

Earnings Press Release, 27 October 2021

Arion Bank's Q3 2021 financial results

- Arion Bank reports net earnings of ISK 8,238 million in Q3 2021
- Return on equity in Q3 was 17.0%, compared with 8.3% in Q3 2020
- Net interest margin of 2.7% in a low interest rate environment, compared with 2.9% in Q3 2020
- Best quarter since 2016 in Net fee and commission income, with 36% increase from Q3 2020
- Core revenues increased by 7.5%, compared with Q3 2020
- Cost-to-income ratio in Q3 was 37.5%, compared with 40.2% in Q3 2020
- The Bank's total assets increased by 14.8% from year-end 2020
- Dividend payment and share buy-backs amounted to ISK 25.5 billion during the first nine months of 2021
- The Bank will launch buy-back on 28 October for the total amount of ISK 5 billion, 50% of share buy-backs authorized by the Central Bank of Iceland
- The Bank's total capital ratio was 25.4% and the CET1 ratio was 20.9% on 30 September 2021
- The Bank finalized a EUR 300 million covered bond in September – the first international covered bond issuance by an Icelandic bank
- The Bank is very well positioned to distribute capital and meet the funding requirements of its customers
- Bancassurance will be a key area at Arion Bank over the coming months when the insurance subsidiary Vördur moves into the Bank's headquarters and will work closely with Retail Banking
- On 1 July 2021 Arion Bank entered into a definitive agreement on the sale of Valitor hf.

Arion Bank reported net earnings of ISK 8,238 million in the third quarter with 17.0% return on equity. Return on equity, assuming 17% CET1 ratio, was 21.8% for the quarter.

Total assets amounted to ISK 1,346 billion at the end of the period, compared with ISK 1,173 billion at the end of 2020. Loans to customers increased by 9.0% from year-end 2020, with mortgage lending increasing by 16.4% during this period. Liquid assets increased by 15.3% despite share buy-backs and dividend payments during the first nine months of 2021. On the liability side, deposits increased by 12.8% from year-end 2020 and borrowings increased by 32.8%, mainly during the third quarter with new issues of green bonds and covered bonds in foreign currency. Total equity amounted to ISK 195 billion at the end of the period. Total equity increased due to the reported net earnings but decreased due to dividend paid and share buy-backs.

The Bank's total capital adequacy ratio was 25.4% and the CET1 ratio was 20.9% at the end of September 2021, assuming 50% dividend payments of net earnings in line with the dividend policy and buy-backs of ISK 10 billion, compared with 27.0% and 22.3% respectively at year-end 2020. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 24.8% and the CET1 ratio was 20.3%. The Bank's capital ratios comfortably exceed the requirements set by law and the Financial Supervisory Authority of the Central Bank.

Benedikt Gíslason, CEO of Arion Bank

“Arion Bank performed well during the third quarter, following on from its strong showing in the first half of the year. All the Bank's key financial indicators have trended positively during the period and core revenues are up 7.5% from the same period last year. Commission income continues to increase, reflecting the diversity of the business. The positive performance of the Icelandic economy is mirrored by the 6% growth in the Bank's loans to customers during the quarter. Arion Bank's capital and liquidity ratios continue to be robust and remain among the highest in Europe.

A new division, Customer Experience, was created during the quarter, adding a new managing director to the executive committee. The division is designed to enhance our comprehensive sales and service channels, with a special focus on digital services. The new division plays a crucial role in developing the partnership between Arion Bank and our subsidiary, the insurance company Vördur, and creating integrated financial services which can be accessed through diverse and modern service channels. Vördur is currently relocating its business and services to the Bank's headquarters in Reykjavík. Some of the people currently at Vördur will eventually be joining the Bank, while others will stay at Vördur, which remains an independent company.

Arion Bank recently issued its inaugural covered bond in euros, adding a new source of funding and opening up access to a new group of investors. The issue was received positively on the international markets. The issue had the tightest pricing achieved by any Icelandic entity, including the Icelandic treasury, on the international markets for 13 years and represents a crucial step in broadening the Bank's future funding options.



