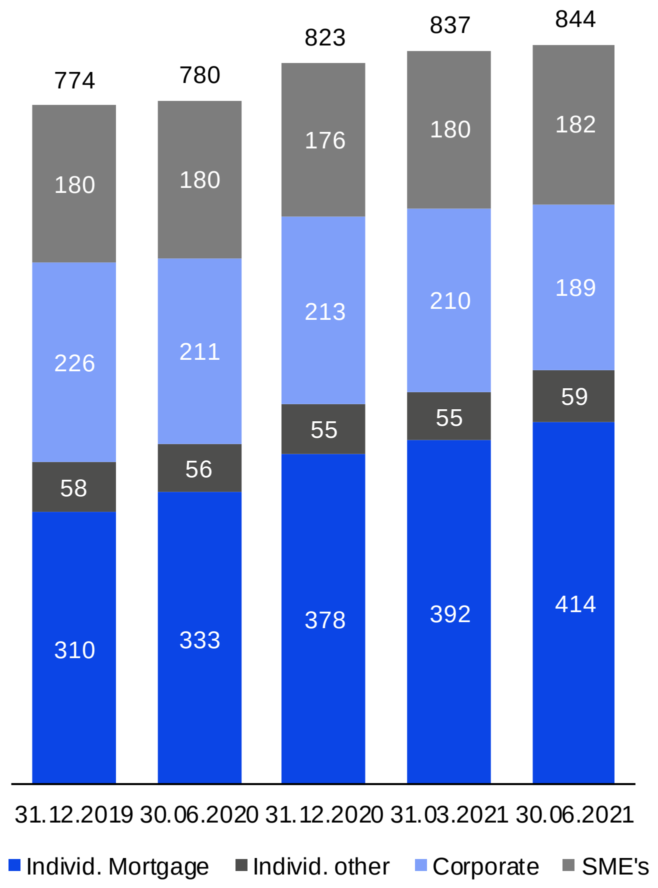
[1]Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets

Loans to customers

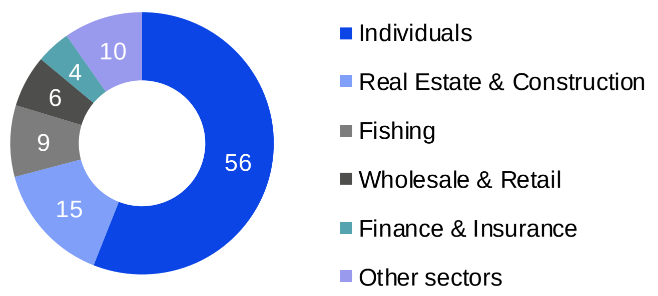
Retail mortgages, which are light on capital usage and offer the highest asset quality, represent 49% of the loan book

- Loans to individuals increased by 5.7% during the quarter due to mortgage lending. Mortgage lending is up 24.4% compared with 30.6.2020
- The corporate loan book decreased during the quarter
  - Considerable activity on the corporate lending side in origination as well as syndications and sales of loans as the Bank follows the strategy of capital velocity
- The importance of index linked lending is reduced and the indexation imbalance has reduced to ISK 24 billion (ISK 55 billion YE 2020)
- The diversification of the corporate loan book is good and in line with the Bank's credit strategy
- IFRS 9 models do not fully capture Covid-19 impact so management overlay on certain customers is necessary (Covid-19 impacted loans)
- Book value of Covid-19 impacted loans is ISK 91 billion or 10.6% of total loan book (ISK 102 billion / 12.0% of loan book YE 2020)
  - ISK 77 billion which is secured by real estate (ISK 86 billion YE 2020)
  - Tourism related loans with book value of ISK 74 billion (ISK 73 billion YE 2020)

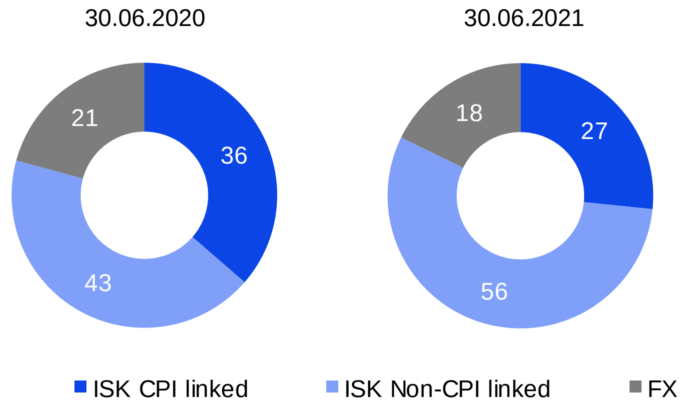
Loans to customers



Loans to customers by sector (%)



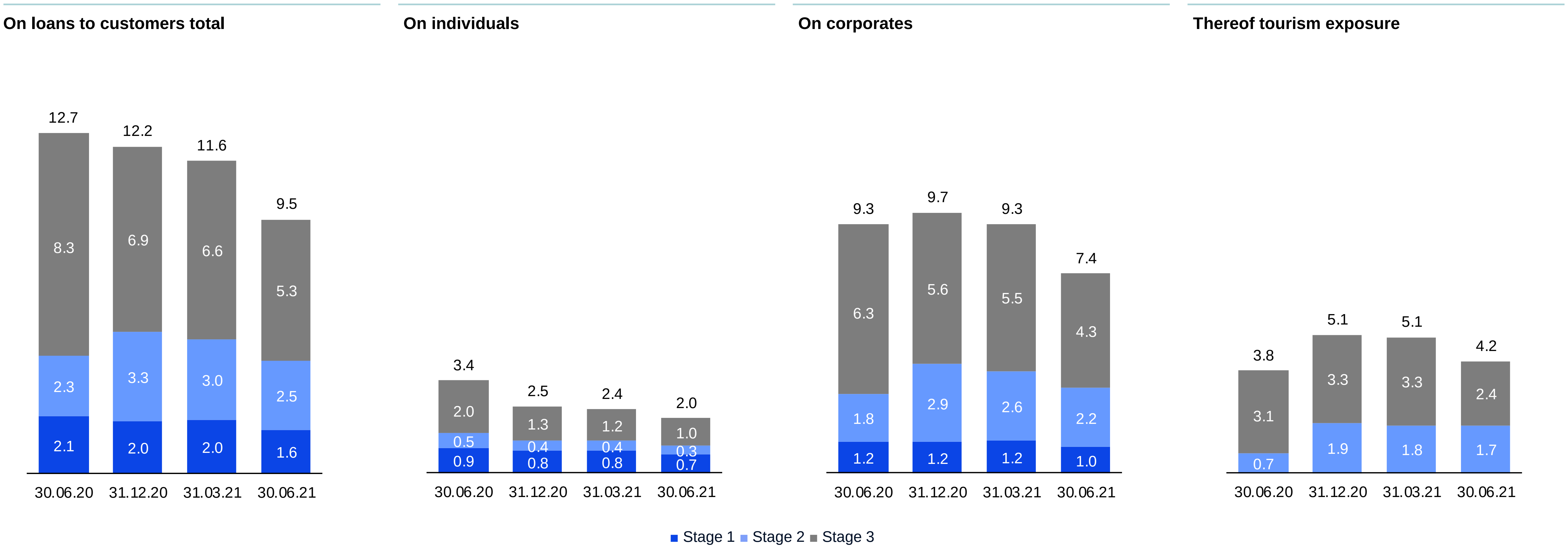
Loans to customers by currency (%)



All amounts in ISK billion

Loss allowance on loans to customers by IFRS 9 stages

Loss allowance decreased significantly during the quarter



- Loss allowance decreased by 18.7% from 31.3.2021 mostly on corporate customers
  - Loss allowance on individuals decreased by 14.3%
  - Loss allowance on corporates decreased by 19.8%
  - Loss allowance on customers in the tourism sector decreased by 17.7%

- Changes in loss allowance from 31.03 to 30.6.2021 partly due to write offs (ISK 1.2 billion) but also due to slightly more optimistic inputs and assumptions in IFRS 9 impairment models, changes of measurement following transfers between stages and shift in combination of the loan book

