



# Arion Bank

Capital Markets Day – London  
12 November 2019



# Agenda

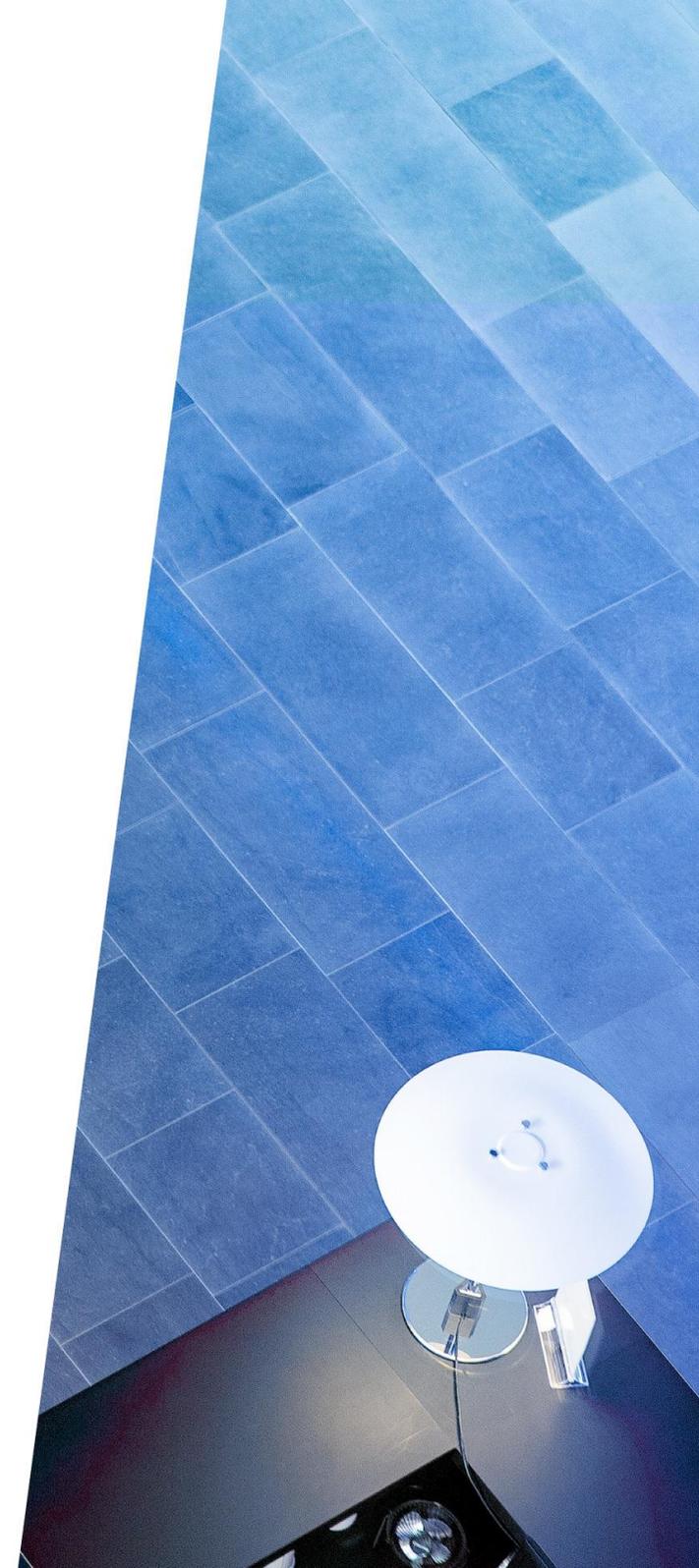
- 8.30 Registration and breakfast
- 9.00 Higher profitability in a more challenging interest rate environment  
Benedikt Gislason – CEO
- 9.30 Soft landing, slow takeoff  
Erna Bjorg Sverrisdottir – Chief Economist
- 9.50 CIB – Relationships and RWAs  
Asgeir Reykjord Gylfason – MD of Corporate & Investment Banking
- 10.10 Coffee Break
- 10.30 Driving Bottom line results through digitalization  
Ida Benediktsdottir – MD of Retail Banking
- 10.50 Arion Bank financials: a new trajectory  
Stefan Petursson – CFO
- 11.10 Q&A





# Higher profitability in a more challenging interest rate environment

Benedikt Gislason  
CEO



# Key messages

A smaller but more profitable bank going forward



Arion Bank is operating in a strong and healthy economy



Arion Bank operates a diversified business model and enjoys strong market position



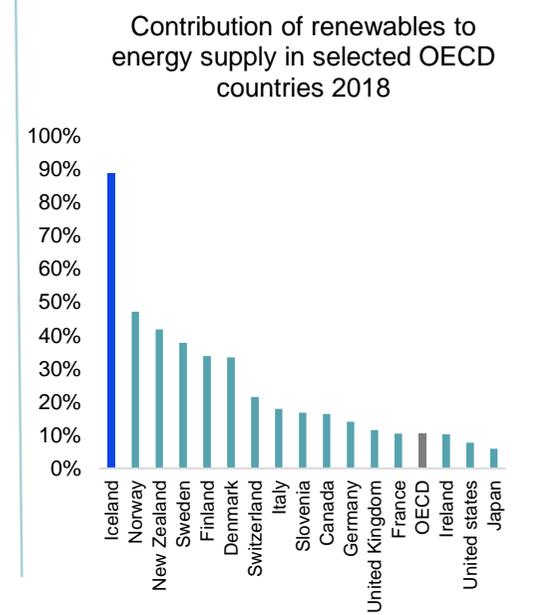
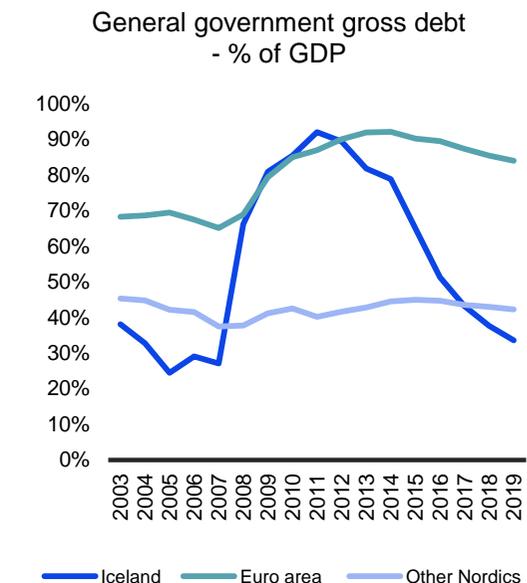
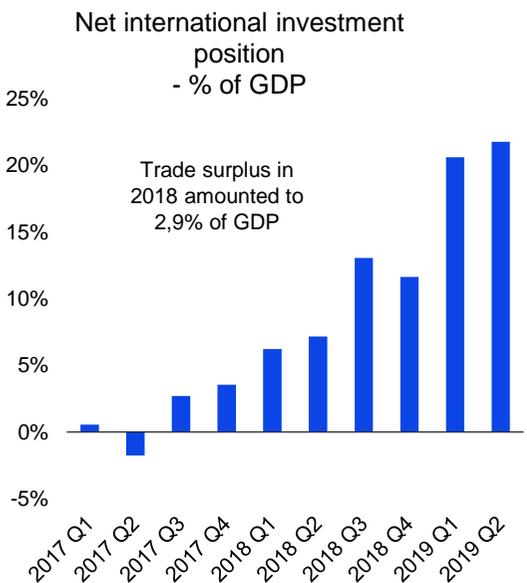
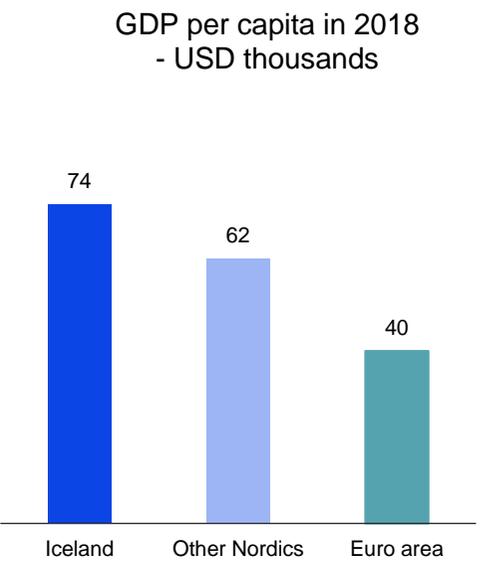
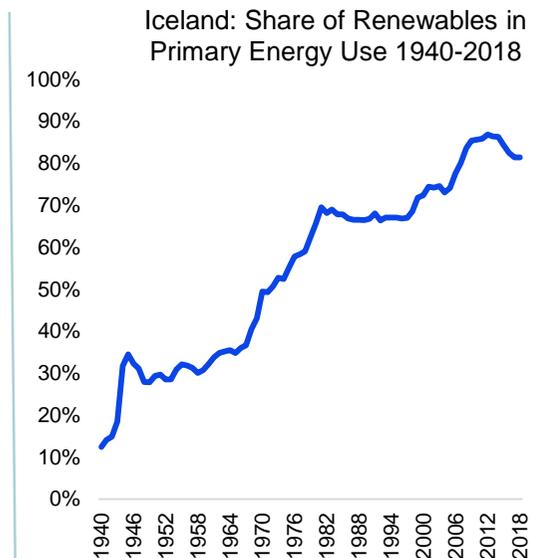
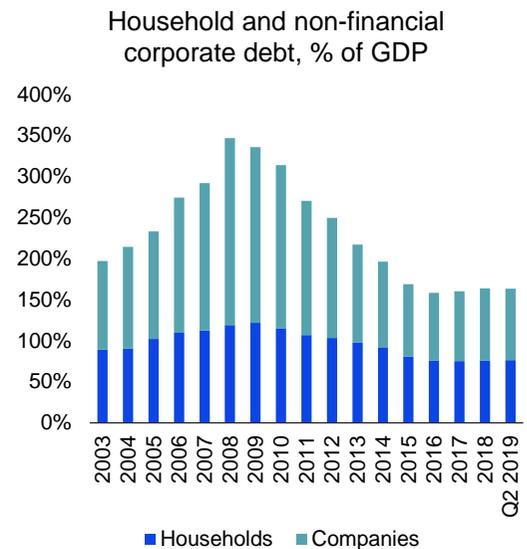
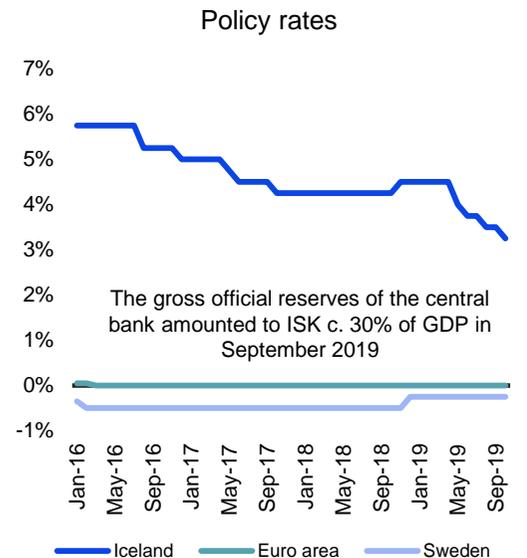
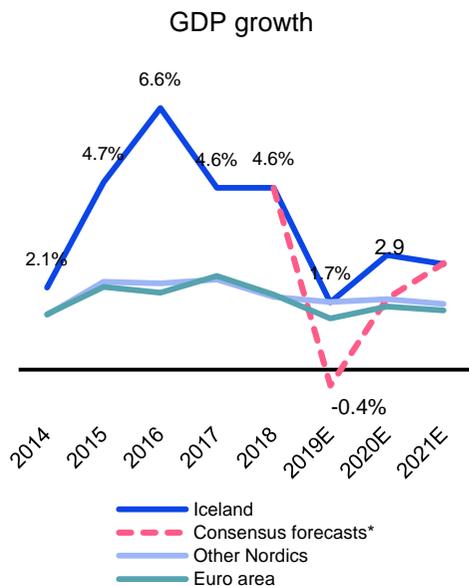
Arion Bank is adopting a more disciplined capital allocation approach to increase ROE



Arion Bank is in a position to continue to release surplus capital to its shareholders



# The Icelandic economy: Strong and healthy



# Diversified business model and strong market position

Banking, insurance and investment services in a robust economy

## Retail Banking

- Digital leader in the retail market
- Large private provider of residential mortgages in Iceland
- ~ 31% market share<sup>1</sup>
- Wide range of financial services for individuals and SMEs<sup>2</sup>



## CIB

- Corporate banking and strategic advisory
- Selective use of own capital with increased capital market intermediation
- Managed c. 2/3 of all IPOs in Iceland since 2011



## Markets

- Largest asset manager in the Icelandic market with ISK 1.057 BN of AuM<sup>2</sup>
- Focus on institutional investors and HNW clients
- A leading capital markets house
- Largest custody service provider in Iceland

Arion Bank's subsidiary **Stefnir** is a leading fund management company in Iceland



## Insurance

- The Bank's subsidiary Vördur is the largest life insurance company in Iceland
- 4th largest universal insurance company in Iceland based on insurance premiums<sup>3</sup>
- Has been a growing contributor to Arion Bank's operating income mix in the last three years



## Business profile:

### Retail Banking

### CIB

### Markets

	Retail Banking	CIB	Markets
No. of clients	c. 100k	c. 500	c. 100k
Client lending	ISK 460bn	ISK 306bn	-
RWA allocation	ISK 283bn	ISK 324bn	ISK 14,3bn

## Payments

- Largest card payments company in Iceland based on operating revenues<sup>3</sup>
- Valitor is currently in a sales process and defined as held for sale in the accounts



# Market leader in life insurance and fast growing in P&C

Vördur Insurance has become the fourth pillar to the group's revenue generation

## Vördur P&C

- 40.400 non-life clients
  - 35.900 individuals
  - 4.500 commercial
- 15% of the non-life premium market<sup>2</sup>

## Vördur Life

- 29.000 life clients
- 33% of the life premium market<sup>2</sup>

### Strong development since Arion Bank acquisition in 2016/17

ISKm	2016 <sup>3</sup>		2018	2019 Q1-Q3
Premiums	8.265		10.844	8.757
Combined ratio	100,5%		92,3%	92,5%
Net Profit	637		1.246	1.450
Equity	5.350		6.753	7.752
Market share premiums <sup>1</sup>	14,6%		15,9%	16,2%

## Leveraging bancassurance partnership in digital innovation

- Insurance in the Arion App launched on September 5th



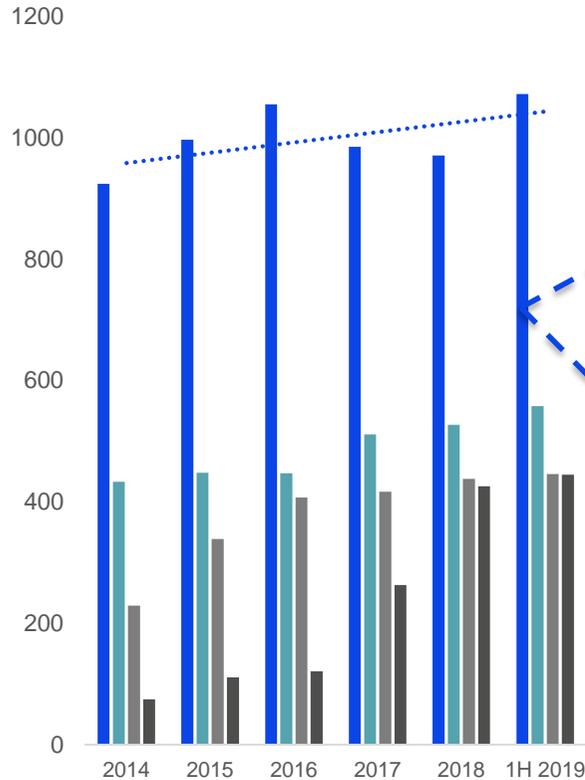
1. Based on Vördur Group premiums vs TM; VIS and Sjova  
 2. Based on 9M 2019 vs TM, VIS and Sjova  
 3. Including Okkar Lif



# Market leader in asset management

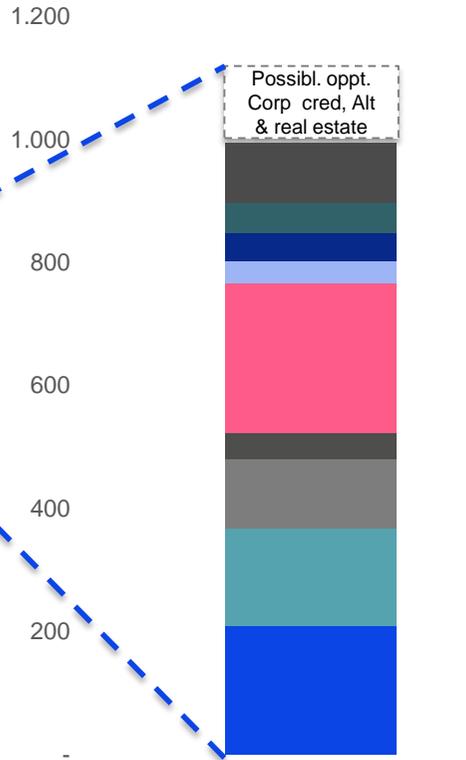
Private banking, institutional services, fund management and PF administration

**AUM: Commercial banks with management companies in Iceland (bn. ISK)**

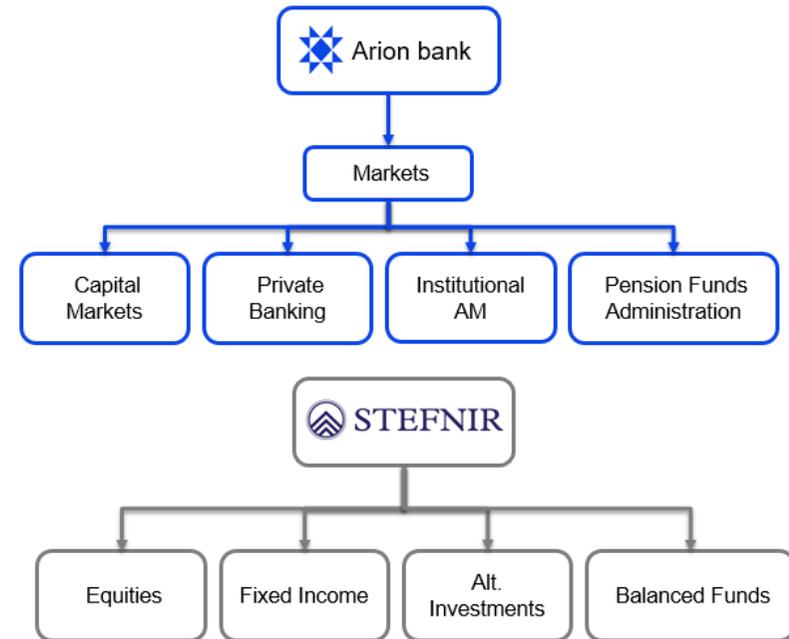


- Arion banki + Stefir
- Íslandsbanki + Íslandssjóðir\*
- Landsbankinn + Landsbréf
- Kvika banki and related parties
- ..... Linear (Arion banki + Stefir)