Equality is of paramount importance to us at Arion Bank, and in recent years we have worked hard to ensure that people get equal pay for equally valuable jobs. The Bank first gained equal pay certification from the union VR six years ago and was awarded the Ministry of Welfare's equal pay symbol three years later. In the last equal pay audit, the unexplained gender pay gap at the Bank was down to 0.1%. It is a fact that the average salaries of men, both at Arion Bank and in society in general, are higher than those of women, and men generally exercise their right to parental leave less than women. We have now decided to pay employees 80% of their salaries for six months during parental leave. The aim is to increase the number of men exercising their right to paternity leave, and we hope that in the long term it will contribute to pay equality and gender equality at management level and in other areas of the Bank."

Income Statement

<i>In ISK millions</i>	Q3 2021	Q3 2020	Δ	Δ %	9M 2021	9M 2020	Δ	Δ %
Net interest income	7,937	7,989	(52)	(1%)	23,295	23,099	196	1%
Net commission income	3,755	2,762	993	36%	10,594	8,526	2,068	24%
Net insurance income	992	1,043	(51)	(5%)	2,577	2,305	272	12%
Net financial income	1,366	692	674	97%	5,069	1,383	3,686	267%
Other operating income	840	526	314	60%	1,456	738	718	97%
Operating income	14,890	13,012	1,878	14%	42,991	36,051	6,940	19%
Salaries and related expenses	(2,899)	(2,504)	(395)	16%	(9,745)	(9,211)	(534)	6%
Other operating expenses	(2,689)	(2,728)	39	(1%)	(8,263)	(8,623)	360	(4%)
Operating expenses	(5,588)	(5,232)	(356)	7%	(18,008)	(17,834)	(174)	1%
Bank levy	(486)	(383)	(103)	27%	(1,171)	(1,038)	(133)	13%
Net impairment	718	(1,340)	2,058	-	2,610	(5,118)	7,728	-
Net earnings before income tax	9,534	6,057	3,477	57%	26,422	12,061	14,361	119%
Income tax expense	(1,920)	(1,096)	(824)	75%	(5,194)	(3,424)	(1,770)	52%
Net earnings from cont. operations	7,614	4,961	2,653	53%	21,228	8,637	12,591	146%
Discontinued operations, net of tax	624	(995)	1,619	-	865	(1,929)	2,794	-
Net earnings	8,238	3,966	4,272	108%	22,093	6,708	15,385	229%
KFI's								
Return on equity (ROE)	17.0%	8.3%			15.2%	4.7%		
Return on equity, continuing operations	15.7%	10.4%			14.6%	6.1%		
Return on equity assuming 17% CET 1	21.8%	10.4%			19.5%	5.5%		
Return on total assets (ROA)	2.6%	1.3%			2.4%	0.8%		
Earnings per share (in ISK)	5.23	2.31			13.68	3.90		
Cost to income ratio (C/I)	37.5%	40.2%			41.9%	49.5%		
Net interest margin (NIM)	2.7%	2.9%			2.7%	2.9%		
Operating income / REA	7.8%	7.2%			7.6%	6.7%		

Net interest income remains relative stable between the third quarter of 2021 and 2020. The net interest margin (NIM) as a percentage of average interest-bearing assets was 2.7% during the quarter, compared with 2.9% for the third quarter of 2020. The Bank aims to maintain NIM in the range of 2.6% - 2.9% whilst the base rate remains at current levels. Interest-bearing assets increased by ISK 66 billion or 6% compared with the same period in 2020. The focus on returns in lending and funding cost, with a higher proportion of funding in deposits, is materializing in an acceptable NIM.

Net commission income increased by 36%, compared with the third quarter of 2020. Net commission income was very strong across the Bank with asset management and corporate lending performing well. Asset management fees increased significantly from third quarter 2020 with increased AuM and performance based fees. Income from lending and guarantees continues to be strong, buoyed by an increased focus on capital velocity as opposed to loan growth.

Insurance premiums earned at the insurance company Vördur have been increasing, but volatility in *net insurance income* is mainly due to seasonal fluctuations in the claim rate. The combined ratio for the third quarter of 2021 was very strong or 91.7%, compared with 93.5% for the same period in 2020, and is highly competitive in the domestic market.

Net financial income was very strong with a profit of ISK 1,366 million, of which 46% was from the subsidiary Vördur insurance. Equity holdings performed well during the quarter due to favorable market conditions and effective management.