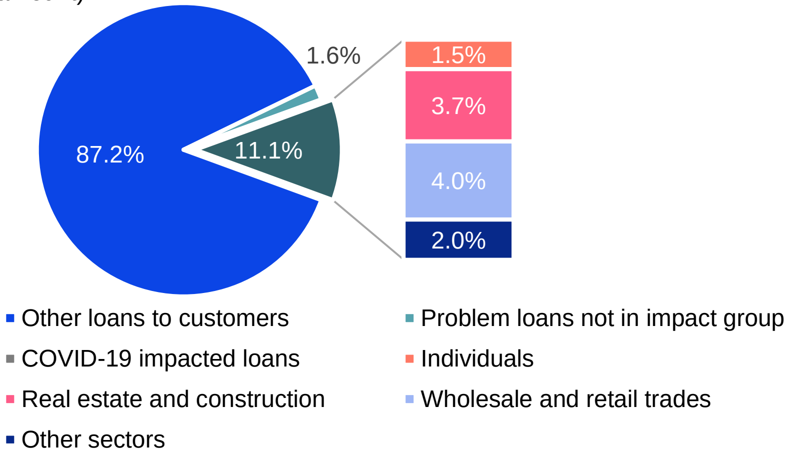
All amounts are in ISK billion

Covid-19 affects ISK 91 billion or 10.6% of the loan book

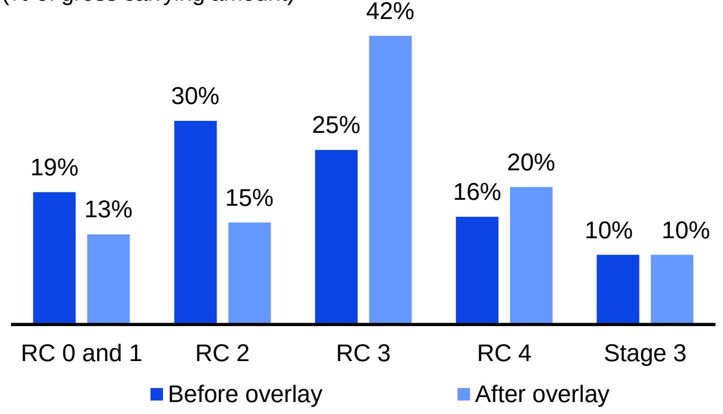
IFRS 9 impairments are forward looking but management overlay is necessary

- Since the IFRS 9 models did not fully capture the Covid-19 impact, management overlay on certain customers was necessary (Covid-19 impacted loans):
  - Tourism
  - Customers with payment moratoria in Q2 2021
  - Recipients of loans through government sponsored loan schemes
- In Q2 2021, however, the tourism sector was assessed again and as a result the impact group overlays are no longer used for cases where the Group's general credit risk assessment methodology adequately captures the risks related to the Covid-19 pandemic
- Book value of Covid-19 impacted loans is ISK 91 billion or 10.6% of the total loan book
  - ISK 77 billion which is secured by real estate
  - Tourism related loans with book value of ISK 74 billion
- Problem loans (loans in stage 3) at the end of Q2 2021 represent 2.8% of the loan book, 1.1% are Covid-19 impacted loans
- Payment moratoria are 82% corporates and 71% tourism related

Breakdown of loans to customers (% of gross carrying amount)

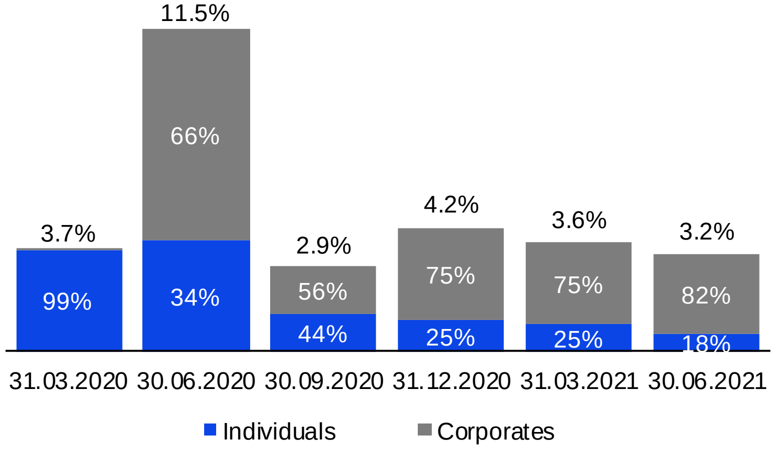


Risk classes (credit ratings) in Covid-19 impacted loans were downgraded based on impact assessment
(% of gross carrying amount)

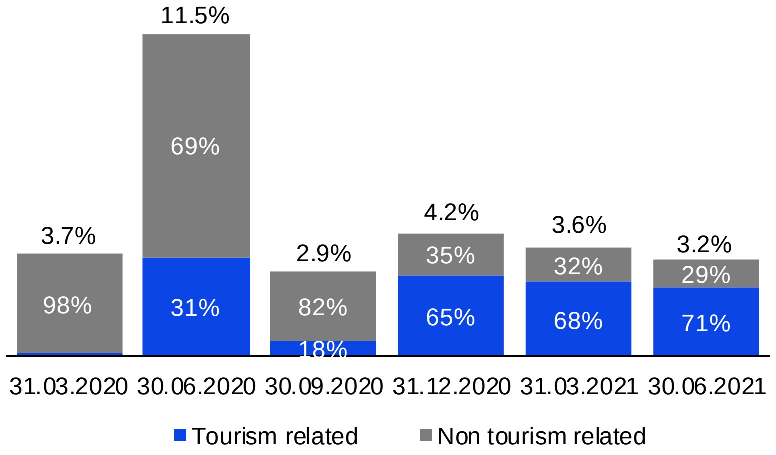


Loans with Covid-19 related payment moratoria (% of gross carrying amount of the loan book)

Individuals and corporates:



Tourism and non-tourism related:



Balance sheet – equity and liabilities

Strong capital position and good funding mix

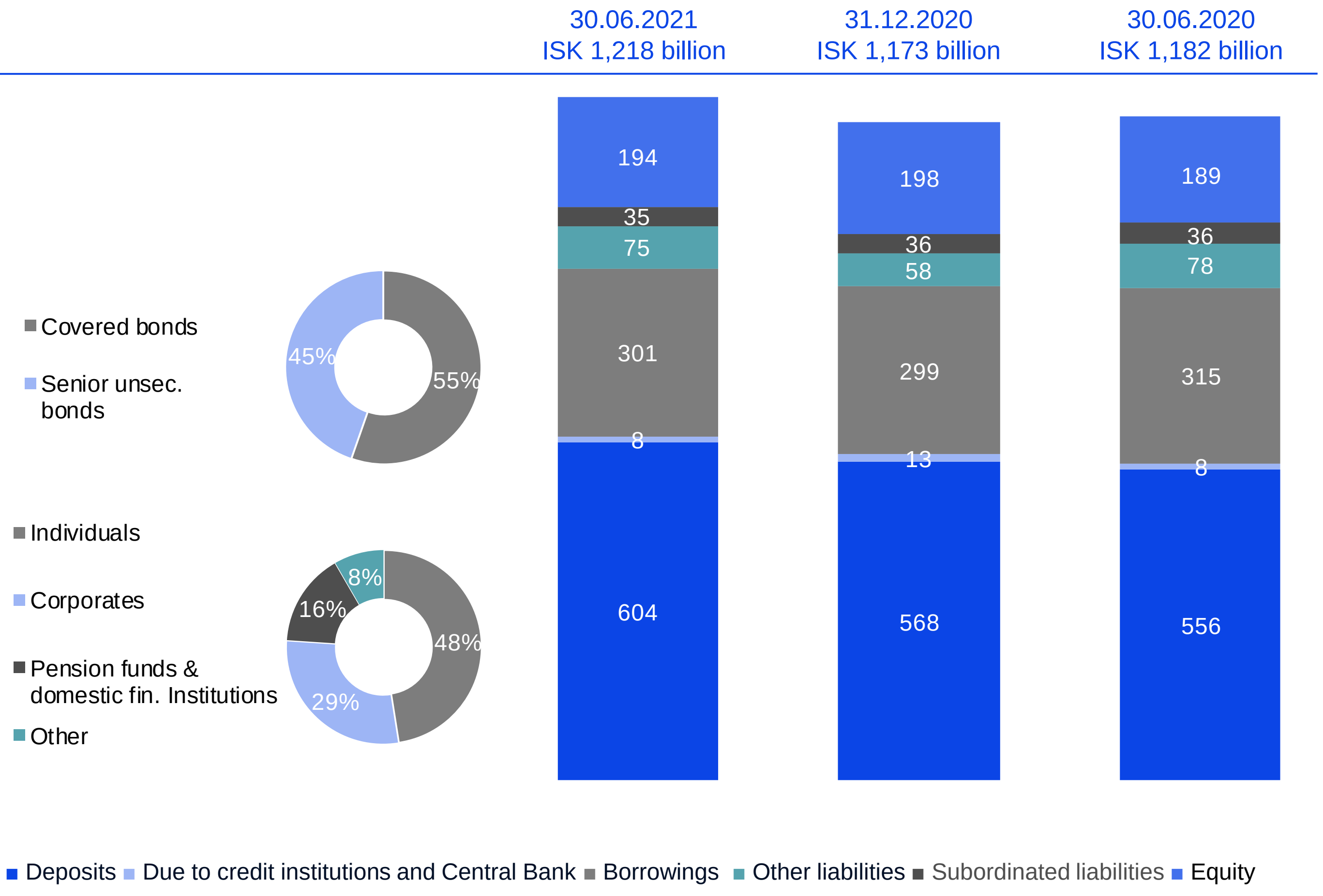
- Strong equity position and very high leverage ratio
- The funding mix is well balanced between deposits, covered bonds and senior unsecured bonds
- Deposits increased by 8.7% from 30.6.2020
- The Bank is a frequent issuer of covered bonds in the domestic market and a regular issuer of senior unsecured debt in the international market.
- Arion Bank will continue its ESG related funding efforts, both in the deposit and wholesale funding space
- The Bank paid a dividend of ISK 2.9 billion and bought back own shares amounting to ISK 14.9 billion during H1

Equity
CET1 ratio 22.7%
CAD ratio 27.2%
Leverage ratio 14.6%

Borrowings (in ISK)
ISK 167 billion
EUR 114 billion
Other currencies 20 billion

Deposits
On demand 74%
Up to 3M 11%
More than 3M 15%

6.3% increase from 31.12.2020



All amounts in ISK billion

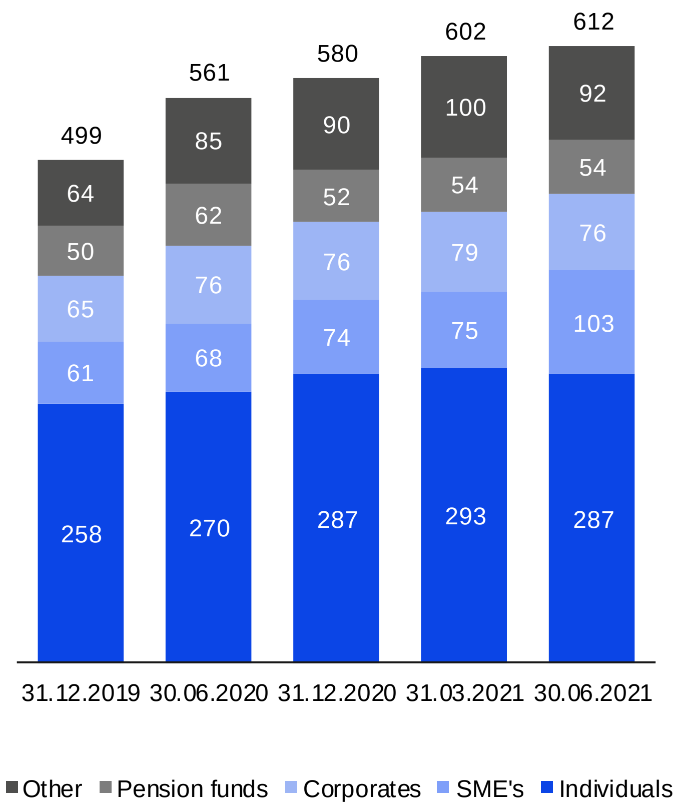
[1] Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities

Deposits

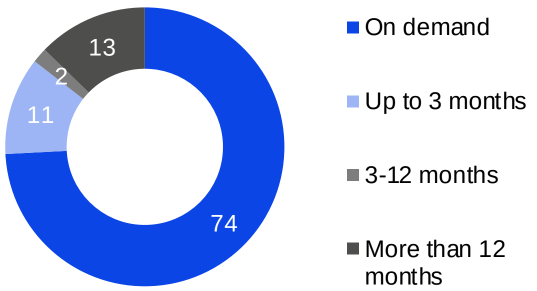
The strategic focus on deposits is showing

- Deposits represent 59% of the Bank's total liabilities
- Strong growth of 12.5% in core deposits from 30.6.2020
  - Core deposits are from individuals, SME's and corporates
- A new product, green deposits, has been very well received and is up 107% since YE 2020, albeit from a small base
- The Bank will continue focusing on deposits from individuals and corporates as they provide stable long-term funding

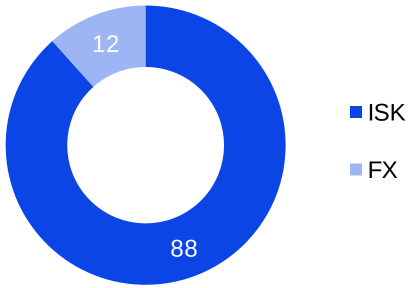
Deposits and due to credit institutions and Central Bank



Maturity of deposits (%)



Deposits by currency (%)



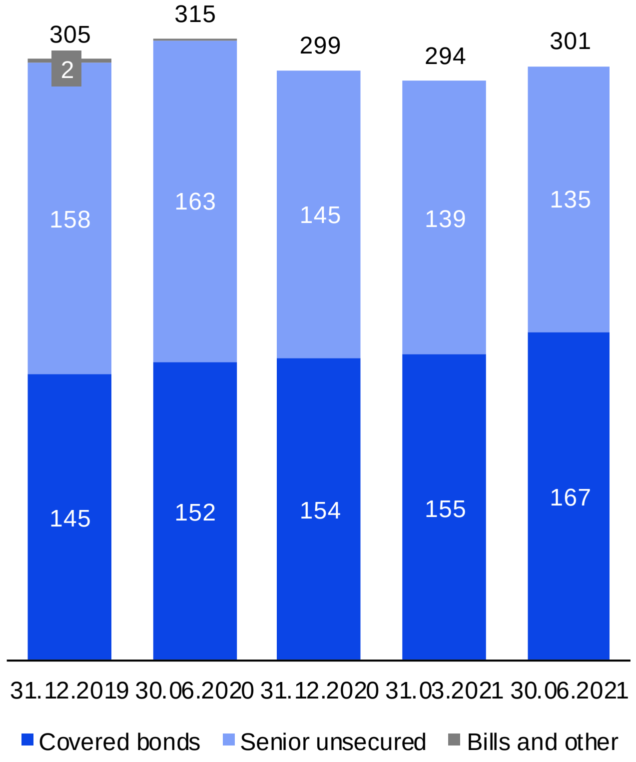
All amounts are in ISK billion

Borrowings

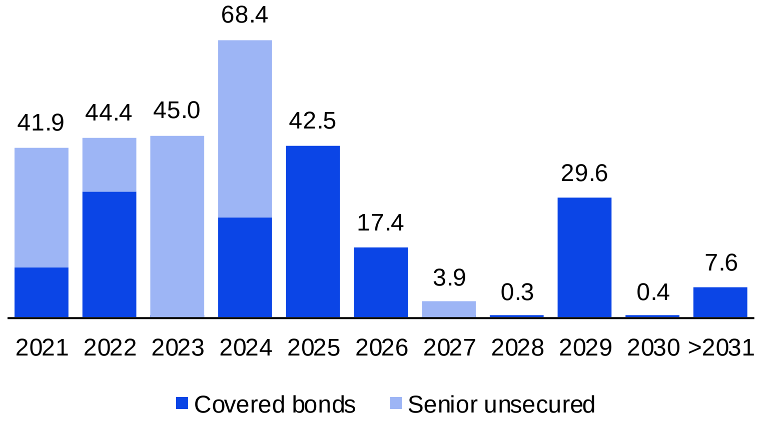
Limited wholesale funding activities in Q2 – Inaugural Green Bond in July