**AUM breakdown (bn. ISK)**



- Government
- Private credit
- Domestic EQ
- Foreign Bonds
- Foreign EQ
- Unlisted real est
- Unlisted Equity
- Unlisted credit
- Cash fx



# Market leader in digital banking

Launching 7 customers facing products in 2019

## 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**

**Debit cards**

**Savings account**

**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



# Sustainable and responsible banking

The dual listing has further supported the emphasis on ESG at the bank



## UN Principles for Responsible Banking (PRB)

- A founding signatory of the **UN PRB**
- Commitment to strategically align our business with the **Sustainable Development Goals** and the **Paris Agreement** on Climate Change



## 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



## Other commitments and certifications

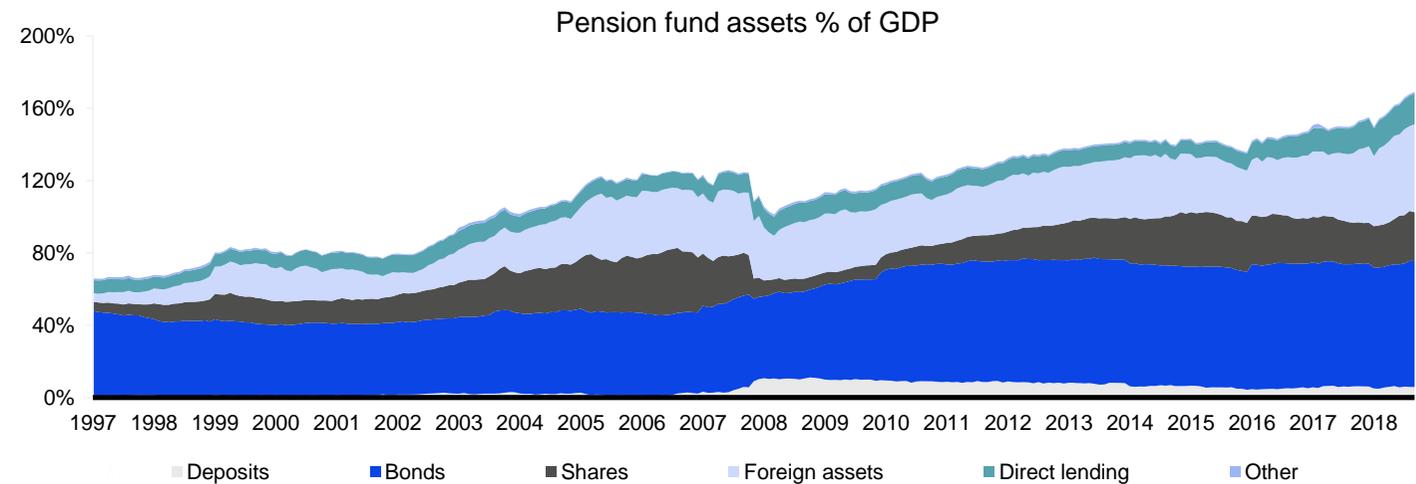
- Recognized as a company which has achieved **excellence in corporate governance** by the Center for Corporate Governance
- **Equal pay** certification by the labor union VR in 2015
- Awarded Ministry of Welfare's **equal pay symbol** in 2018



## A more disciplined capital allocation approach

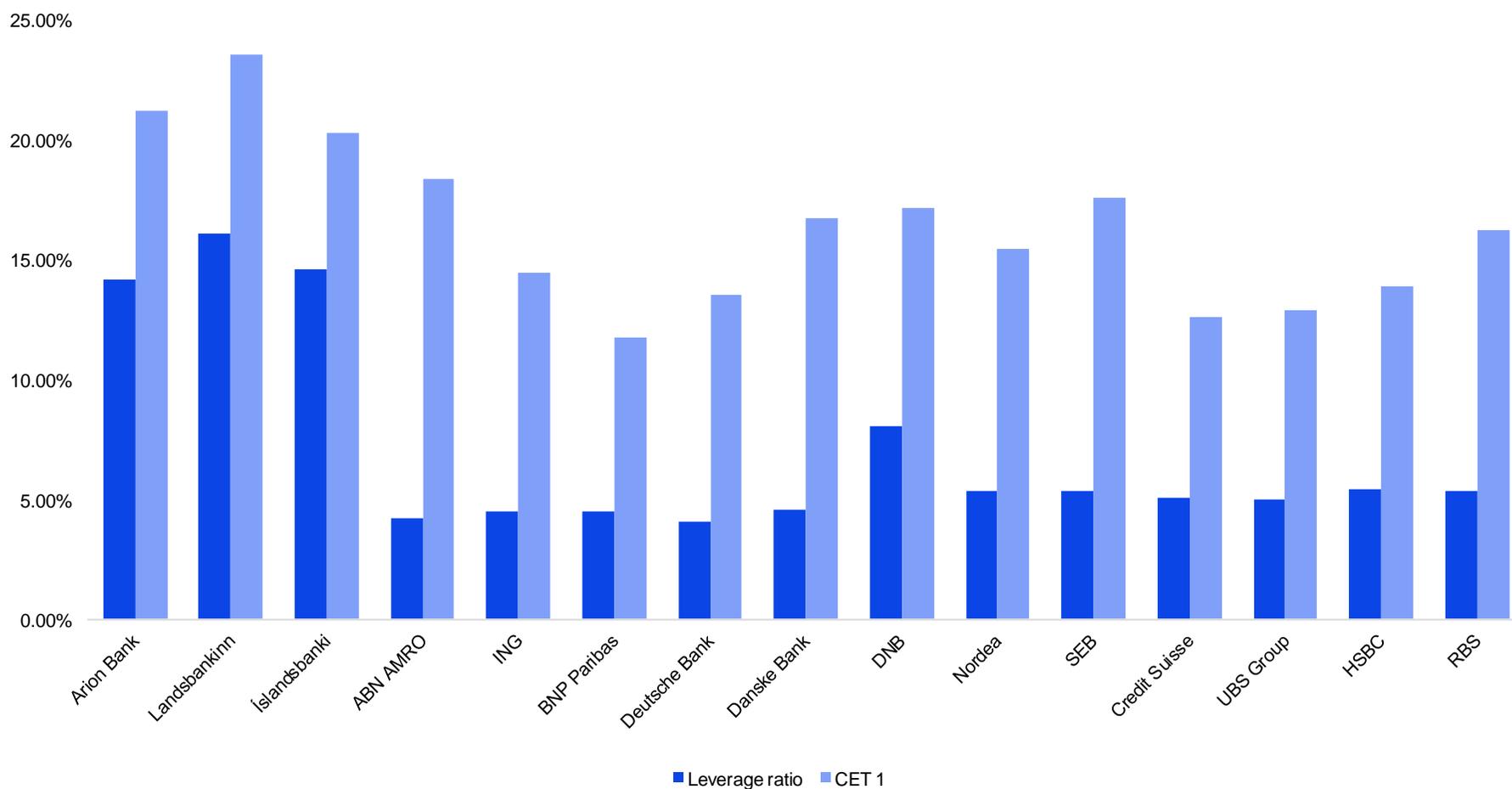
Capital requirements, taxation and growth of pension fund system a catalyst for co-investment strategy through syndication and intermediation

- SA risk weights and next to full utilization of capital buffers result in high capitalization requirements for banks in Iceland
- Specific bank taxes in Iceland are very high in international comparison
- Continued growth of pension fund system and increasing involvement in diverse asset classes
  - Hunt for yield likely to increase appetite for mortgages and corporate credit
- 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



# Capital requirements are high

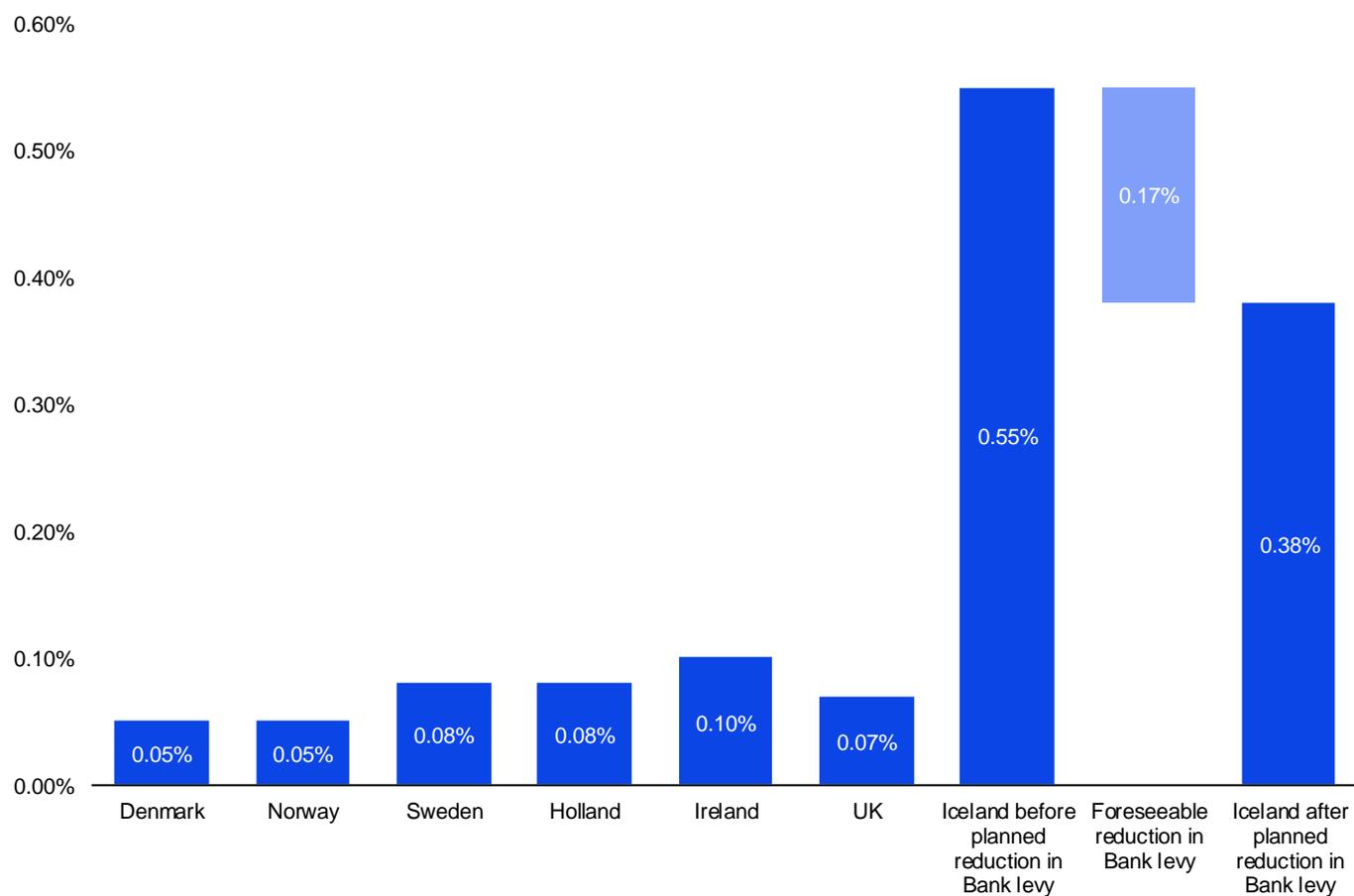
Icelandic banks apply the standardized approach to RWAs and capital buffers are almost in full force



# Taxation is also high

Bank levy increase was expected to be temporary but “temporary” can take a long time

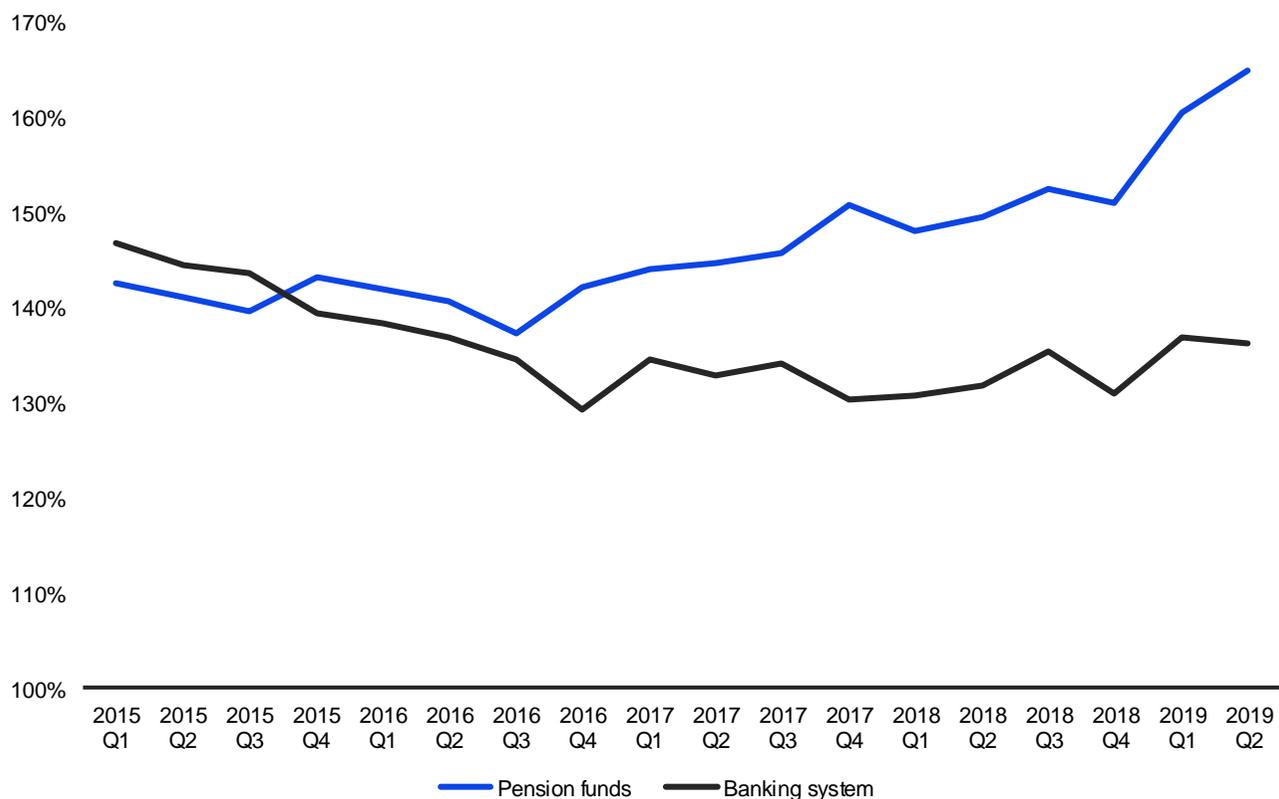
**Bank specific taxes and government charges on systematically important banks,  
% of average total assets** 2017 Figures



# National savings: now the largest balance sheet and growing quickly

Expanded by half of Arion Bank's total assets in H1 2019

## Pension funds and banking system, total assets, % of GDP



# Building long-term shareholder value

Customer focus with efficient use of capital

## Enhance operational efficiencies

- Cutting costs / improve margins
  - Leveraging partnerships for infrastructure costs
  - Leveraging partnerships in Fintech
- Digital solutions at the core of all activities
- Strengthen and build on existing competitive advantages
- Enhance product / client ownership and responsibility and improve cost transparency

## Reduce earnings volatility

- Long term client relationships and disciplined capital allocation
  - Increased co-investment strategy through syndication and intermediation
- Cut assets / products that have ongoing and foreseeable sub-par returns
- Building a winning team