Operating expenses increase between years. Additional salary expense is mainly due to less capitalization of salaries in 2021, compared with 2020, and increased layoff expense. At the end of September the number of full-time equivalent positions (FTEs) was 763 at the Group and 629 at the Bank, a 3% decrease at Group level compared with the same period in 2020. Other operating expenses remains stable compared with the same period the previous year.



Net impairment is positive in the third quarter of 2021 as the Bank is reversing a part of its impairments. This is partly due to changes in the loan book, with a higher proportion in mortgages instead of corporate loans. IFRS models remain more or less unchanged as the expectation is that the worst is behind us in terms of the economy. However, uncertainty does persist regarding the valuation of assets due to the pandemic, especially as the COVID-19 delta variant is still being dealt with.

Income tax, as reported in the financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1 billion. The effective income tax rate was 19.7% for the first nine months. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate.

Discontinued operations held for sale comprise the operating results of the subsidiary Valitor hf. and valuation changes of the underlying assets of the subsidiaries Stakksberg ehf. and Sólbjarg ehf. The impact of HFS assets is positive during the quarter partly due to a fair value change of assets at the subsidiary Sólbjarg and a positive effect from operations at Valitor. On 1 July 2021 Arion Bank entered into a definitive agreement regarding the sale of Valitor hf. Arion Bank expects to recognize a net profit of approximately ISK 3.5 billion from the sale when all conditions precedent have been met. The sale agreement for Valitor hf. does not affect the financial statements for the period, in accordance with IFRS.

Balance sheet

The balance sheet increased by 15% from year-end 2020. The liquidity position remains very strong despite ISK 25.5 million capital distribution through dividends and buy-backs of own shares.

<i>In ISK millions</i>	30.09.2021	31.12.2020	Δ	Δ %	30.09.2020	Δ	Δ %
Cash & balances with CB	70,136	42,136	28,000	66%	87,517	(17,381)	(20%)
Loans to credit institutions	30,376	28,235	2,141	8%	39,484	(9,108)	(23%)
Loans to customers	896,940	822,941	73,999	9%	807,866	89,074	11%
Financial instruments	249,979	227,251	22,728	10%	234,937	15,043	6%
Intangible assets	9,732	9,689	43	0%	9,398	334	4%
Assets and disposal groups HFS	16,775	16,811	(36)	(0%)	30,821	(14,046)	(46%)
Other assets	72,154	25,643	46,511	181%	26,193	45,961	175%
Total assets	1,346,092	1,172,706	173,386	15%	1,236,216	109,877	9%

KFI's

REA / Total assets	58.0%	63.6%	58.9%
Share of stage 3 loans, gross	2.6%	2.9%	3.2%

Assets

Loans to customers increased by 9.0% from the end of 2020, primarily mortgage lending, whereas loans to corporates increased slightly. Lending activities remained robust during the first nine months of 2021 with significant sales of corporate credit exposures to institutional investors taking place. The loan book continues to be well balanced between individuals and corporates. Loans to individuals increased by 15.9% during the first nine months, with mortgages driving growth with a 16.4% increase.

The Bank's liquidity position is very strong with the total LCR ratio at 221% and the ISK LCR ratio at 152%. This is reflected in the strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments.

Assets and disposal groups held for sale comprise the subsidiaries Valitor ehf., Stakksberg ehf. and Sólbjarg ehf. The impact of HFS assets is positive during the quarter, partially due to binding offer of sale of assets at the subsidiary Sólbjarg. On 1 July 2021 Arion Bank entered into a definitive agreement regarding the sale of Valitor hf. for a purchase price of USD 100 million. The transaction is 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, a condition applicable until the end of 2023. The sale agreement for Valitor hf. does not affect the financial statements for the period, in accordance with IFRS.



Liabilities and equity

In ISK millions	30.09.2021	31.12.2020	Δ	Δ %	30.09.2020	Δ	Δ %
Due to credit institutions & CB	8,484	13,031	(4,547)	(35%)	10,802	(2,318)	(21%)
Deposits from customers	641,306	568,424	72,882	13%	602,842	38,464	6%
Other liabilities	52,362	42,217	10,145	24%	58,103	(5,741)	(10%)
Borrowings	397,031	298,947	98,084	33%	308,913	88,118	29%
Subordinated liabilities	35,477	36,060	(583)	(2%)	36,867	(1,390)	(4%)
Liabilities associated w/disposal groups HFS	16,852	16,182	670	4%	26,193	(9,341)	(36%)
Total liabilities	1,151,512	974,861	176,651	18%	1,043,720	107,792	10%
Shareholders equity	193,900	197,672	(3,772)	(2%)	192,324	1,576	1%
Non-controlling interest	680	173	507	293%	172	508	295%
Total equity	194,580	197,845	(3,265)	(2%)	192,496	2,084	1%
Total liabilities and equity	1,346,092	1,172,706	173,386	15%	1,236,216	109,876	9%