- Limited funding activities during the quarter. The Bank sold previously issued covered bonds for ISK 11 billion
- Green Financing Framework established in July
  - Followed with an inaugural green bond
  - €300 million for 4 years
  - Spread 80 bps over inter bank rates
  - The bond issue was oversubscribed as orders were received for over €600 million
- Green Financing Framework
  - Alignment with ICMA Green Bond Principles
  - Second Opinion from Cicero which rated the framework Medium Green
  - Green Asset Pool upon issuance consisted mainly of green buildings and sustainable fishery and aquaculture
  - Eligible categories also include: sustainable forestry and agriculture, renewable energy, clean transportation, energy efficiency, pollution prevention and control and wastewater management

Borrowings by type



Maturities of borrowings



Ratings – S&P (April 2020)

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

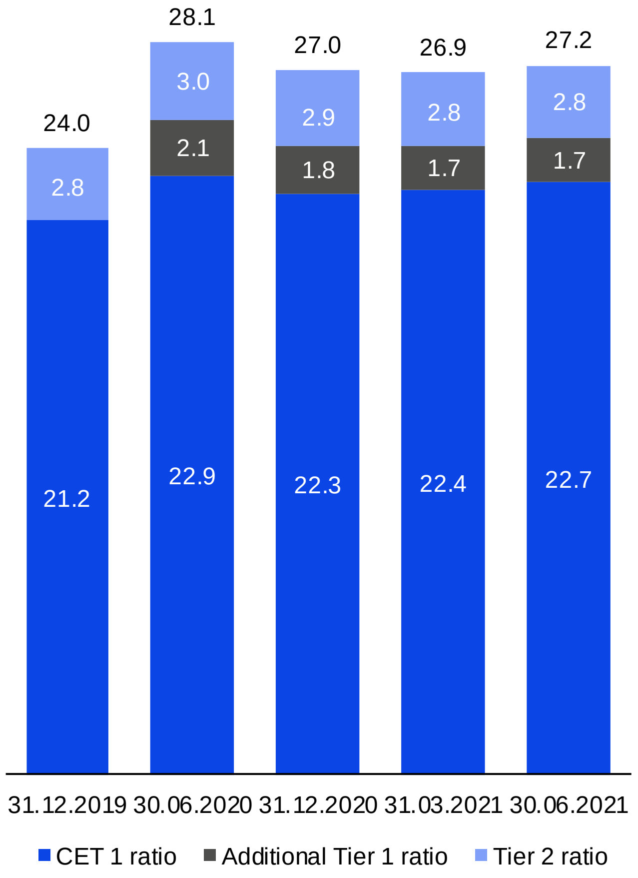
All amounts are in ISK billion

Own funds

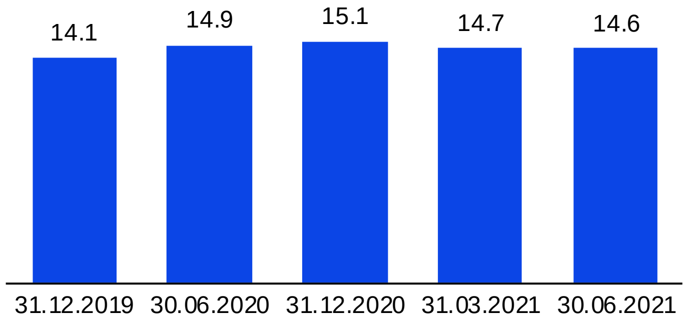
The capital ratios are unrivalled in a European context

- The CET1 increased by 30 bps from 31.03.2021
  – Deducting from the capital base 50% of net earnings and foreseeable share buy-backs
- REA's decrease by 1.1% during the quarter
- Arion Bank filled the Tier 2 bucket with issuance in 2018 and 2019
- The AT1 bucket was filled with issuance in February 2020
- Both instruments strengthen the Bank's own funds and are a milestone towards bringing the Bank's CET1 ratio down to the 17% medium-term targets
- Leverage ratio remains very strong in all respects

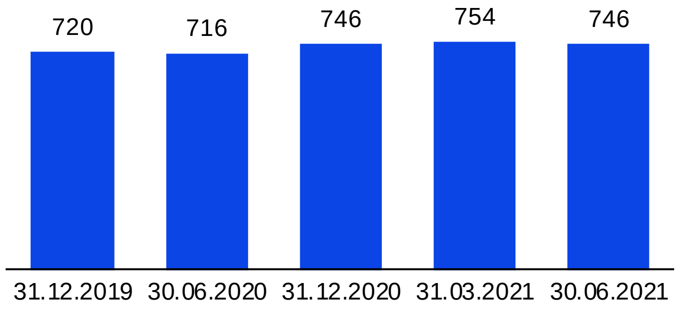
Total capital ratio (%)



Leverage ratio (%)