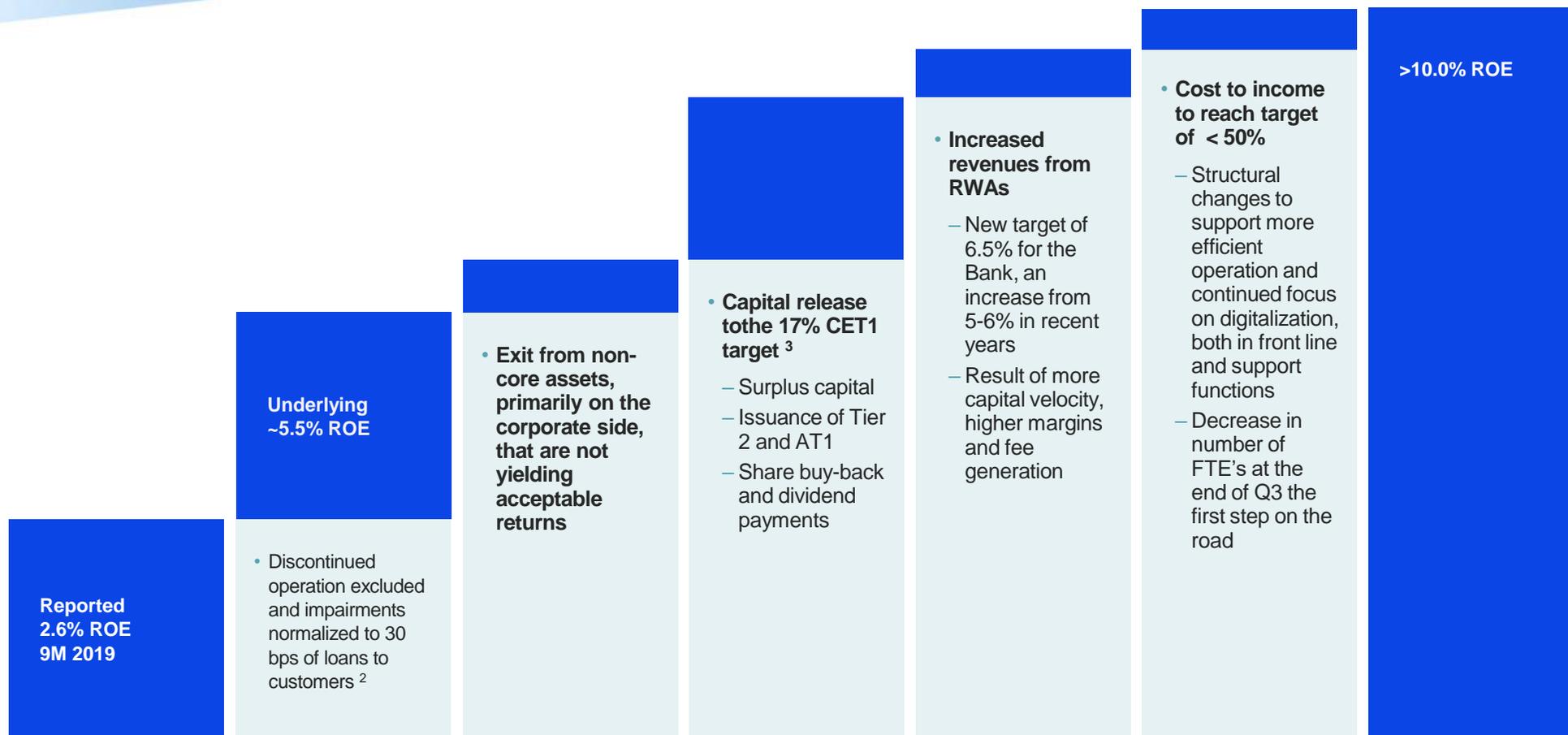
## Optimize capital structure and returns

- Group capital and funding optimization
  - Share buy-back program
- Increase capital turnover
- Disciplined capital allocation towards higher ROE / growth products & clients



# The road to sustainable +10% ROE <sup>1</sup>

Release of CET1 plays a fundamental role



# Key takeaways

Higher profitability in a more challenging interest rate environment



Arion Bank is operating in a strong and healthy economy



Arion Bank operates a diversified business model and enjoys strong market position



Arion Bank is adopting a more disciplined capital allocation approach to increase ROE



Arion Bank is in a position to continue to release surplus capital to its shareholders





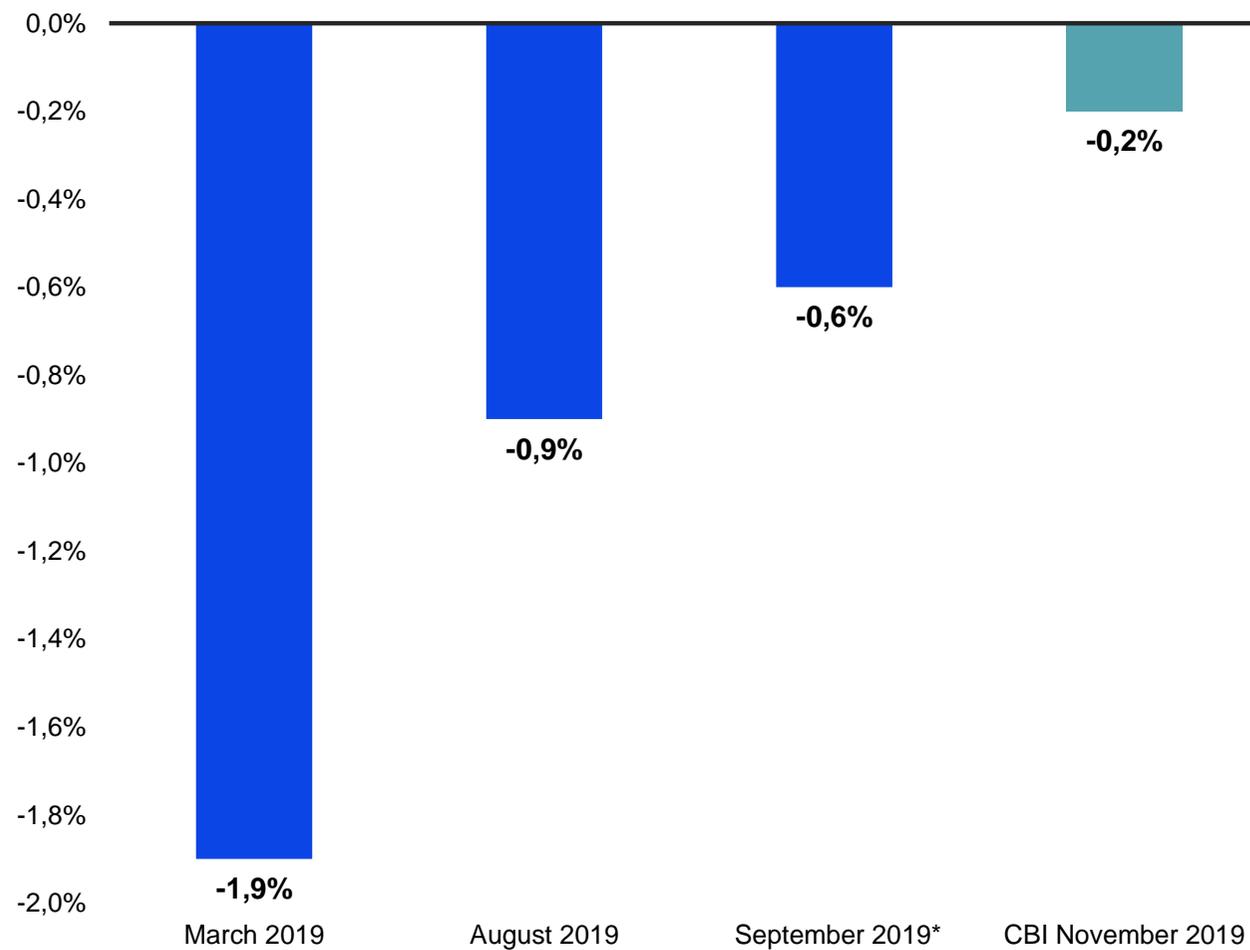
# Soft Landing, Slow Takeoff

Erna Björg Sverrisdóttir  
Chief Economist

## The missing recession?

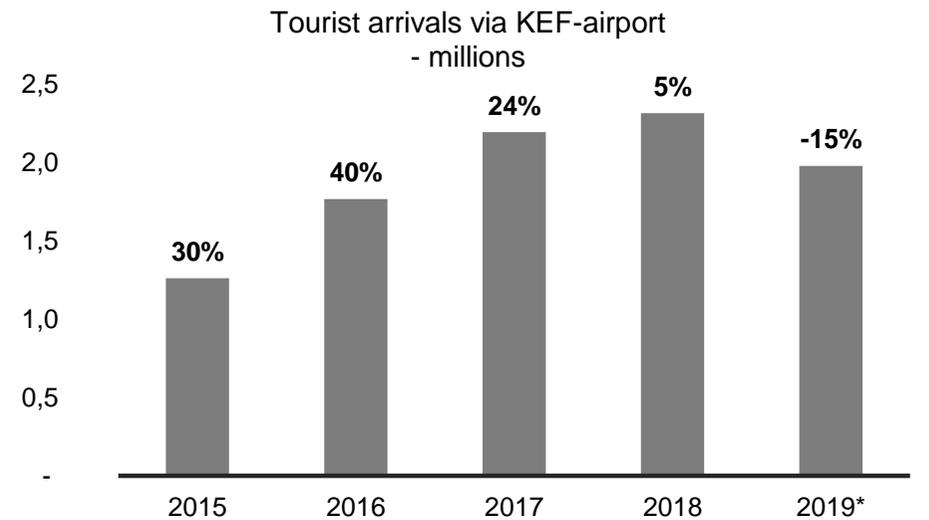
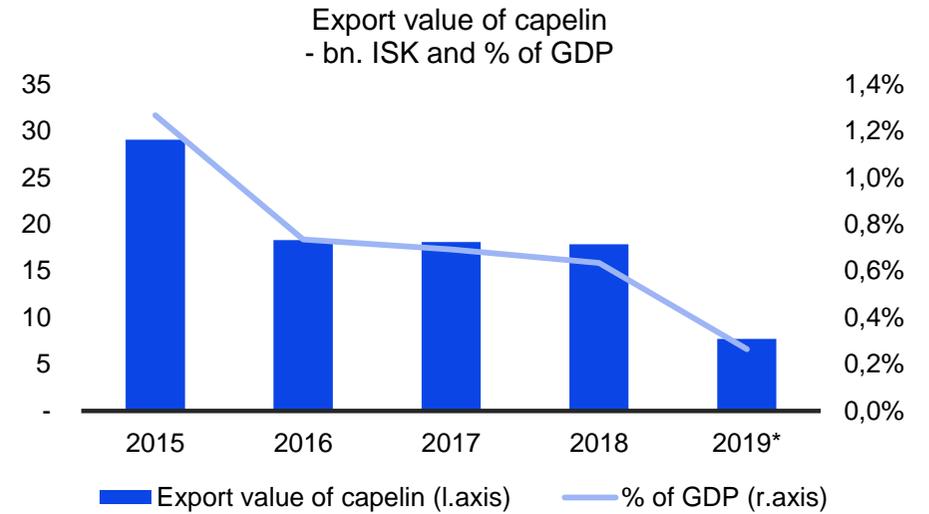
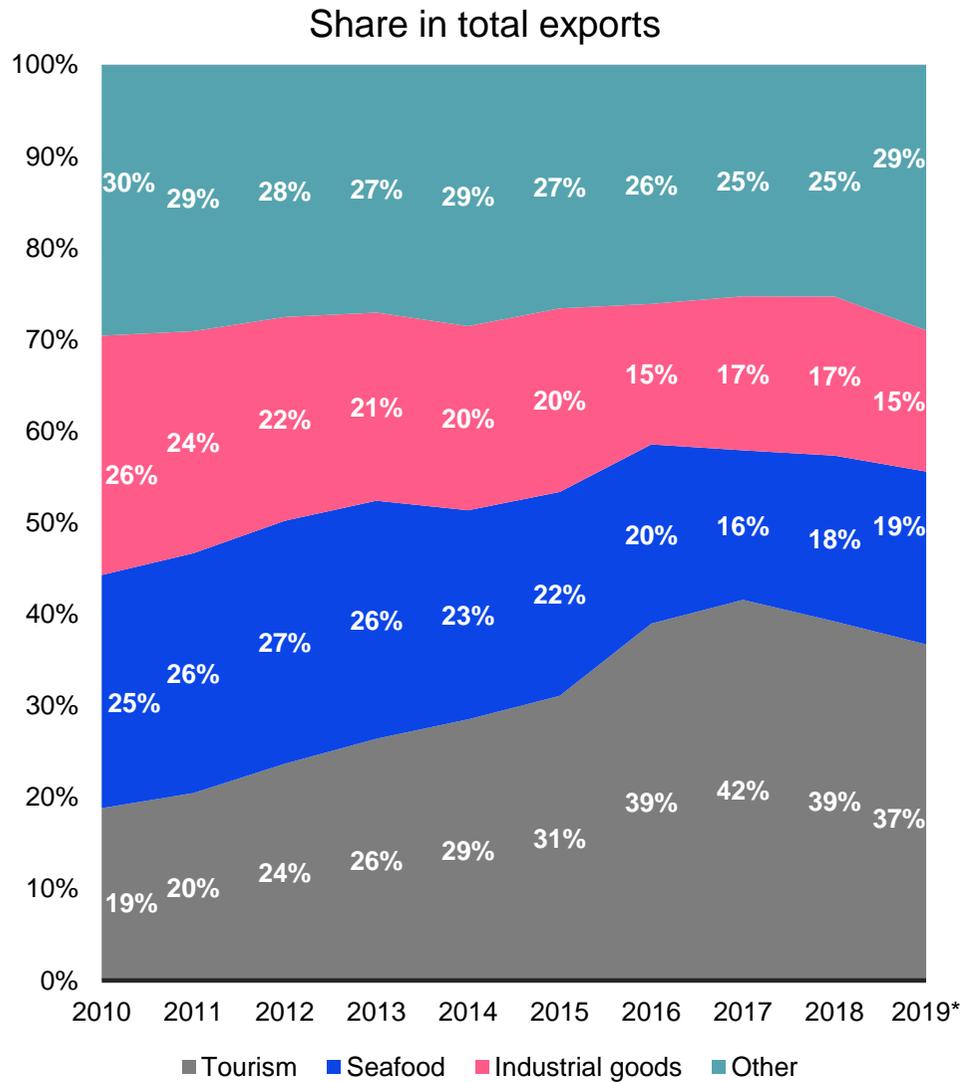
According to the latest forecast from the CBI, published in the beginning of November, GDP will contract by only 0.2% this year.

Arion Bank's forecast for GDP growth in **2019**



# Export sectors are resilient against headwinds

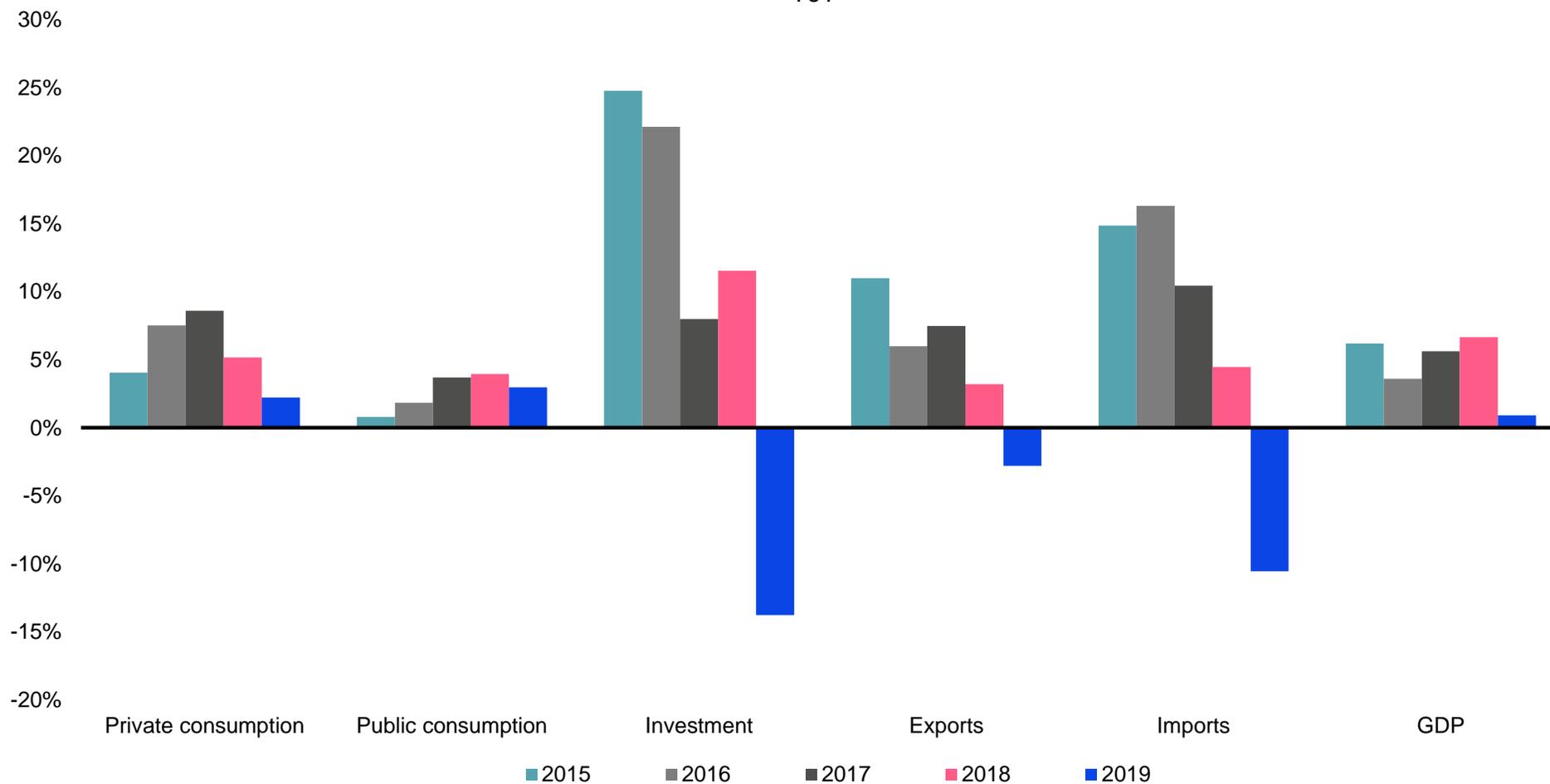
Together tourism, seafood and aluminum account for over 70% of total export revenues of the Icelandic economy