KFI's

Loans to Deposits ratio	139.9%	144.8%		134.0%
CET1 ratio	20.9%	22.3%		22.5%
Capital adequacy ratio	25.4%	27.0%		27.6%

Deposits from customers remain the most important source of funding for Arion Bank and a greater focus on deposit funding has resulted in a significant increase. The increase is in all the main classes i.e. from individuals, corporates and public entities, which increased by 14.2% from 30 September 2020.

The increase in *borrowings* from the end of 2020 is due the Bank's inaugural green bond issue, with a EUR 300 million 4-year transaction in July and a EUR 300 million 5-year covered bond at the end of September, an issuance which marks the first international covered bond from an Icelandic bank. The covered bond was sold at a 0.27% spread over interbank rates, which is the best funding spread that any Icelandic entity, including the Treasury of Iceland, has achieved in the international markets since the Bank was established 13 years ago.

Shareholders' equity decreased due to the dividend payment and purchase of own shares, in total ISK 25.5 billion, which is partly offset by the net earnings for the period. The leverage ratio was 12.4% at the end of September, compared with 15.1% at the end of 2020, which is very high in international comparison. At the end of the period the Group had ISK 57 billion of CET1 capital in excess of regulatory requirements and ISK 30 billion in excess of the Group's target CET1 ratio of 17%, in addition to the foreseeable equity release of ISK 21.3 billion.

For further information on the accounts please visit Arion Bank's [website](#).

Financial targets

Return on Equity	Exceed 10%
Revenues / RWA's	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	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.



Investor meeting / webcast on 28 October at 10:30 CET (8:30 GMT)

Arion Bank will be hosting an investor meeting / webcast at the Bank's headquarters in Borgartún 19, Reykjavík, on Thursday 28 October at 10:30 CET (8:30 GMT) where CEO Benedikt Gíslason and CFO Ólafur Hrafn Höskuldsson will present the results and answer questions from participants. The meeting will take place in English.

The webcast will be accessible live on financialhearings.com and a link will also be made available on the Bank's website under [Investor Relations](#).

To participate in the webcast via telephone and to ask questions, please call in using the relevant number indicated below before the start of the webcast:

Sweden	+ 46 856 642 703
UK	+ 44 333 300 9034
USA	+1 646 722 4902
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For any further information please contact Theodór Fridbertsson, [Head of IR](#), tel.+354 856 6760, or Haraldur Gudni Eidsson, [Head of Corporate Communications](#), tel. +354 856 7108.

Financial calendar

The Bank's Financial Statements are scheduled for publication as stated below. The calendar may be subject to change.

Capital Markets Day	17 November 2021
Q4 / 12M 2021 Financial results	9 February 2022
AGM 2022	16 March 2022
Q1 2022 Financial results	4 May 2022
Q2 2022 Financial results	27 July 2022
Q3 2022 Financial results	26 October 2022

This is information that Arion Bank hf. is obliged to make public pursuant to the EU Market Abuse Regulation. The information was submitted for publication through the agency of the contact persons set out above.

Forward-looking statements

This release contains forward-looking statements that reflect management's current views with respect to certain future events and potential financial performance. The information in the release is based on company data available at the time of the release. Although Arion Bank believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Accordingly, results could differ materially from those set out in the forward-looking statements as a result of various factors. The most important factors that may cause such a difference for Arion Bank include, but are not limited to: a) the macroeconomic development, b) change in inflation, interest rate and foreign exchange rate levels, c) change in the competitive environment and d) change in the regulatory environment and other government actions. This release does not imply that Arion Bank has undertaken to revise any forward-looking statements, beyond what is required by applicable law or applicable stock exchange regulations if and when circumstances arise that will lead to changes after the date when this release was made. Arion Bank assumes no responsibility or liability for any reliance on any of the information contained herein. It is prohibited to distribute or publish any information in this release without Arion Bank's prior written consent.