Risk-weighted exposure amount



All amounts are in ISK billion

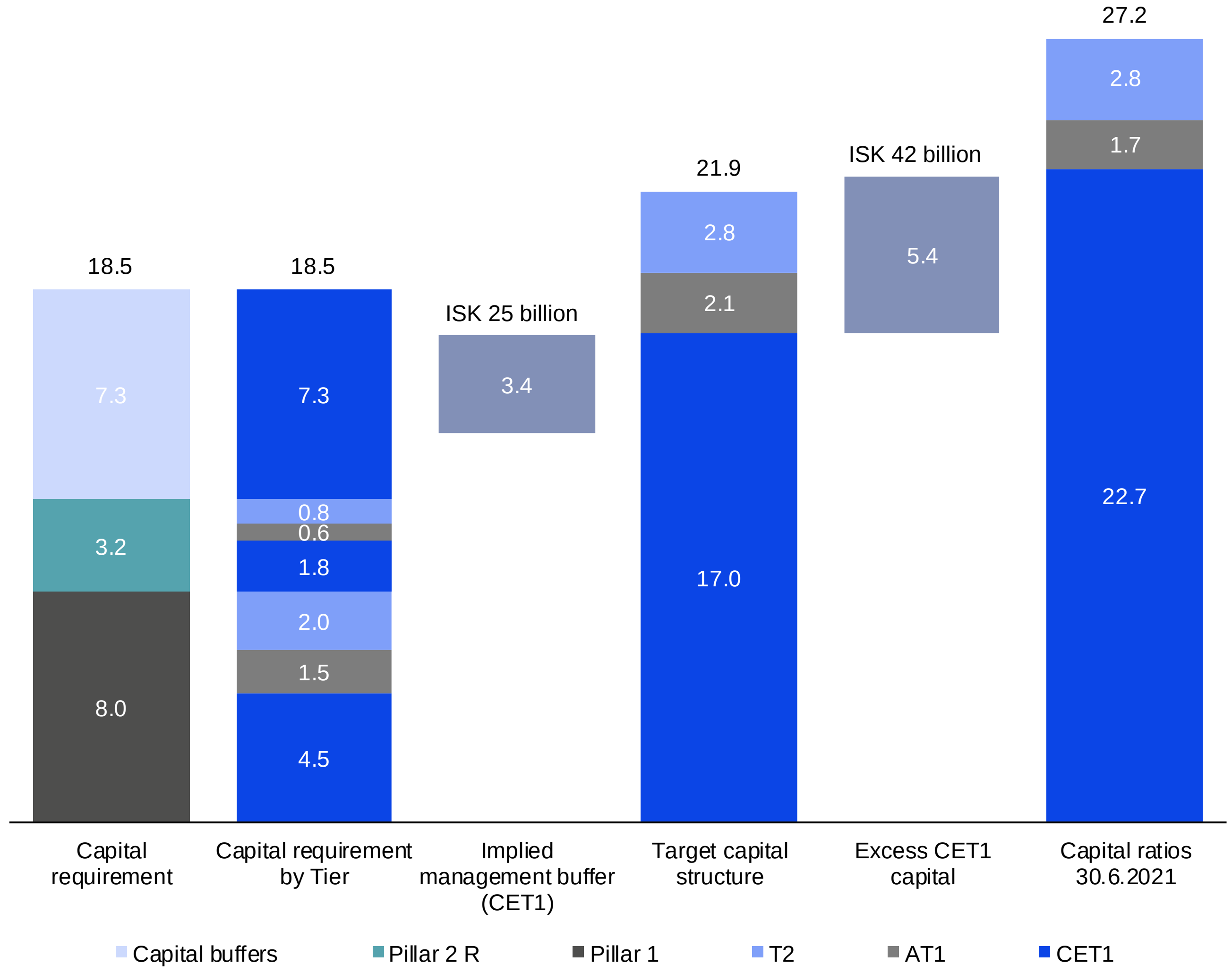
Capital adequacy

Capital ratios remain very strong following significant distributions to shareholders

- Purchase of own shares and dividend payment in H1 2021 was ISK 17.8 billion
- Foreseeable dividend and buy-backs of own shares of total ISK 14.9 billion is included in the capital ratios
- The Pillar 2 requirement increased from 3.1% to 3.2% as a result of the SREP process based on year-end 2020 financials
- Target CET1 ratio remains unchanged at 17%
  - Implied 3.4% CET1 management buffer (ISK 25 billion) which is the difference between the target CET1 ratio and regulatory CET1 requirement
  - CET1 capital of ISK 42 billion in excess of target capital structure, in addition to the foreseeable equity release
- The solvency ratio of Vördur insurance was 151% at 30 June 2021
- Subject to regulatory approval for the treatment of operational risk REA, the sale of Valitor will increase the Bank’s surplus capital from ISK 42 billion to ISK 51 billion (total capital ratio from 27.2% to 28.6%)

- On 28 June 2021, changes to the EU Capital Requirements Regulation No. 575/2013 through Regulation (EU) 2019/876 (CRR II) were adopted in Iceland
- Furthermore, various EU amendments in response to the Covid-19 pandemic have been implemented in Iceland
- These changes have considerable effect on the Bank’s capital adequacy
  - Changes to the SME supporting factor reduce REA by ISK 14 billion
  - Counterparty credit risk is now calculated using the SA-CCR method which leads to an increase in REA of ISK 4 billion
  - Prudentially valued software assets are no longer deducted from own funds which increases CET1 capital by ISK 4 billion

Own funds and capital requirements (%)



Going forward

Arion Bank will strive to build on the positive operational progress from the last quarters and the improving economy offers a number of opportunities for the Bank

Bancassurance and further inclusion of the insurance company Vördur will be in focus with the objective to increase market share in insurance

The Bank is well ESG funded, both with green deposits and through green bond issuance in the international markets and will enhance even further green lending

The Bank is committed to its capital release strategy and still has substantial surplus capital. The BoD reserves the right to call an extraordinary shareholders meeting later in the year to propose additional dividends

In light of its strong capital position and earnings generation the Bank expects to pay dividend and/or buy-back own shares in excess of ISK 50 billion over the next years in addition to already foreseeable dividend and share buy-backs of ISK 14.9 billion included in equity calculation

Arion Bank’s medium term targets

Return on Equity

Exceed **10%**

Revenues / REAs

Exceed **6.7%**

Cost to Income Ratio

Reduce to **45%**

Loan growth

The loan book will **grow in line with economic growth,** with growth in mortgage lending expected to outpace corporate lending

CET 1 Ratio (Subject to regulatory requirements)

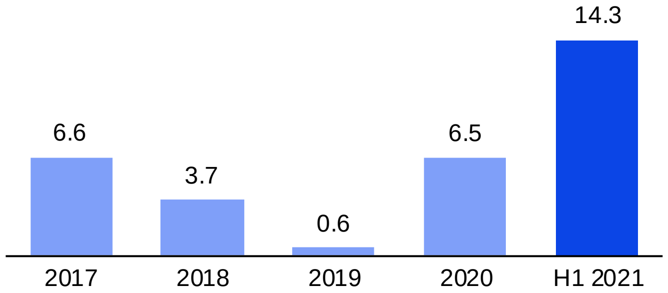
Reduce to **17%**

Dividend Policy / Share buy-back

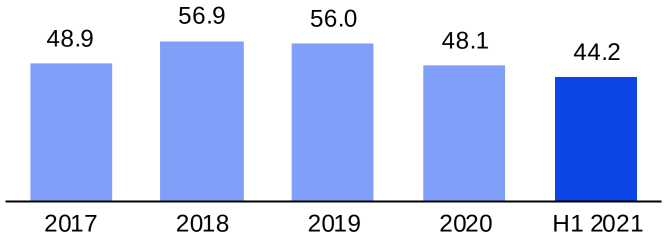
Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buy-back of the Bank’s shares or a combination of both. Additional distributions will be considered when Arion Bank’s capital levels are above the minimum requirements set by the regulators in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

Key financial indicators – annual

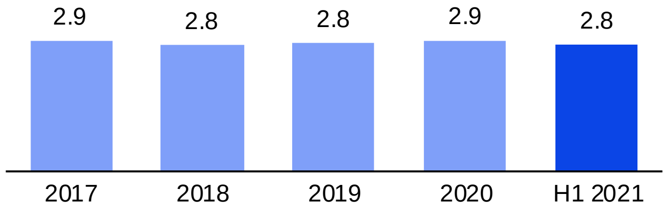
Return on equity (%)



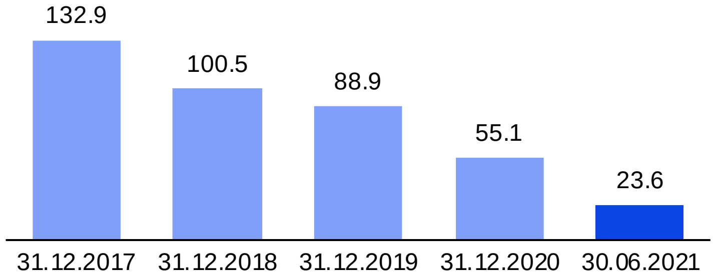
Cost-to-income ratio (%)



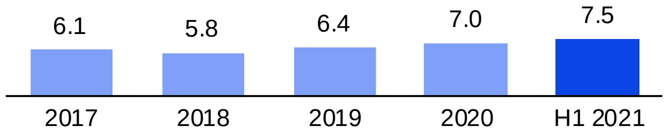
Net interest margin (%)



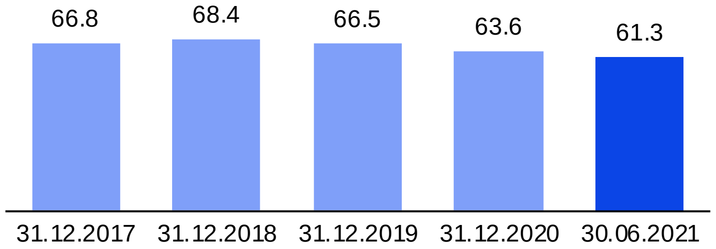
CPI imbalance (ISK billion)



Operating income / REA (%)