# 0.9% GDP growth in 1H

Stronger GDP figures result of weaker imports than expected

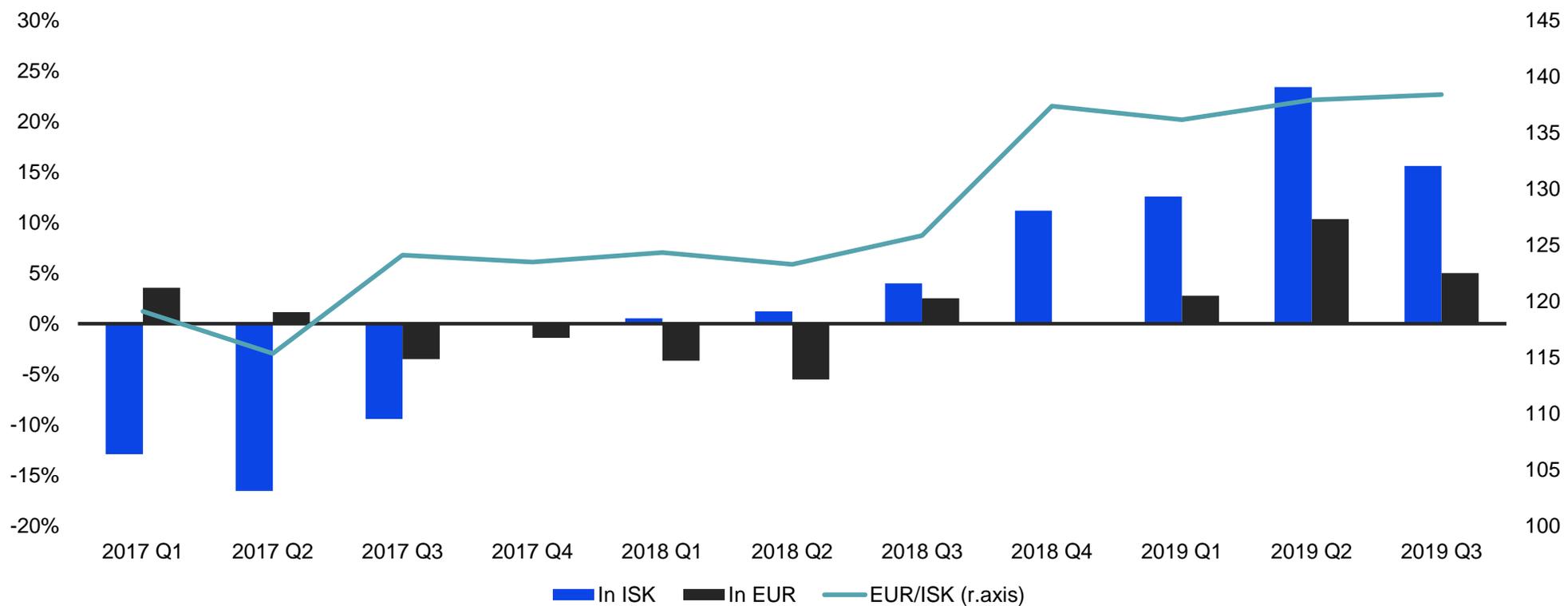
### GDP growth in the first six months of each year - YoY



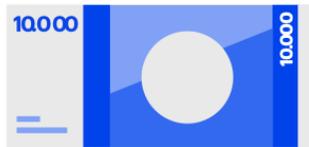
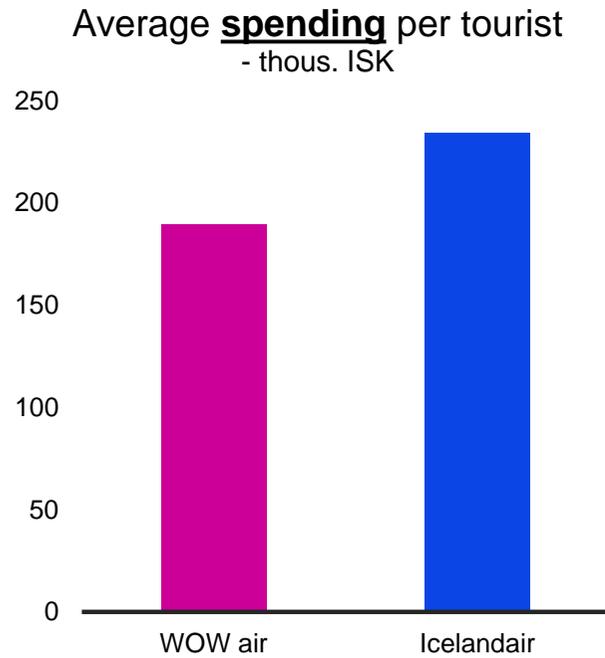
# Icelandic tourism has risen to the challenge

Each tourist is spending more than before, softening the economic blow of WOW air's bankruptcy

Foreign payment card turnover **per tourist**  
- YoY %-change

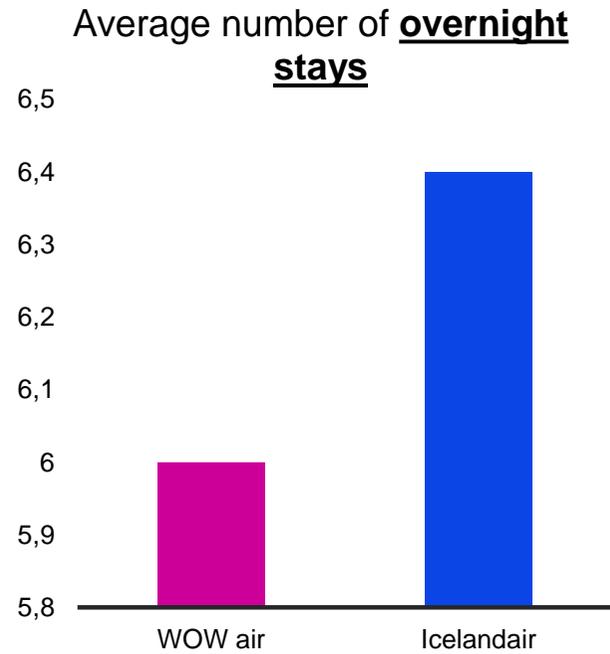


# Wooing the high-yield tourist



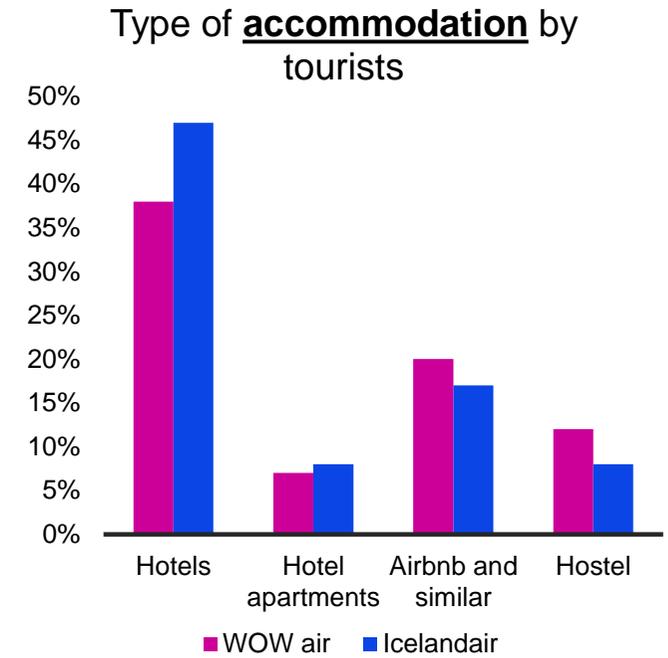
**19%**

Increase in spending per tourist in ISK  
April – September, YoY change



**17%**

Increase in duration of stay  
April – September, YoY change



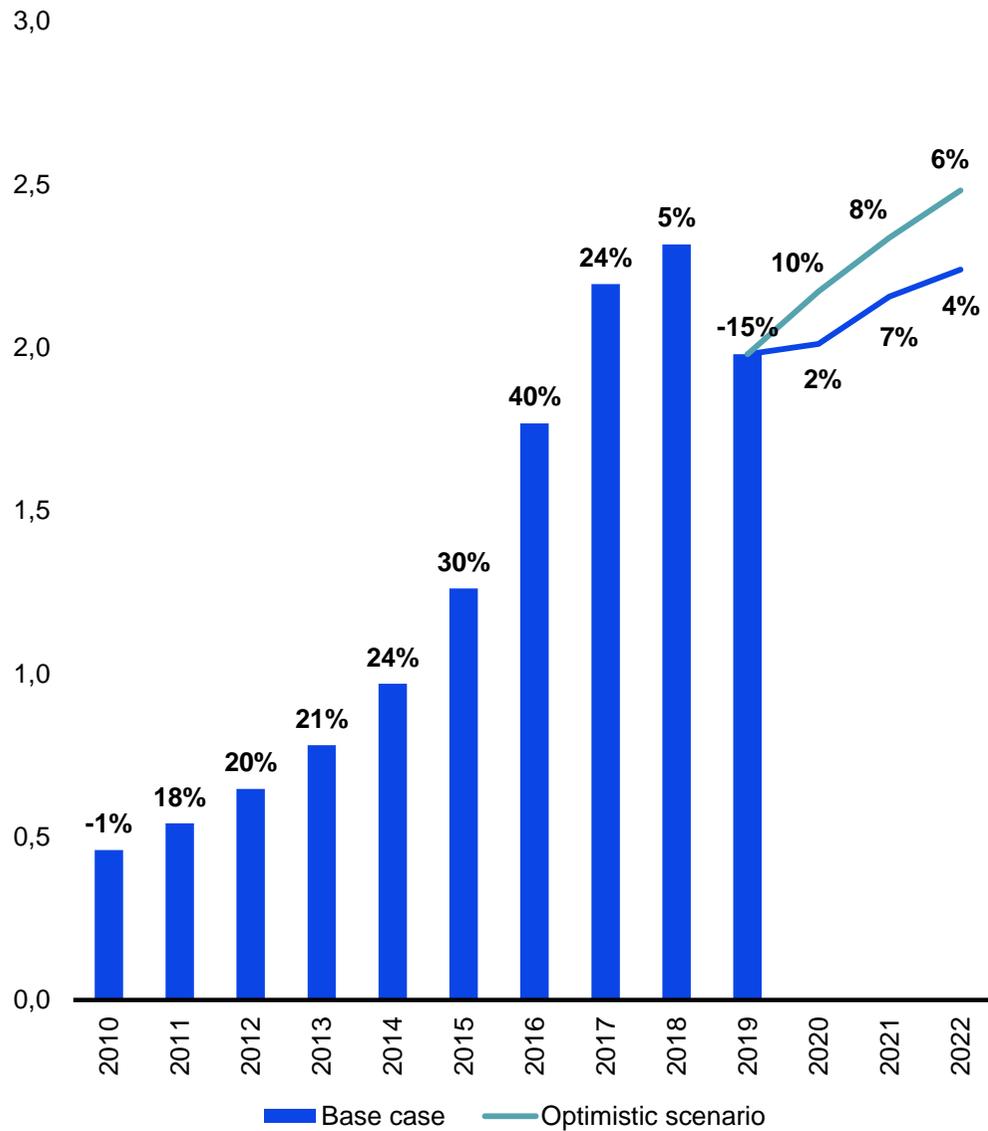
**22%**

Increase in overnight hotel stays per tourist  
April – September, YoY change

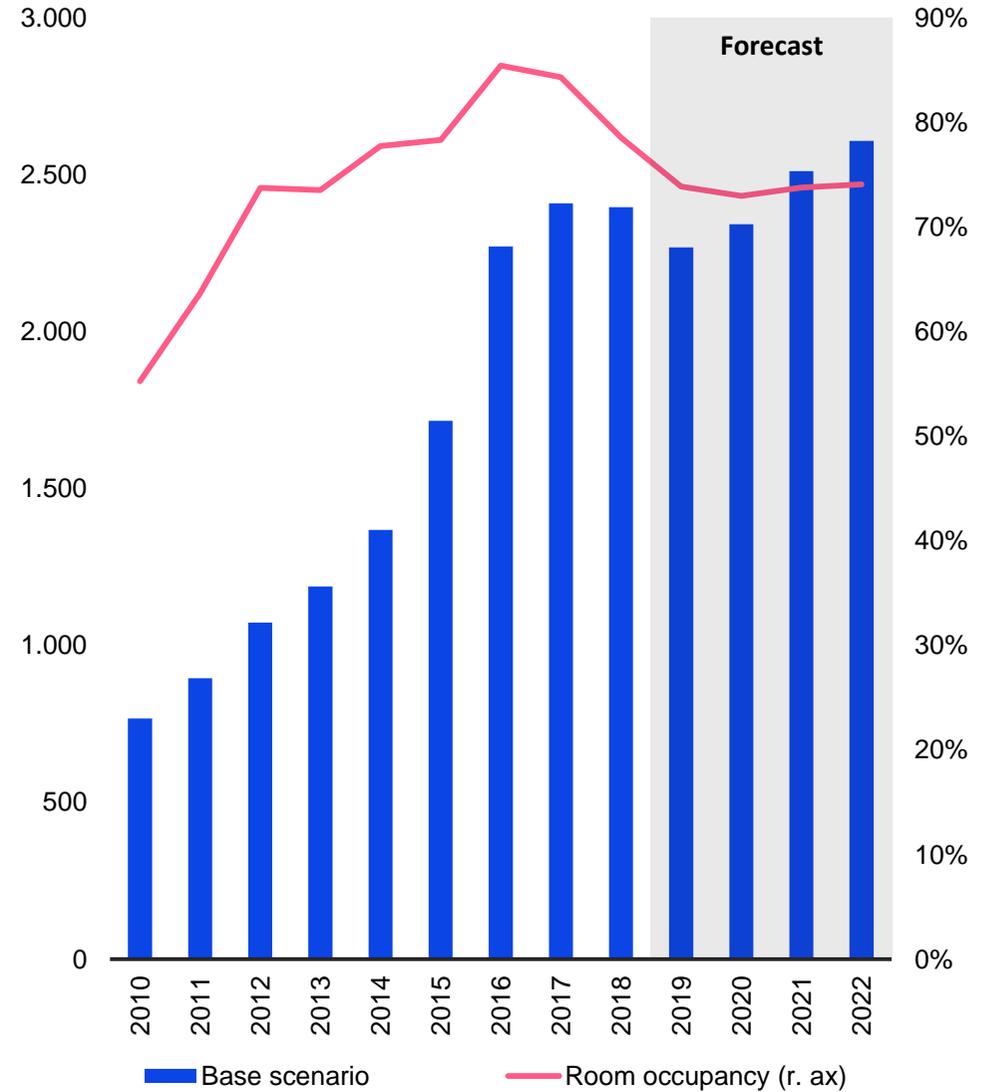


# Modest angle of attack

Tourist arrivals via KEF airport  
- Arion Bank's forecast, millions annually, % increase

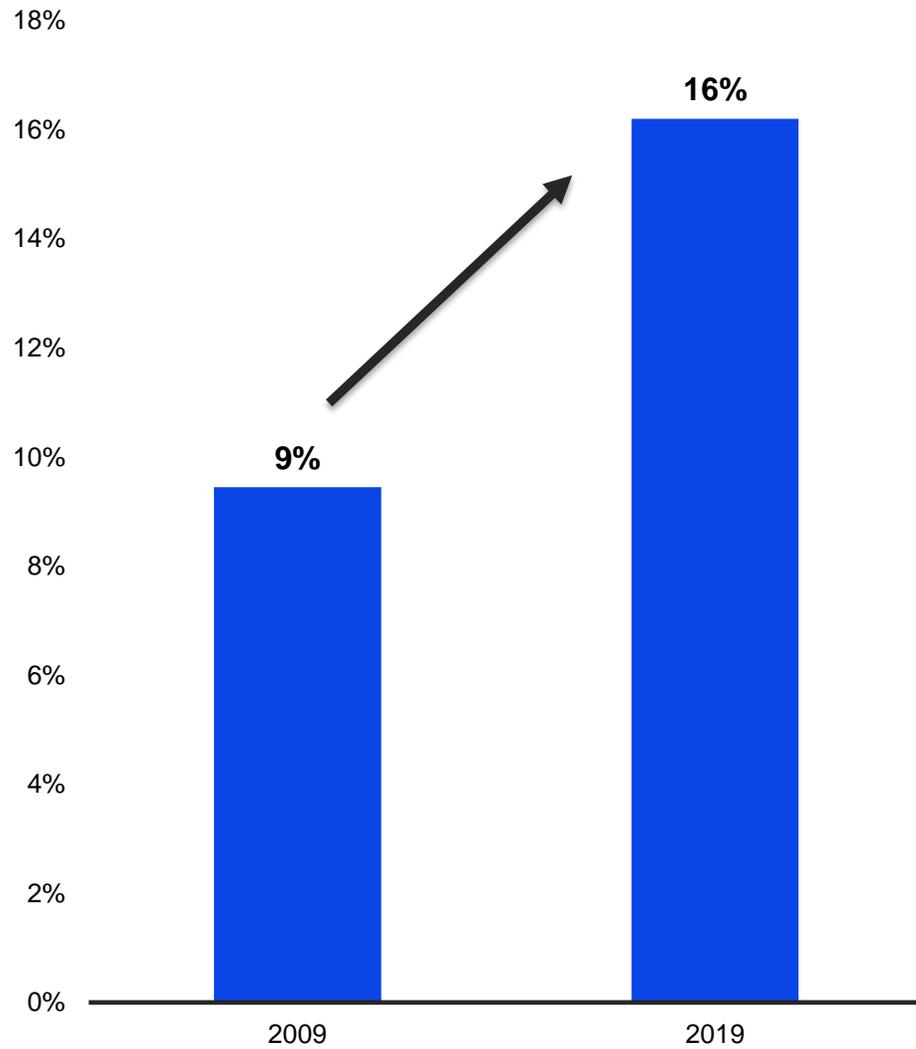


Overnight hotel stays and occupancy in the capital area  
- Arion Bank's forecast, thousands

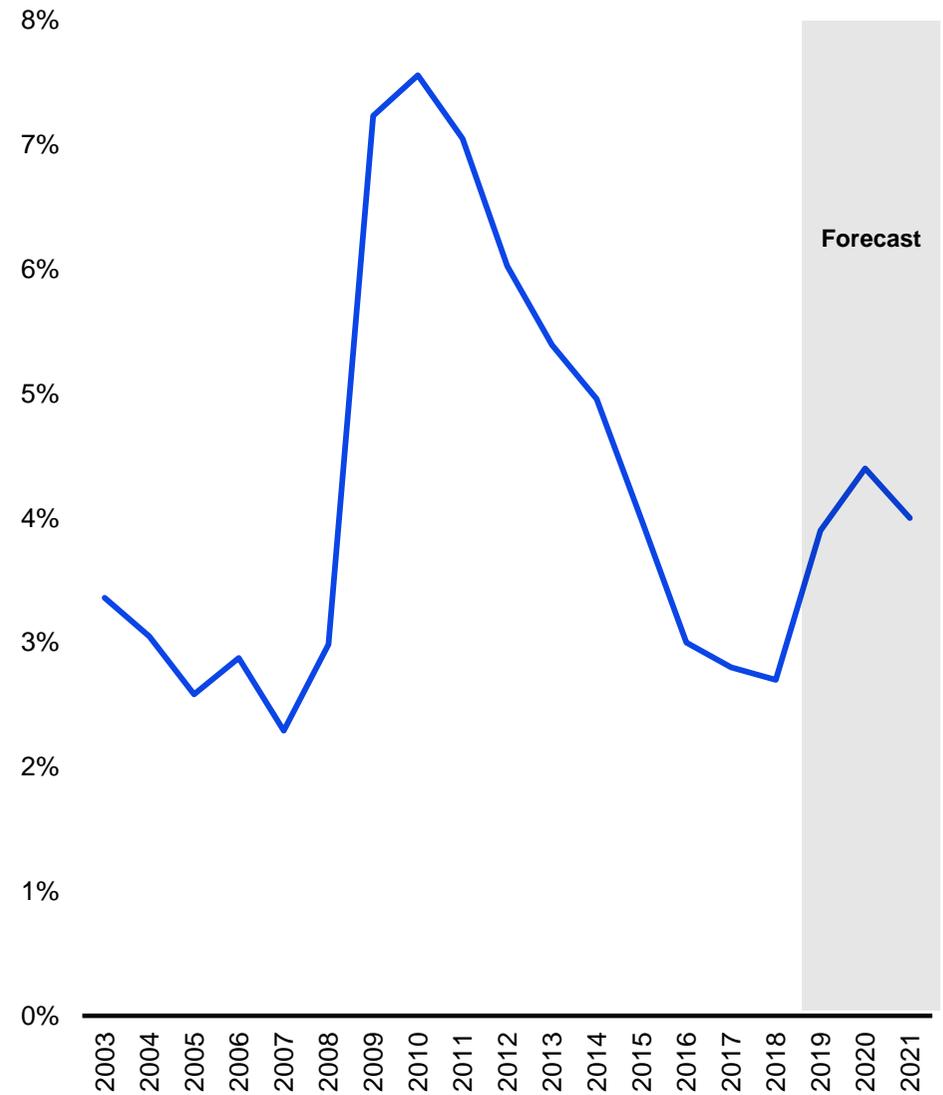


# The resilience of tourism has cushioned the blow to the labor market

Register based employment in tourism industries  
- % of total in employment



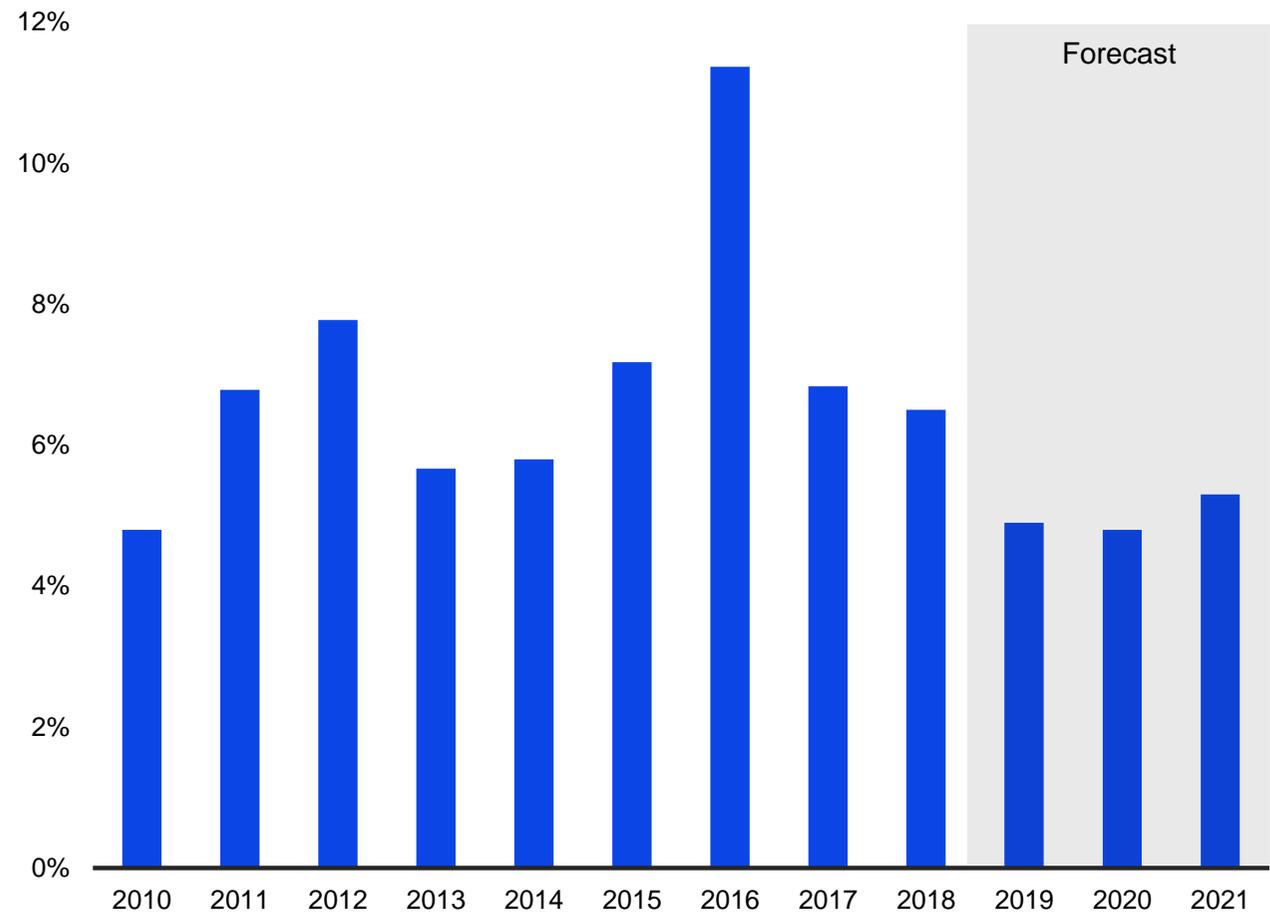
Unemployment rate  
- Arion Bank's forecast



## Moderate wage increases... in Iceland?!

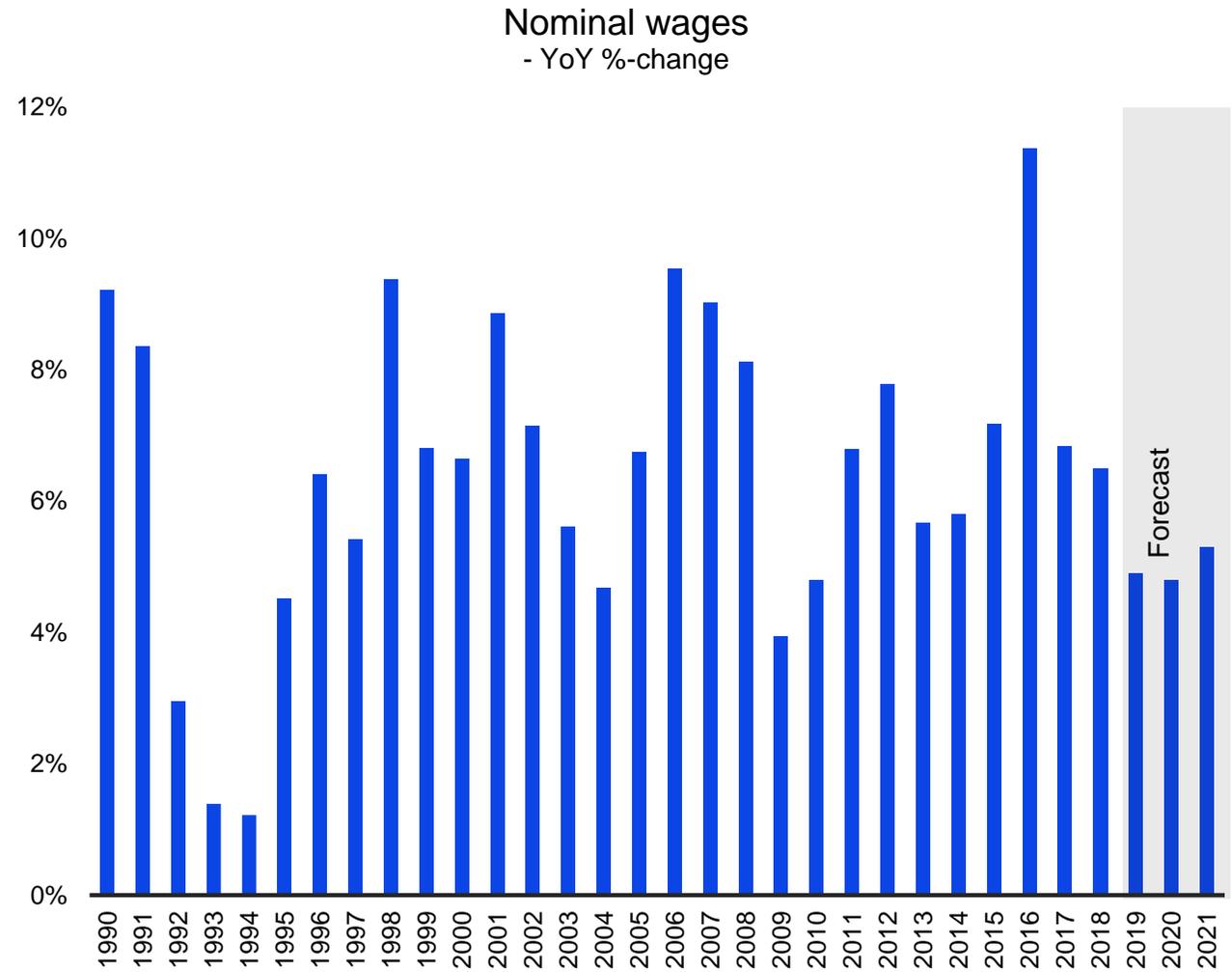
Iceland has been known for hefty wage increases

Nominal wages  
- Arion Bank's forecast, YoY %-change



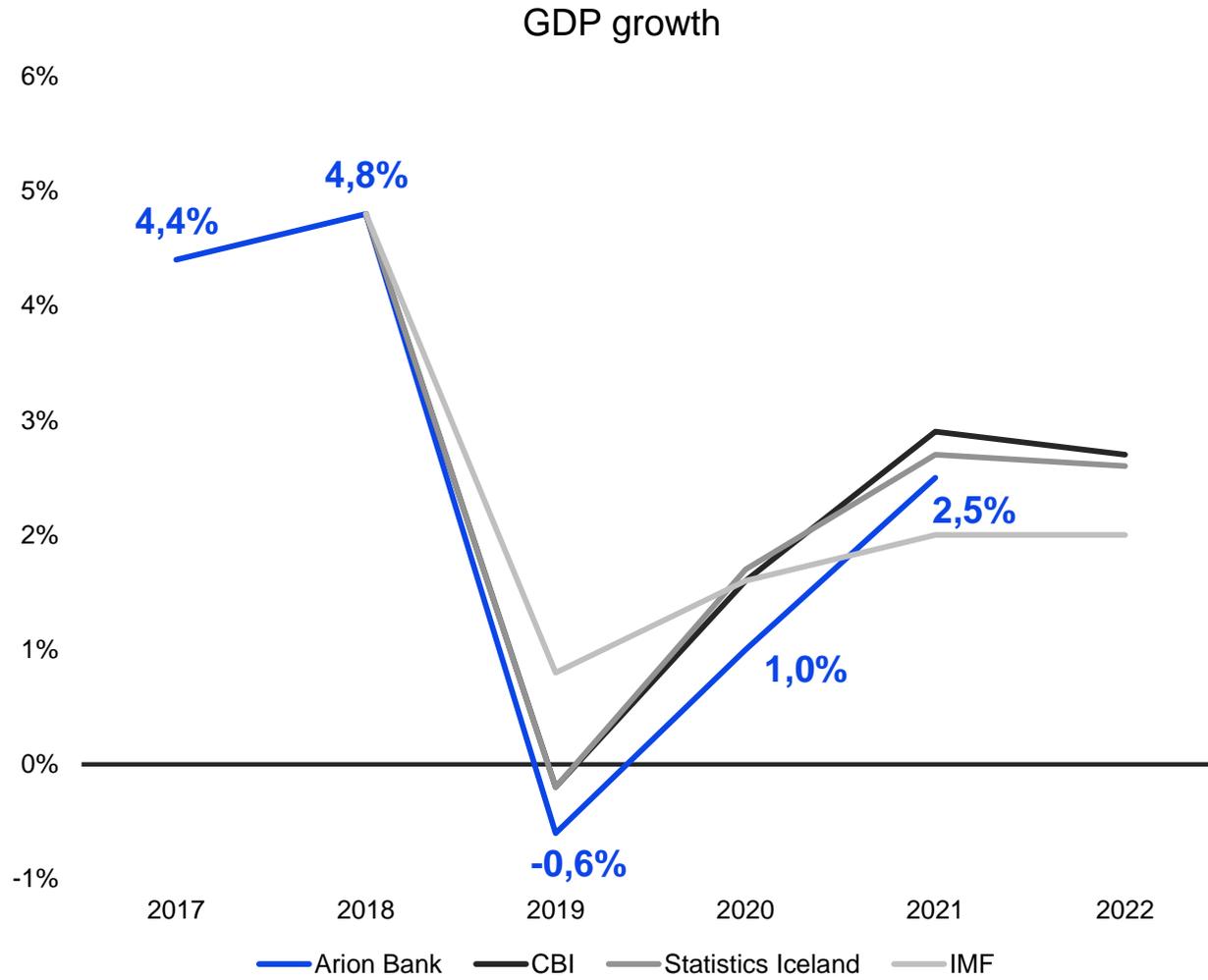
## Moderate wage increases... in Iceland?!

Iceland has been known for hefty wage increases. Average annual wage increases have been around 6.5%.



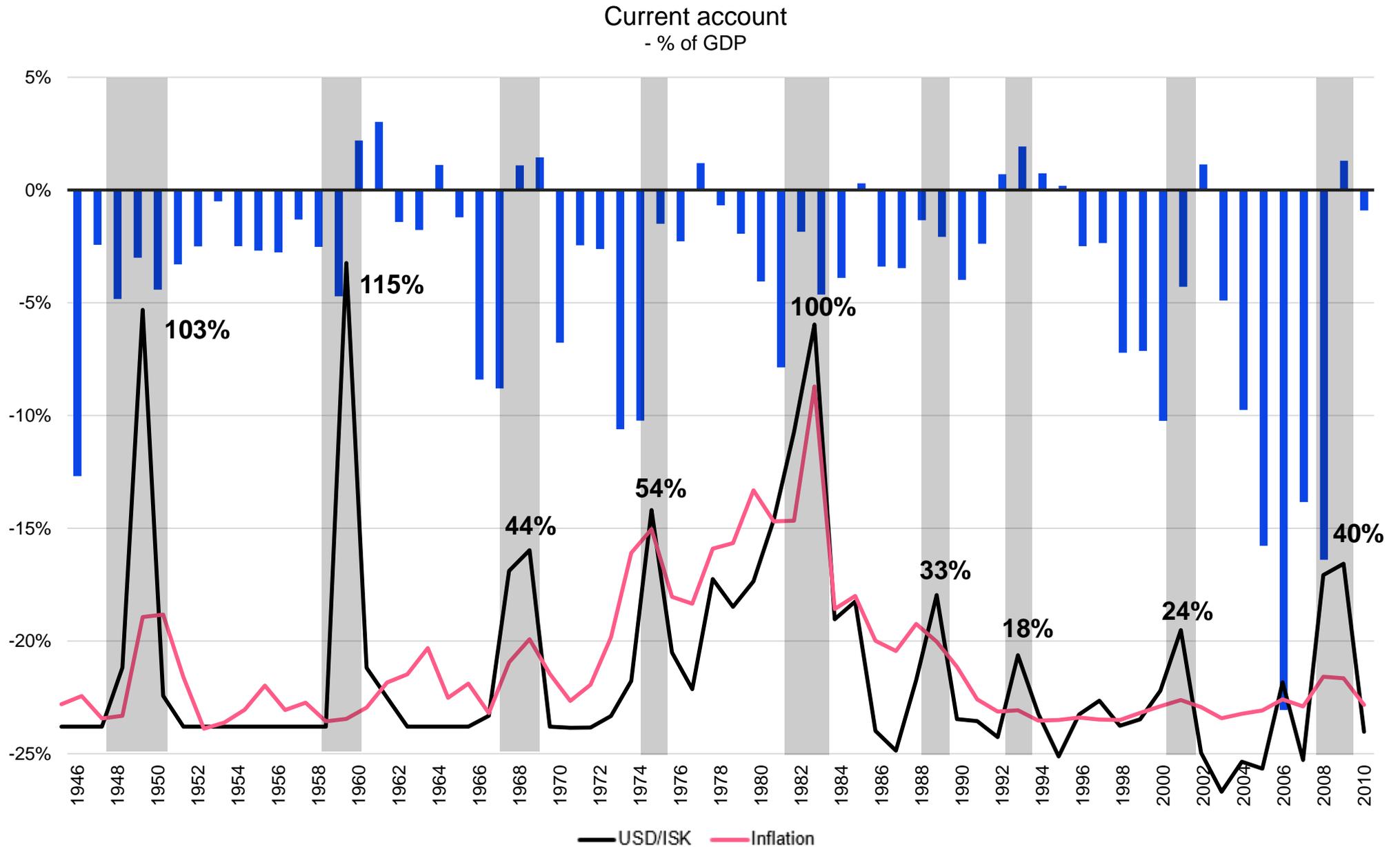
# The desirable soft landing within reach?

Analyst expect the recession to be short lived, followed by a gradual turnaround



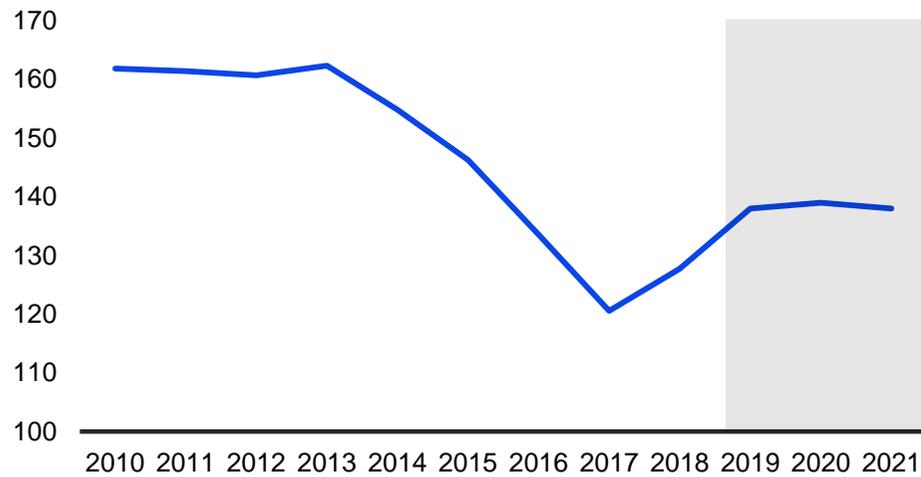
# That's so Iceland!