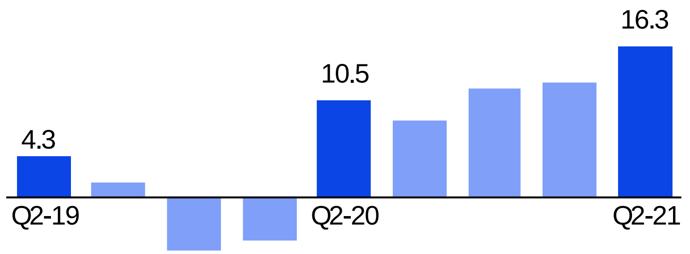


Risk weighted assets / Total assets (%)

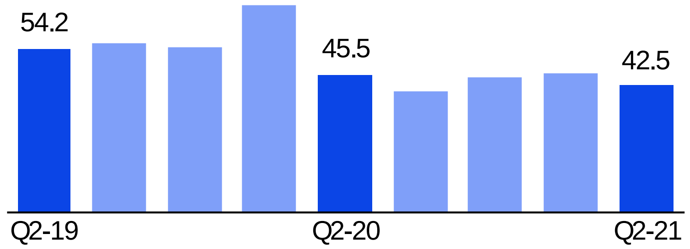


Key financial indicators – quarterly

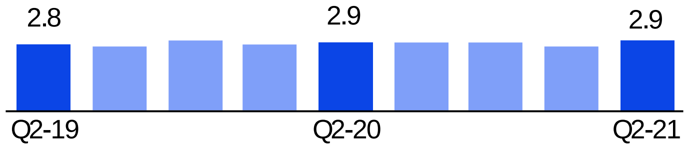
Return on equity (%)



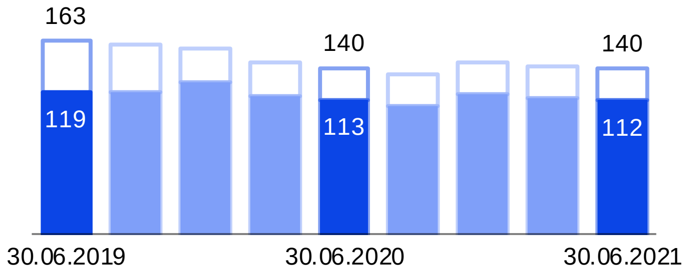
Cost-to-income ratio (%)



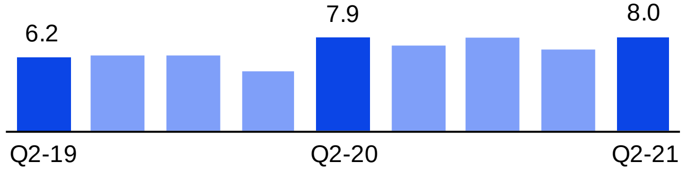
Net interest margin (%)



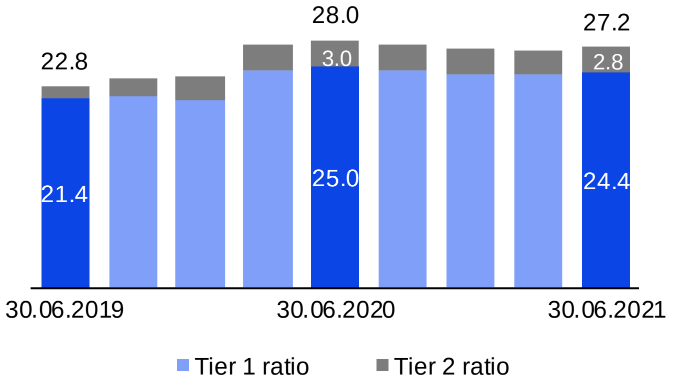
Loans-to-deposits ratio (%)
(without loans financed by covered bonds)



Operating income / REA (%)



Capital ratio (%)



Key figures

Operations	H1 2021	H1 2020	H1 2019	H1 2018	H1 2017	Q2 2021	Q1 2021	Q4 2020	Q3 2020	Q2 2020
Net interest income	15,358	15,110	15,242	14,141	14,824	8,016	7,342	8,059	7,989	7,857
Net commission income	6,839	5,764	4,696	4,917	4,608	3,562	3,277	3,116	2,762	2,688
Operating income	28,101	23,039	23,928	23,315	24,813	15,004	13,097	14,713	13,012	14,063
Operating expenses	12,420	12,602	13,480	13,686	10,519	6,372	6,048	6,607	5,232	6,395
Net earnings	13,855	2,742	3,116	5,010	10,466	7,816	6,039	5,761	3,966	4,913
Return on equity	14.3%	2.9%	3.2%	4.7%	9.7%	16.3%	12.5%	11.8%	8.3%	10.5%
Net interest margin	2.8%	2.9%	2.8%	2.7%	3.0%	2.9%	2.7%	2.9%	2.9%	2.9%
Return on assets	2.3%	0.5%	0.5%	0.9%	1.9%	2.6%	2.1%	1.9%	1.3%	1.7%
Cost-to-income ratio	44.2%	54.7%	56.3%	58.7%	42.4%	42.5%	46.2%	44.9%	40.2%	45.5%
Cost-to-total assets	2.1%	2.2%	2.2%	2.4%	1.9%	2.1%	2.1%	2.2%	1.7%	2.2%
Balance Sheet										
Total assets	1,217,920	1,182,250	1,233,419	1,174,844	1,126,411	1,217,921	1,181,093	1,172,706	1,236,217	1,182,250
Loans to customers	843,988	779,902	821,731	803,694	733,649	843,988	837,162	822,941	807,866	779,902
Mortgages	452,881	356,312	369,583	348,434	190,008	452,881	423,732	409,641	387,271	356,312
Share of stage 3 loans, gross	2.8%	3.4%	2.4%	3.0%	-	2.8%	2.9%	2.6%	3.2%	3.4%
REA/ Total assets	61.3%	60.6%	63.1%	67.8%	67.0%	61.3%	63.9%	63.6%	58.9%	60.6%
CET 1 ratio	22.7%	22.9%	21.4%	21.8%	27.7%	22.7%	22.4%	22.3%	22.5%	22.9%
Leverage ratio	14.6%	14.9%	13.3%	0.0%	0.0%	14.6%	14.7%	15.1%	14.3%	14.9%
Liquidity coverage ratio	215.1%	206.3%	198.0%	231.7%	266.2%	215.1%	191.6%	188.5%	212.6%	206.3%
Loans to deposits ratio	139.6%	140.3%	162.8%	168.8%	167.7%	139.6%	141.3%	144.8%	134.0%	140.3%

All amounts are in ISK million

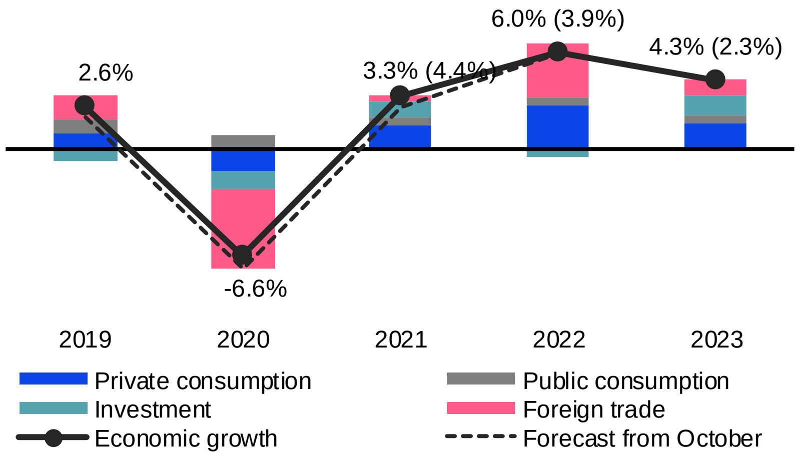
Macroeconomic environment

Economic impact of the pandemic softer than expected

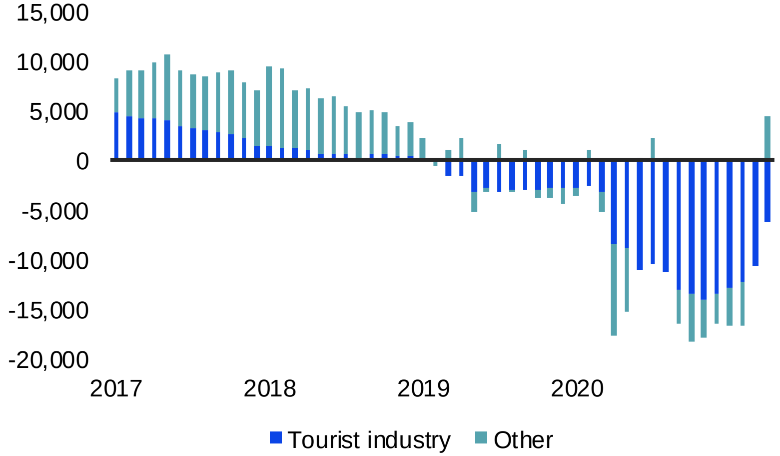
Economic support schemes are paying off and increased number of tourists are positively affecting unemployment figures