The ISK has been used as a reset button in the past.

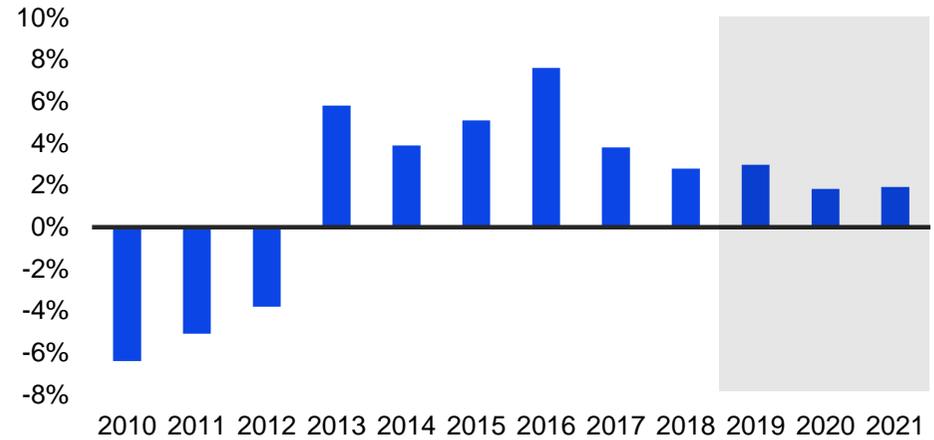


# Setting the stage for a more stable ISK

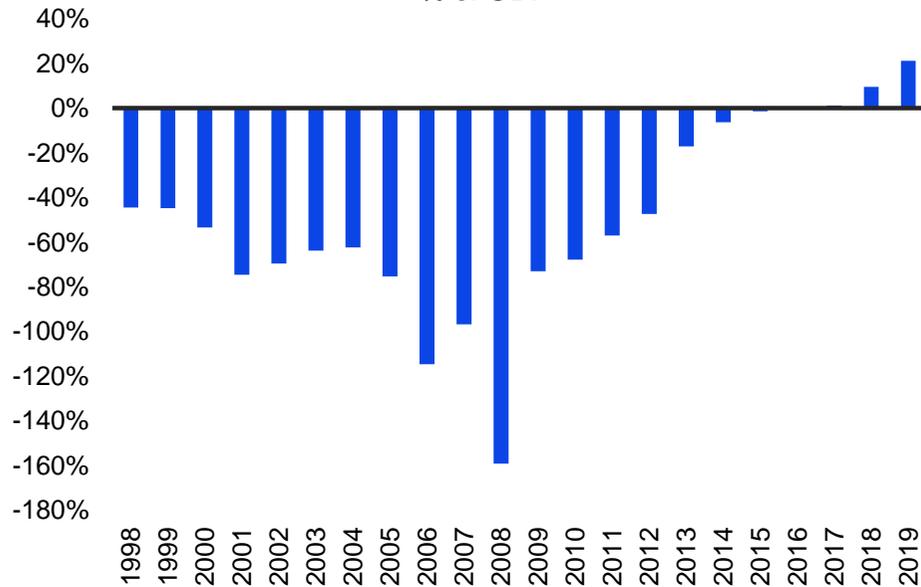
## EUR/ISK



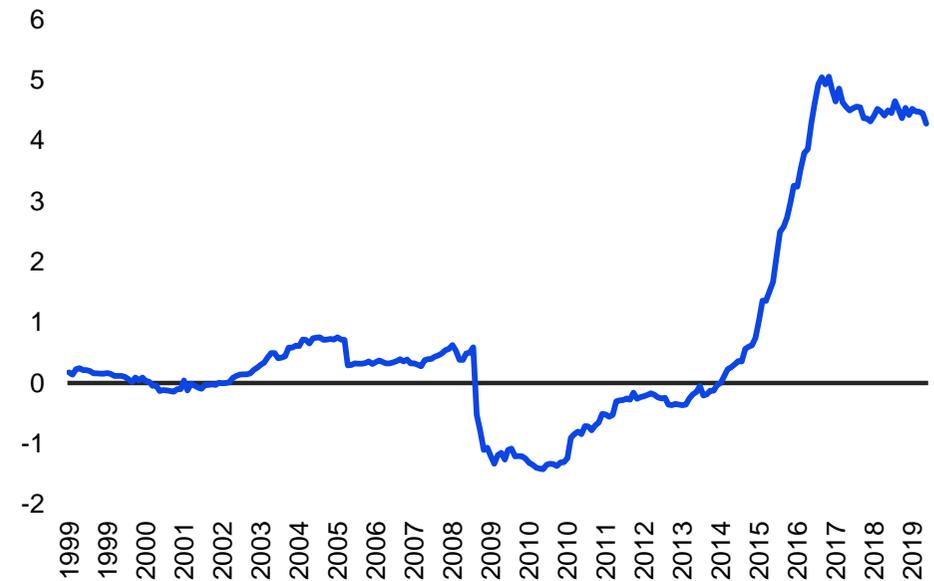
## Current account\* - % of GDP



## Net IIP\*\* - % of GDP

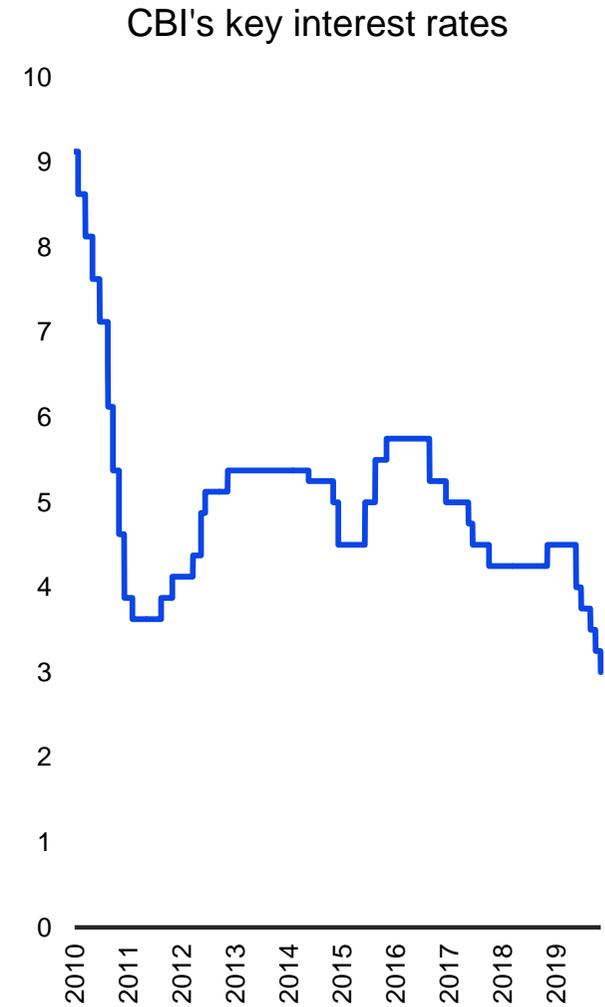
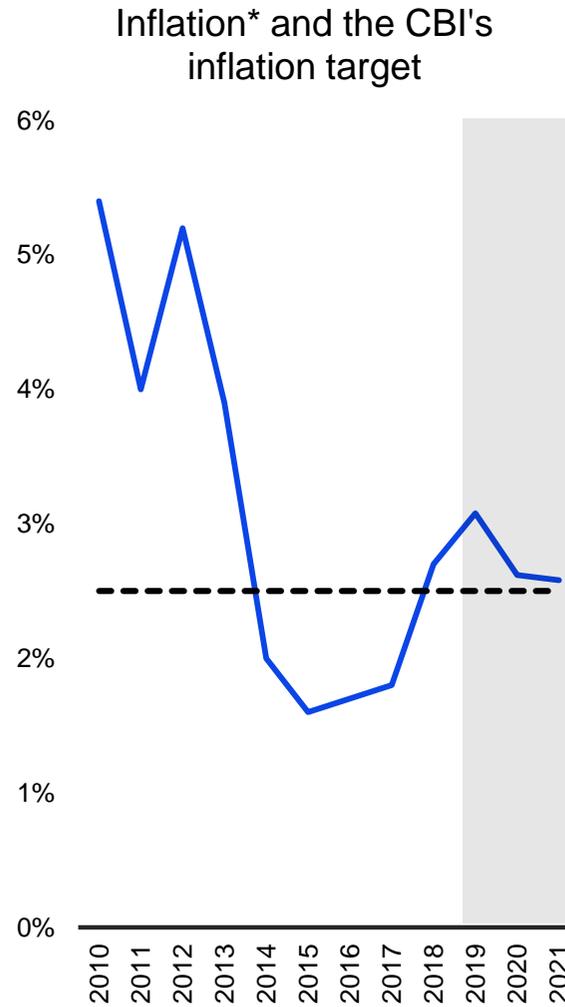


## CBI's FX net reserves - bn. EUR



# Are we breaking the mold?

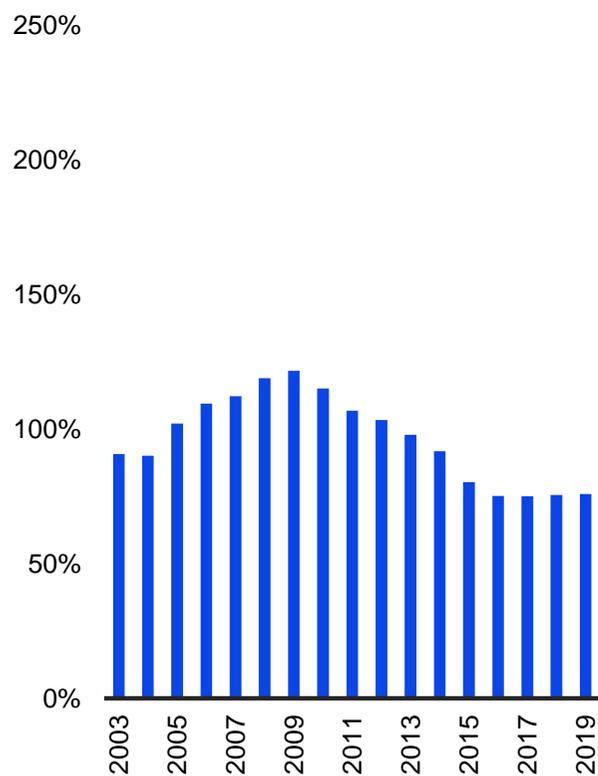
Low inflation, interest rate cuts and adjustment through the labor market, not the typical Icelandic way



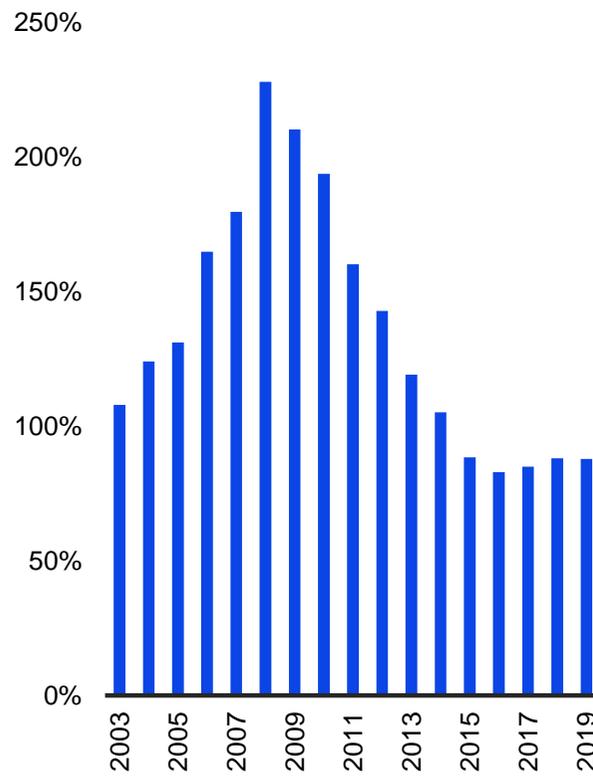
# Well equipped to handle the turn of the tide

The GDP growth has been export driven

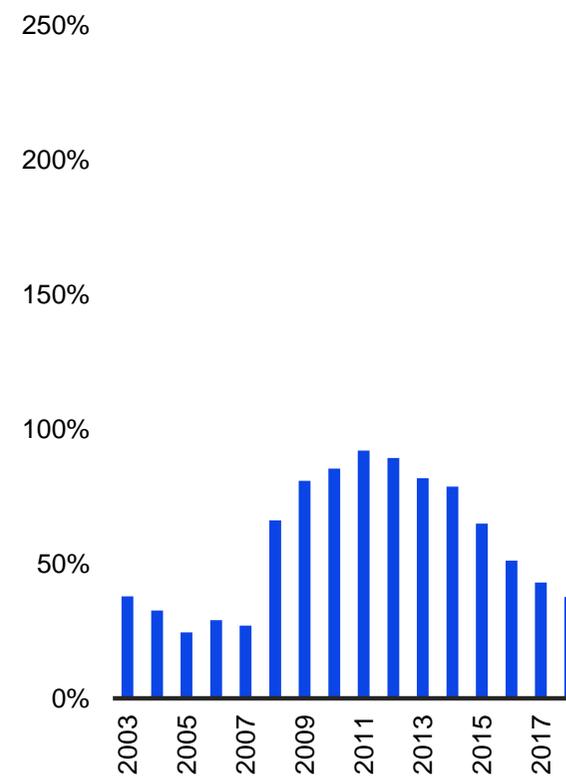
### Household debt - % of GDP



### Non-financial corporate debt - % of GDP



### General government debt - % of GDP





# CIB – Relationships and RWAs

Asgeir Reykford Gylfason – Deputy CEO and  
MD of Corporate and Investment banking

# At Corporate Banking we are changing course



After a **period where the emphasis was on loan growth**, partly at the expense of pricing, sector split and composition of the loan book, **we are changing course**.



**We have reviewed our corporate loan book and formed an opinion** on where we want to position ourselves, both within industries and size of companies.



**Our focus is clear** - addressing mispricing within the loan book. We will increase our ROE with margin adjustments, repayments of certain exposures or placements where exposures, which do not fit our portfolio vision, will be sold to a third party or refinanced through bond issuance.



## Arion Bank has already begun with the HFF transaction



Following the Q2 results, Arion Bank announced an agreement to sell to the Housing Financing Fund (HFF) a **mortgage loan portfolio in the amount of ISK 48 bn.**



The agreement has a **positive impact** due to the realization of interest discounts, lower funding costs and lower bank tax.



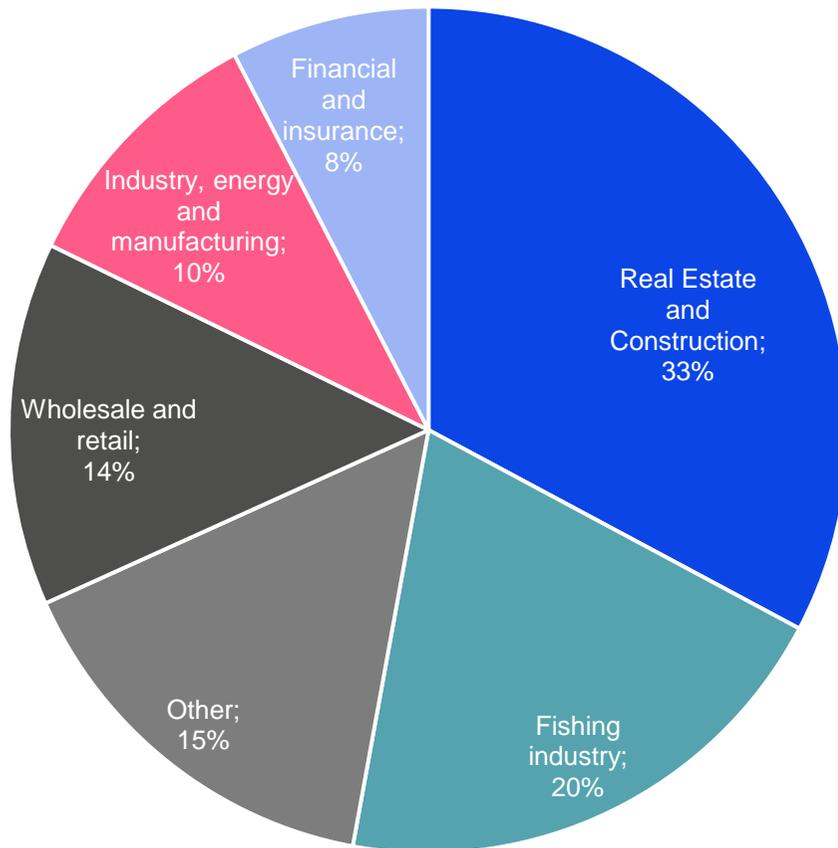
**The transaction released ISK 16 bn. of RWAs** (2% of total) and ISK 3.5 bn. of regulatory capital, which can be re-deployed to other profitable business and/or distributed to shareholders



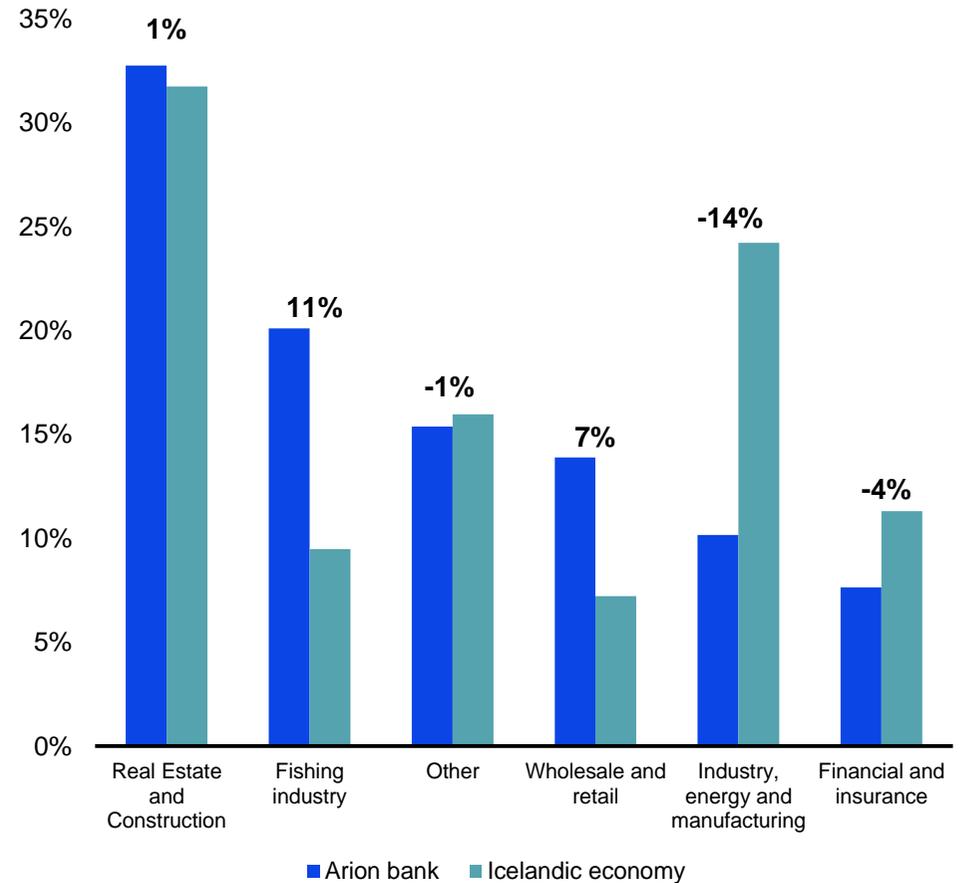
# Our corporate portfolio shows similarities to the Icelandic economy

Relative to the Icelandic economy, our book is overweighted in fisheries and wholesale and retail, but underweighted in industry, energy and manufacturing. However, debt related to the energy industry in particular is to a large extent listed both domestically and internationally.

Corporate portfolio – as of 30.9.2019



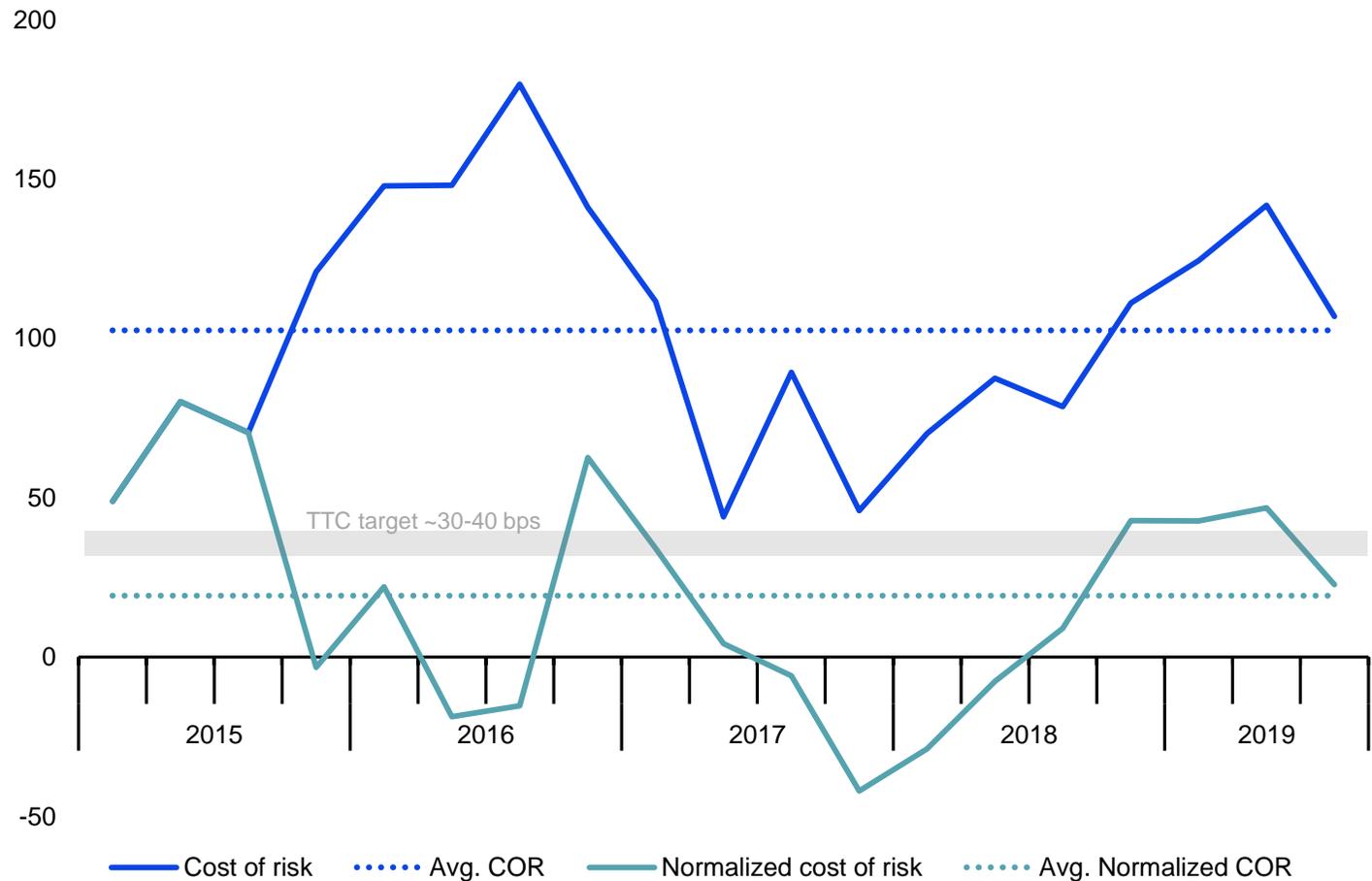
Arion Bank's corporate loan portfolio vs. Icelandic economy's debt\* – by sectors, data labels indicate over/underweight



# Four large impairments significantly color Corporate Banking's historic cost of risk

- The corporate loan book has taken four large hits in recent years: a offshore services company, two airlines and United Silicon.
- If the above impairments had not occurred, and for demonstration purposes only, the average cost of risk would have been approximately 80 bps. lower during the period
- With more diversity, reduced concentration within individual sectors, more accountability and asset-backed loans we will see the cost of risk reduced to more normalized levels in the future.

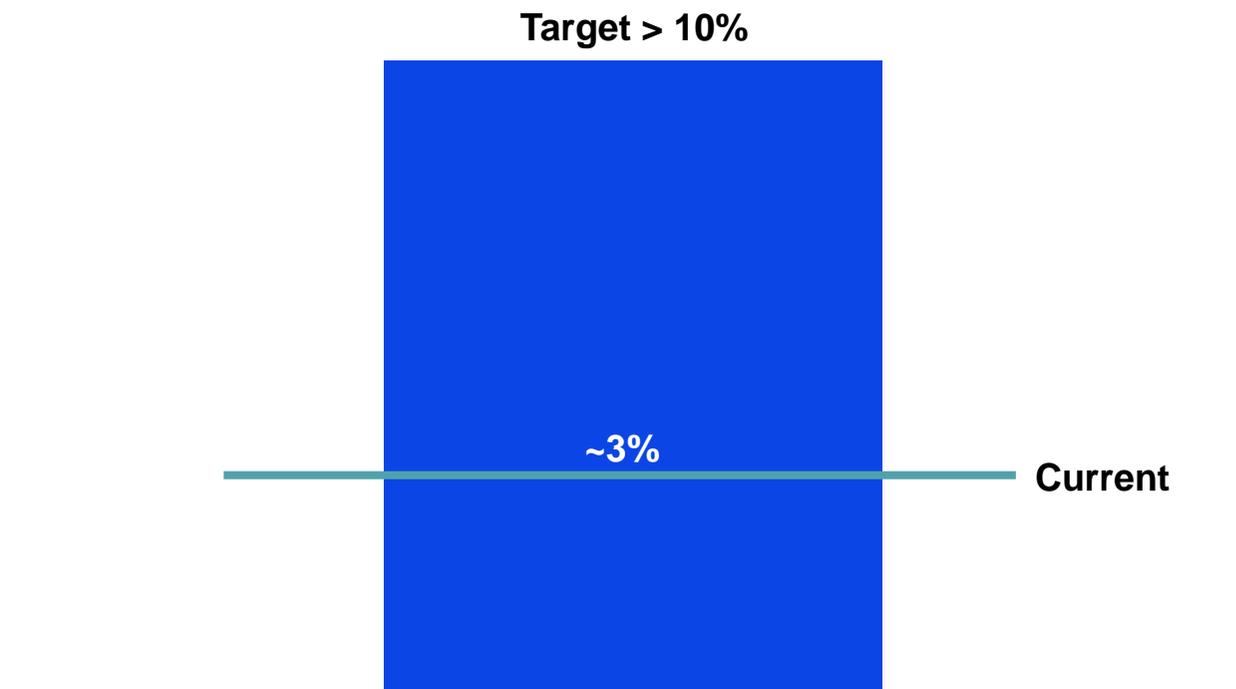
Corporate Banking cost of risk – in bps.



# Corporate Banking's ROE is not acceptable

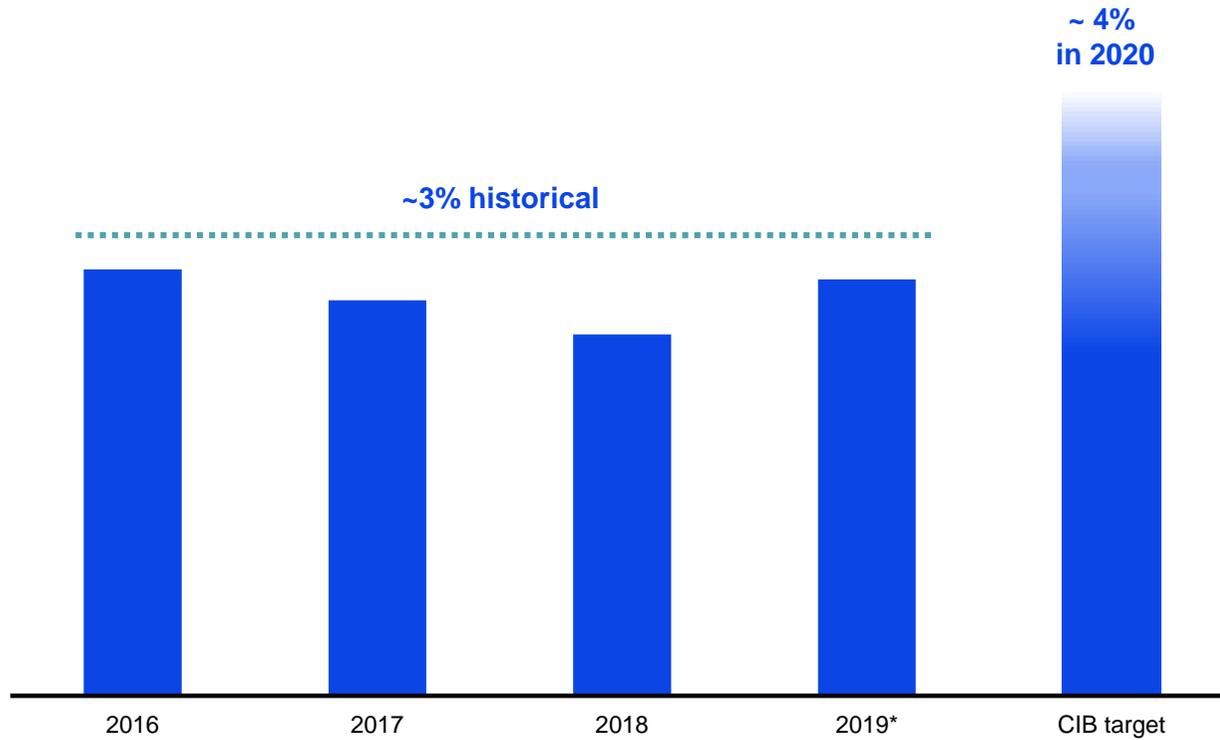
Our task ahead is to get ROE to 10% or higher

- We will be in direct contact with approximately 50% of our loan book in the next two years
- Clear focus on addressing mispricing
- With strong view on sectors, projects, margins and duration we are determined to get ROE to >10% target
- We want to syndicate certain risks, which are capital intensive, but fit with the investment mandate of institutional investors
- Syndication will lead to higher returns on certain projects within Corporate Banking



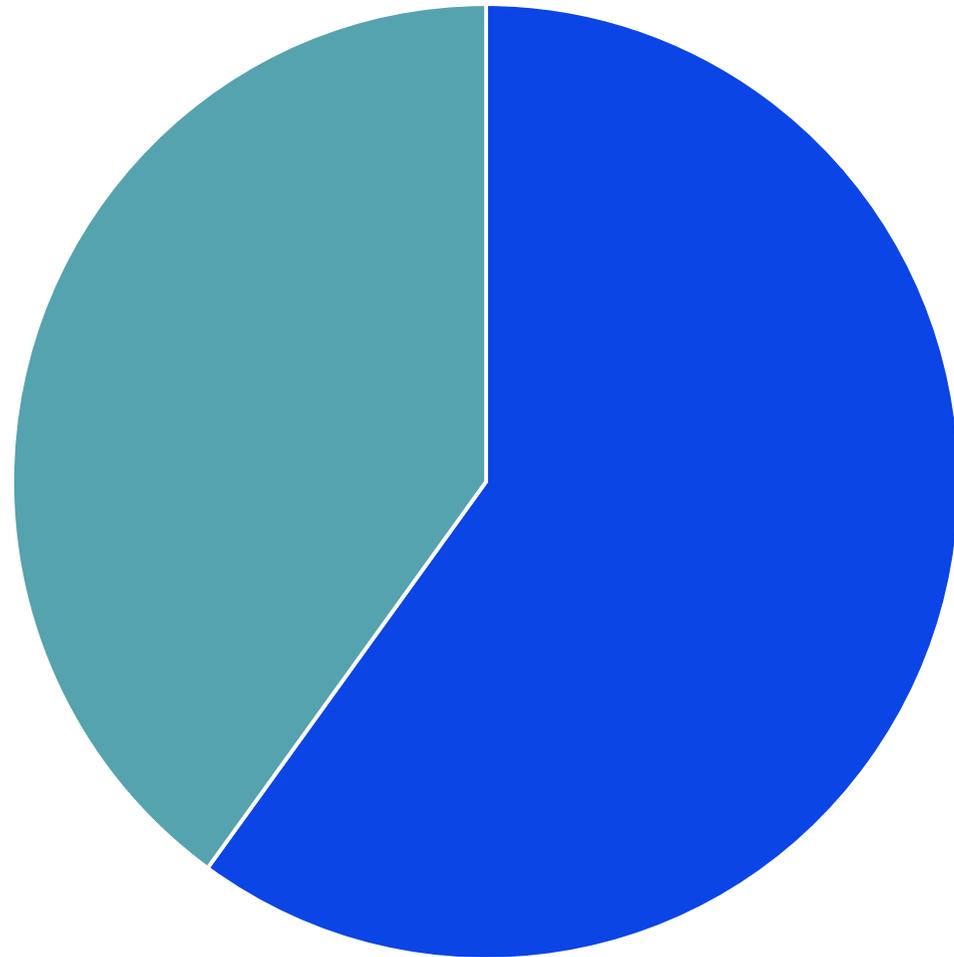
# By increasing our multi-product clients, we will contribute more towards the bank's Revenue / RWA target

## Revenues / RWA – Corporate & Investment Banking and Arion Bank's target

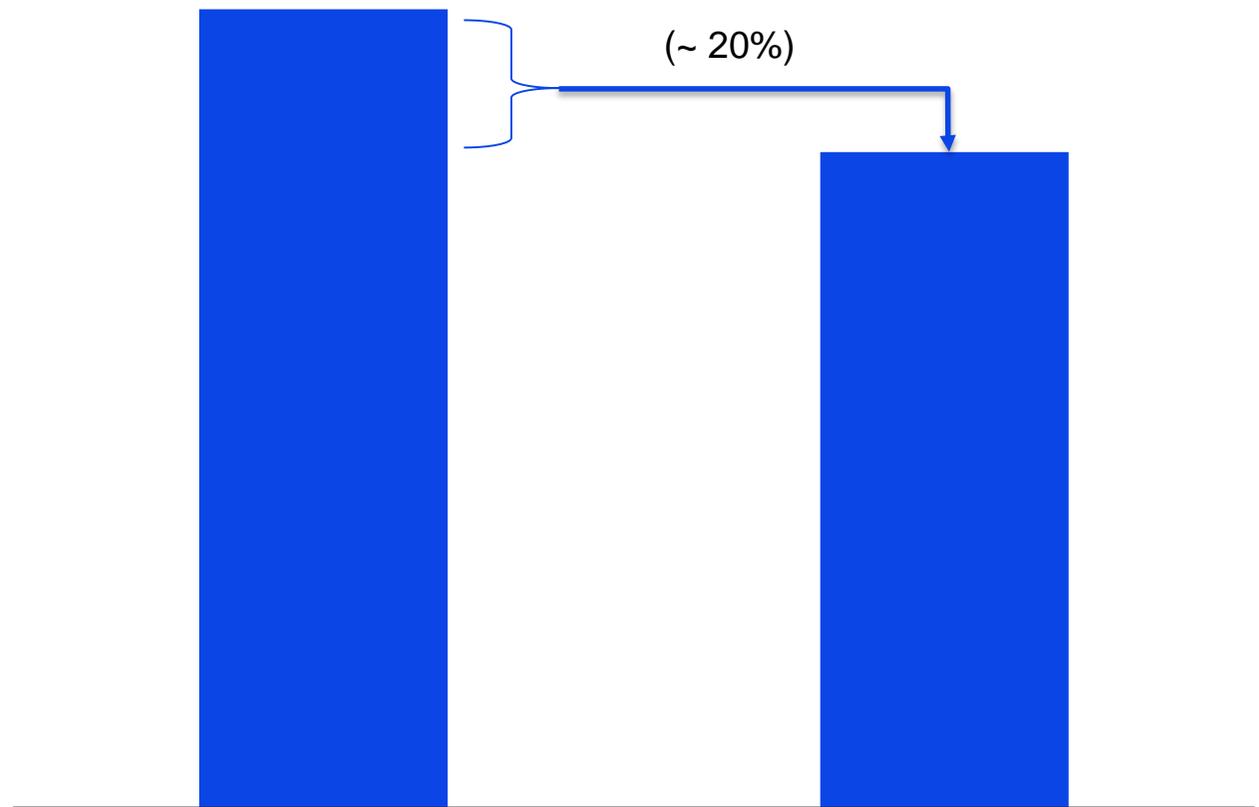


## Currently, 60% of Corporate Banking's clients are multi-product

Our goal is to increase this ratio across the Bank



# We are aiming to reduce our corporate loan book by ~ 20% by year-end 2020



## Our corporate loan book should be placed in mid cap companies

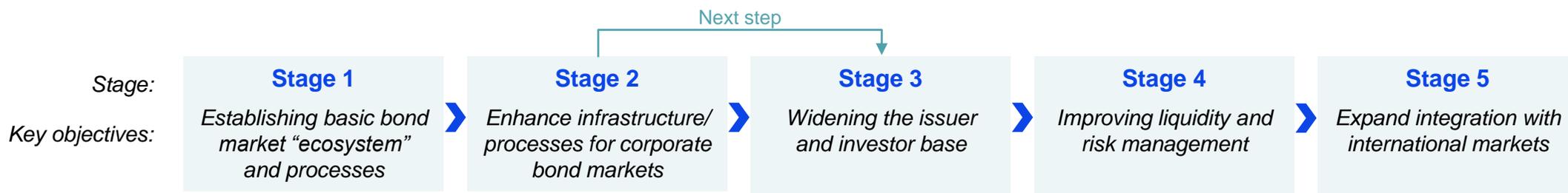
The large cap companies are bound for debt capital markets, where Arion Bank is a well suited partner to handle the listing, underwriting and market making. The corporate book can work within the mid cap companies, where more risk distribution and higher margins can be achieved.