- The number of tourists is rising fast, rapidly approaching pre COVID-19 levels. It is getting difficult to find accommodation outside of the capital area in July-August and demand for car rentals has also risen dramatically
- The situation in the labor market is improving. According to the latest figures unemployment in June was 7.4% compared to 9.1% in May and 11.6% at the beginning of the year
- 74% of all inhabitants (16 years+) in Iceland are fully vaccinated. This is number 3 in the world, only Gibraltar and Malta having a higher share of people fully vaccinated
- Most domestic COVID-19 restrictions have been removed in Iceland and fully vaccinated tourists are able to visit the country
- This should support the tourism sector which has started to feel the increased demand for travel to Iceland
- In addition to the fact that the country is sparsely populated, clean, safe and has solid and reliable data in the battle against Covid-19, a volcanic eruption has begun on the Reykjanes peninsula that should help Iceland attract tourists anew

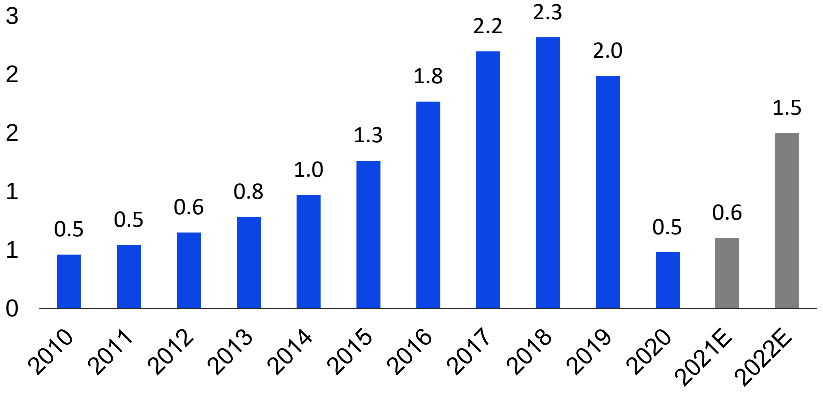
GDP growth (EU average in brackets)



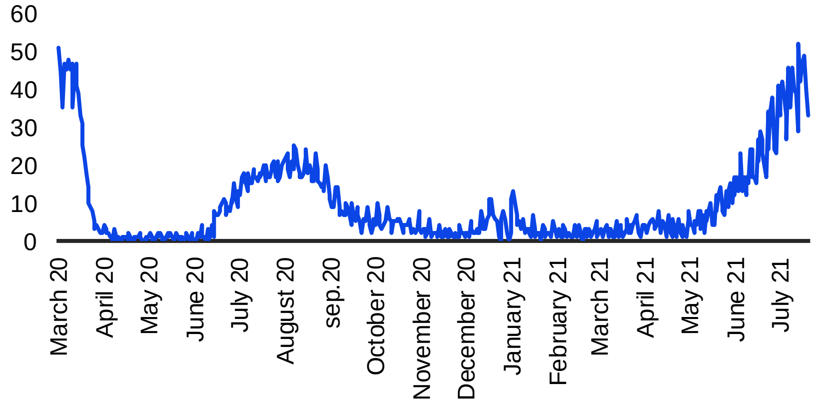
Change in number of people working in each sector according to tax register – YoY change



Tourist arrivals via KEF airport (millions, Arion Bank's March 2020 estimates)



Departures from KEF airport



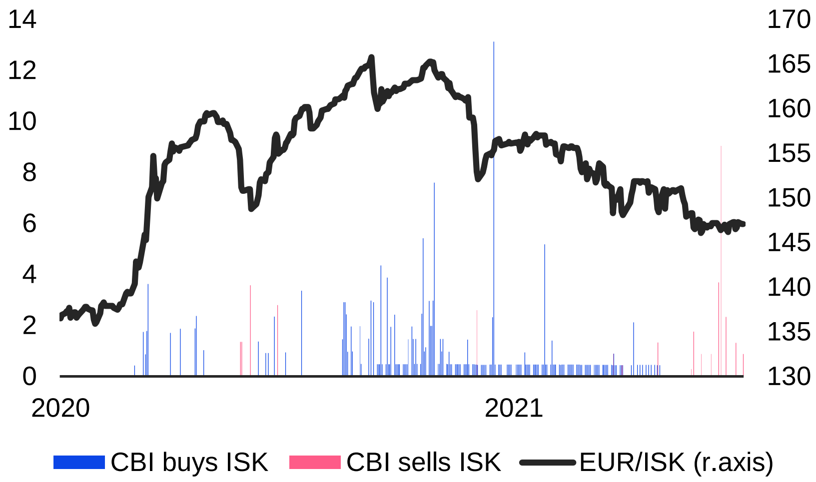
All amounts are in ISK billion

Soaring housing prices stoke inflation

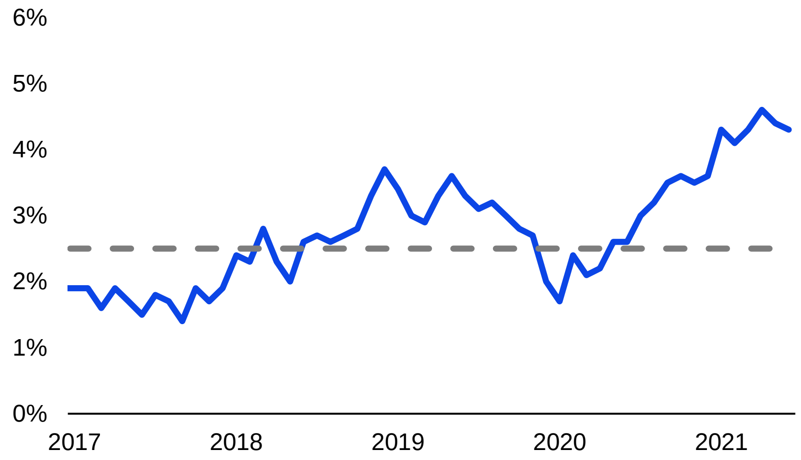
Housing prices are rising, and inflation figures are reducing slower than anticipated

- Inflation has been more persistent than expected and is still above 4%. Although this persistence has come as a surprise, most analysts expect that inflation has peaked
- Rising housing prices have stoked inflationary pressures in the past months following hefty rate cuts. At the same time housing investment is decreasing, causing many to worry that a housing bubble is in the works
- The Central Bank of Iceland (CBI) is trying to reduce risk in the housing market by lowering LTV of new mortgages to 80% from 85%. First time buyers are still allowed to take on a mortgage with 90% LTV
- The ISK has appreciated by 6.3% against the EUR YTD. The CBI used ISK 187 billion of FX reserves to reduce volatility in the ISK market but let the ISK depreciate during 2020. Lately the ISK market has experienced stronger inflows of FX and the CBI has been able buy back approx. 20% of it
- The appreciation of the ISK should somewhat offset the inflationary effects of the housing market

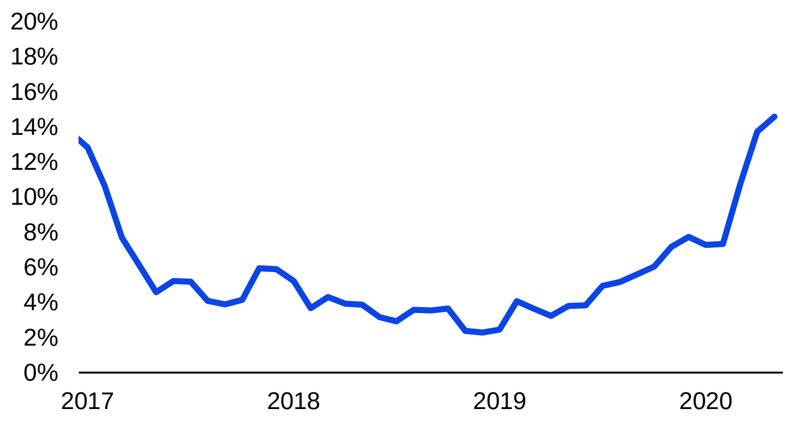
EUR/ISK and CBI's intervention in the FX market



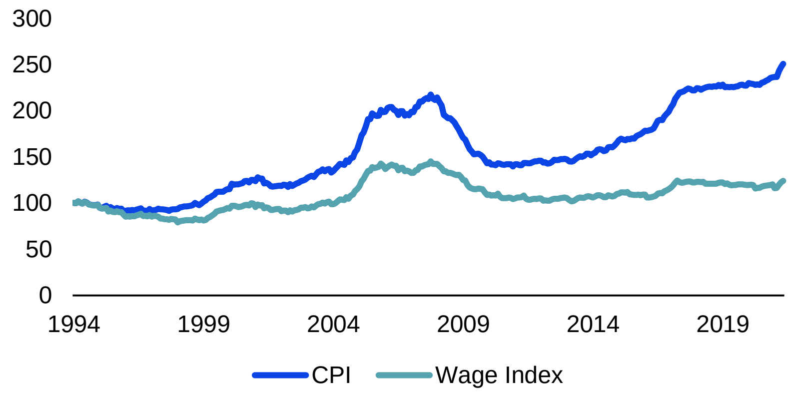
Inflation and inflation target



Housing prices in the Capital Area (YoY %-change)



Housing prices in the Greater Reykjavík area in real terms



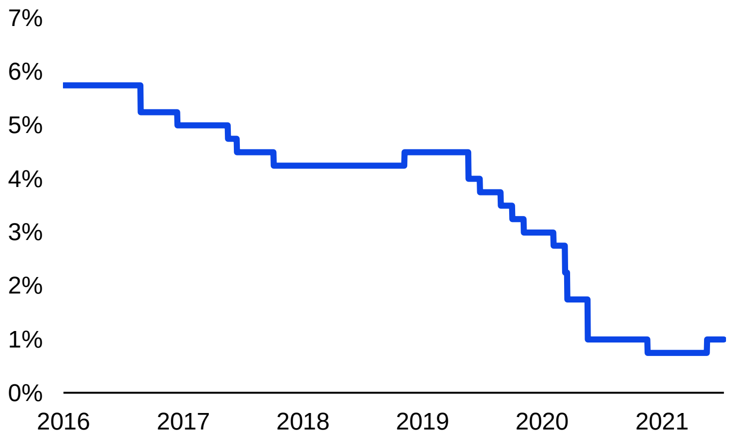
All amounts are in ISK billion

Soaring housing prices stoke inflation

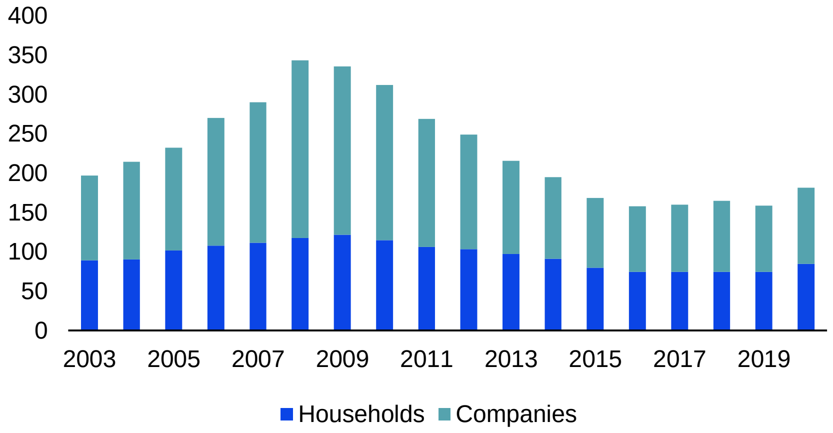
Housing prices are rising, and inflation figures are reducing slower than anticipated

- Persistent inflation has compelled the CBI to raise interest rates by 25 bps. The Governor of the Central Bank has reiterated that the CBI can and will use the tools at its disposal to quell inflation
- However, interest rates are still historically low and similar fiscal easing is expected this year supporting economic growth
- A 6.3% wage increase in 2020 coupled with broad-based Government measures and payment holidays have shielded households' balance sheets and disposable income – despite the high unemployment rate
- Debt levels only rose modestly in 2020 in the private sector, even though credit was readily available to households at least. Strong balance sheets and the successful vaccination roll-out have buoyed consumer confidence, with the Gallup Consumer Confidence Index reaching a three-year high in May

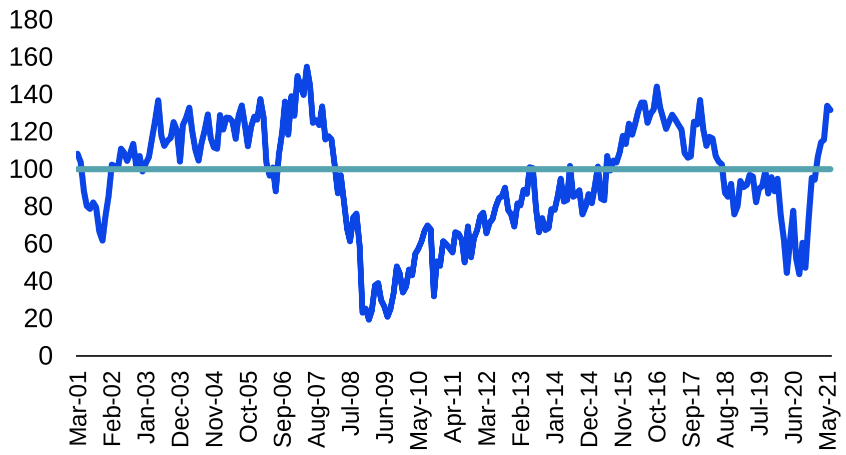
Key interest rates (seven-day term deposit rate)



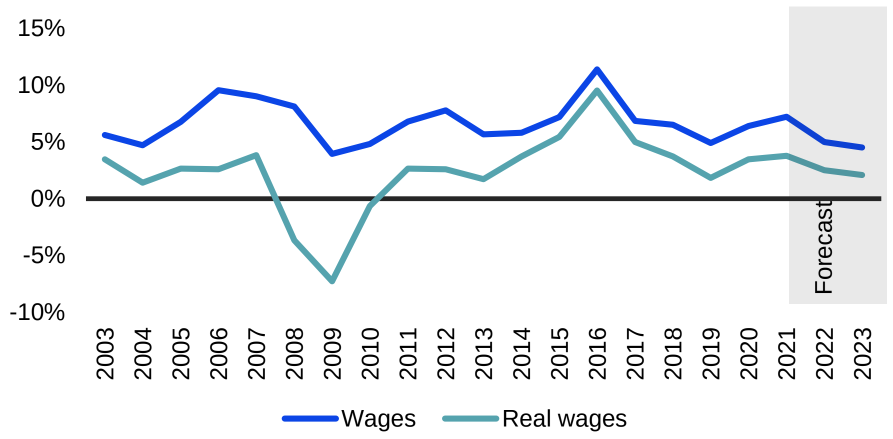
Household and non-financial corporate debt (% of GDP)



Consumer confidence



Wages and real wages – YoY %-change



All amounts are in ISK billion

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