	Small cap	Mid cap	Large cap
Annual revenues	< ISK 500m	ISK 0.5 – 10bn	> ISK 10bn
Number of companies	~ 24,000	~ 1,200	~ 100
% of total debt	25%	36%	39%
Long-term debt / Revenues	73%	50%	47%

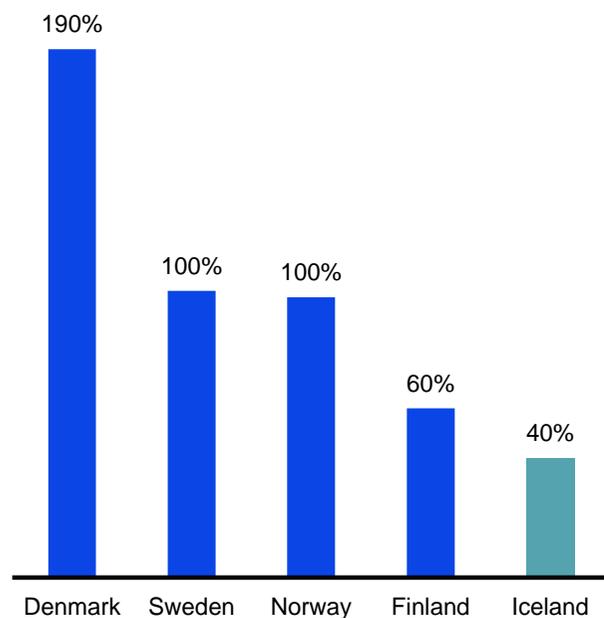


# It's time for the debt capital market to take the next step in its growth stage

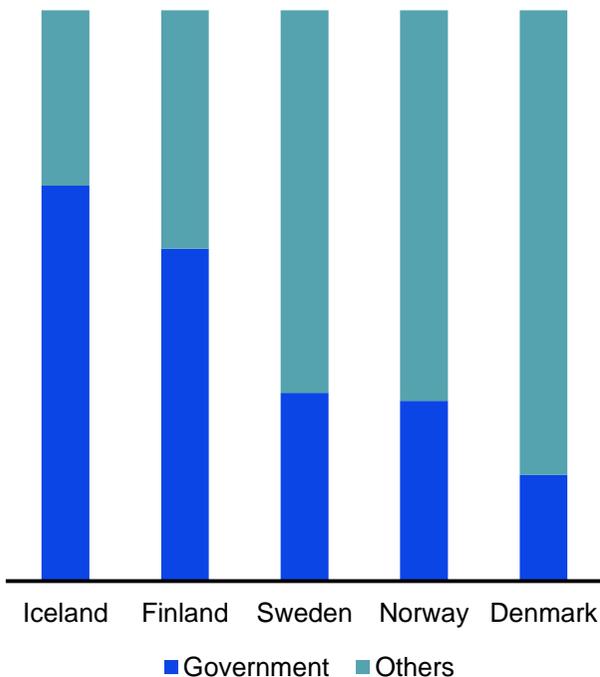
The government is by far the most prominent market player on the Icelandic debt capital market. We want to help it take its next step, to grow and show more similarities to other Nordic countries.



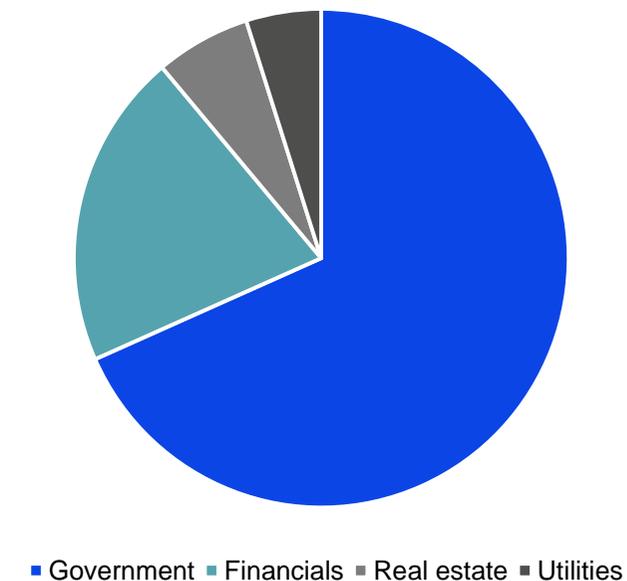
Corporate bond markets in the Nordics - % GDP\*



Breakdown of Nordics debt capital mkt.



Icelandic bond mkt. by category of issuer, % of total



## Key takeaways

### We are committed to:



Diversifying our sector allocation and achieving sustainable relationships with selected multi-product clients



Reducing RWA, lowering our costs and having strict discipline in capital allocation

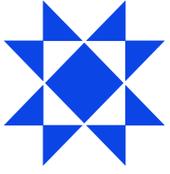


Supporting the Icelandic debt capital market to take the next step forward in its growth phase

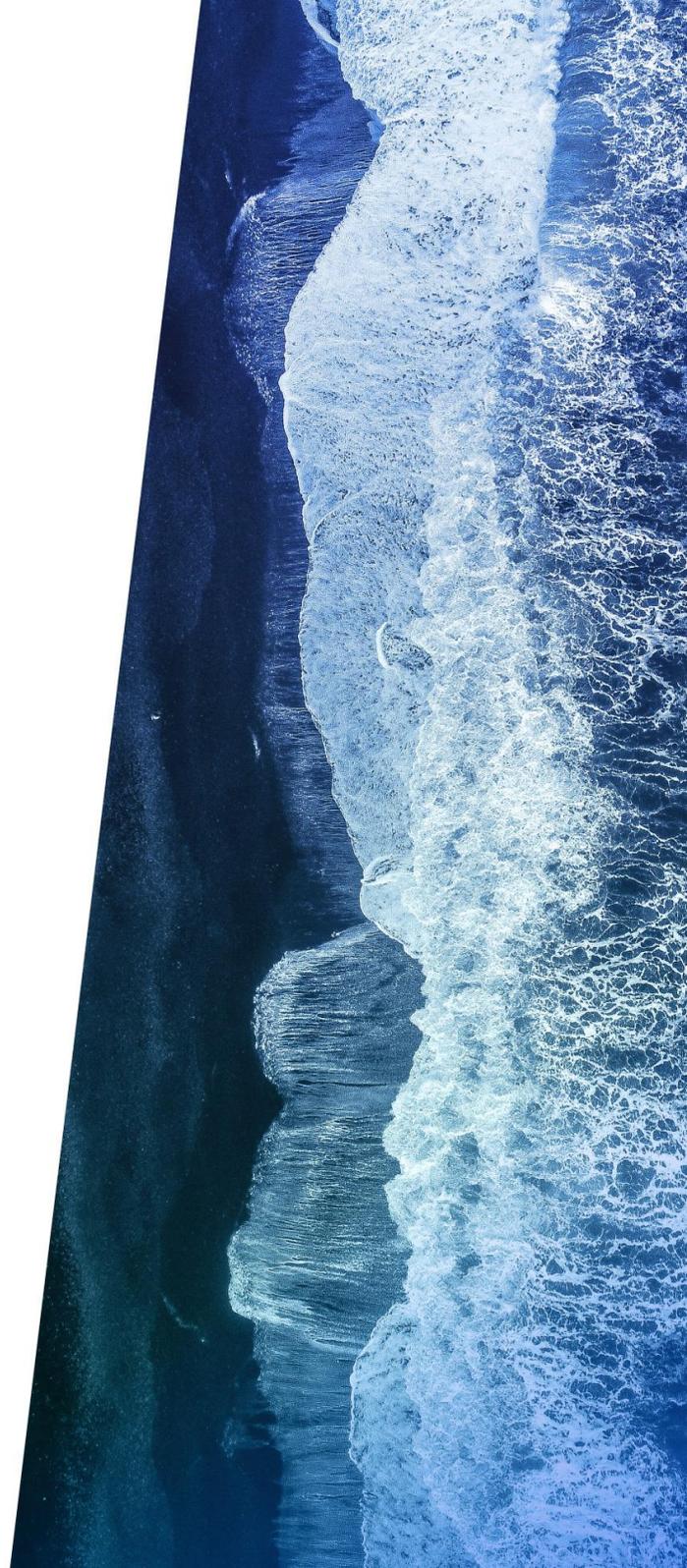


Deliver our >10% ROE and contribute more towards the >6.5% Revenue / RWA targets on the back of ancillary services





**Coffee break**





# Driving bottom line results through digitalization

Iðja Benediktsdóttir

MD of Retail Banking

# Where are we coming from?

Our digital journey started in 2016



The focus of power is shifting towards the customers who expect more convenience, choice and quality



A more competitive environment demands increased cost efficiency, clear differentiation and faster development



We needed to radically rethink our culture, service and product offering to stay relevant



# We introduced a new marketing plan and a new way of doing things

Focus on fast development and go to market of digital solutions



**A customer-oriented purpose:** We work with our customers to build a prosperous future



**The main target group:** Families with diverse financial needs



**A simple proposition:** More convenient banking



**A clear ambition:** To be the leading digital bank in Iceland



**The vehicle:** in-house digital accelerators we call “digital future”

- Cross Functional Teams
- End to End Processes
- Focus on Customer Journeys
- Fixed Timeframe of 16 weeks



# Our distribution network

98% of all customer touchpoints are digital



Telephone calls  
**290,000**



Branch visits  
**407,000**



Digital branch visits  
**441,000**



Online Banking logins  
**6,355,000**



arionbanki.is  
**13,900,000**



App  
**21,500,000**





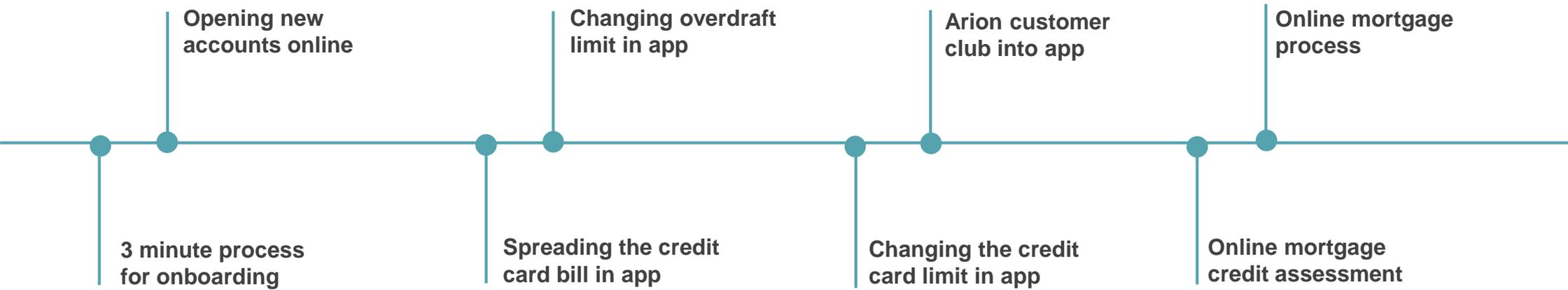
# Digital service

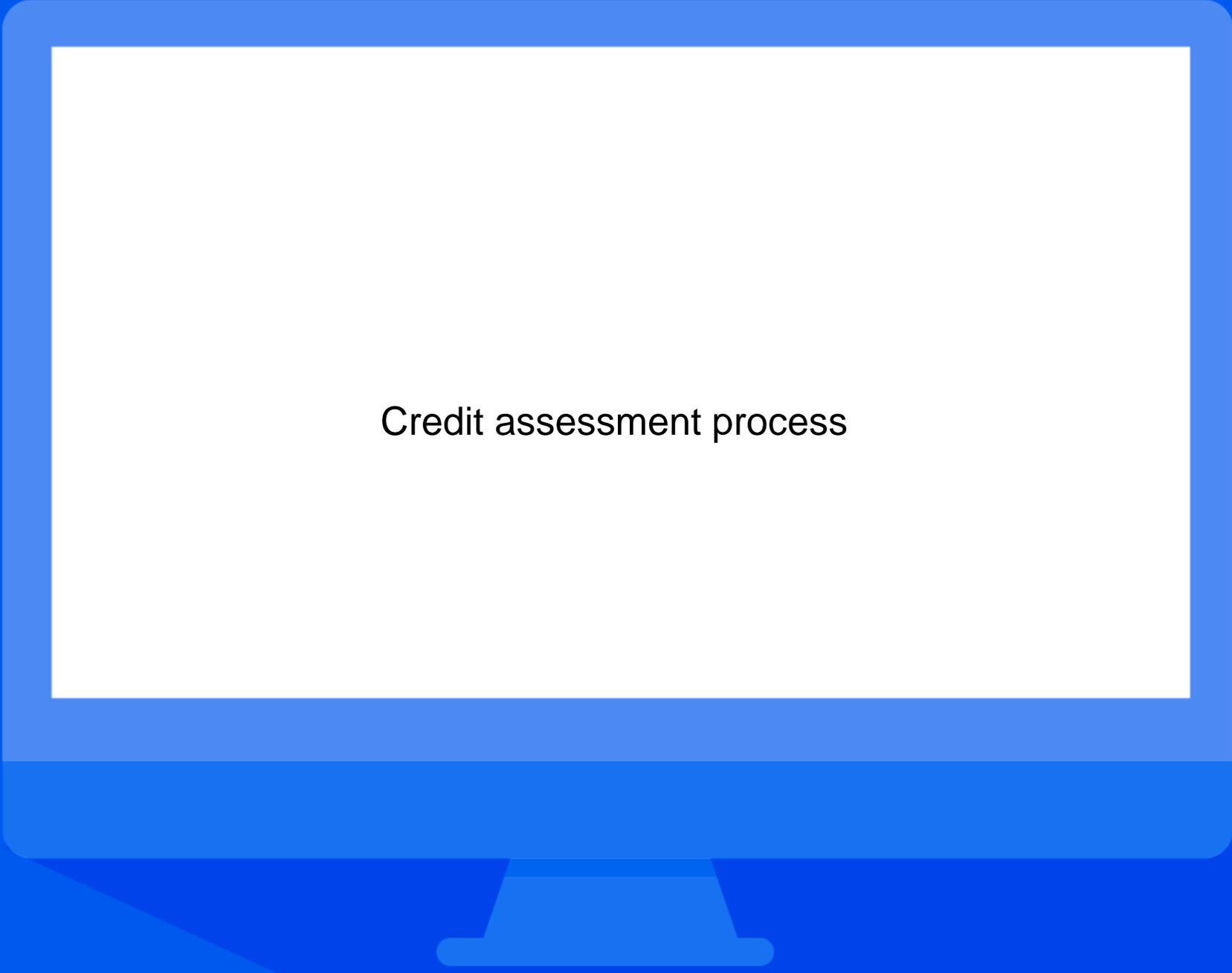
Focus on the best user experience



# Daily interactions made available online in 2016-2017

The first wave was focused on the most common interactions

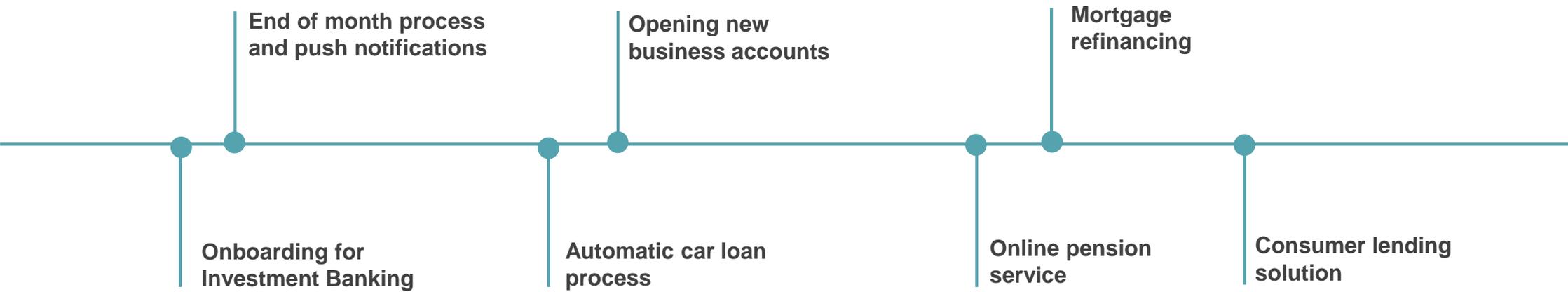




Credit assessment process

# Winning daily interactions in 2018

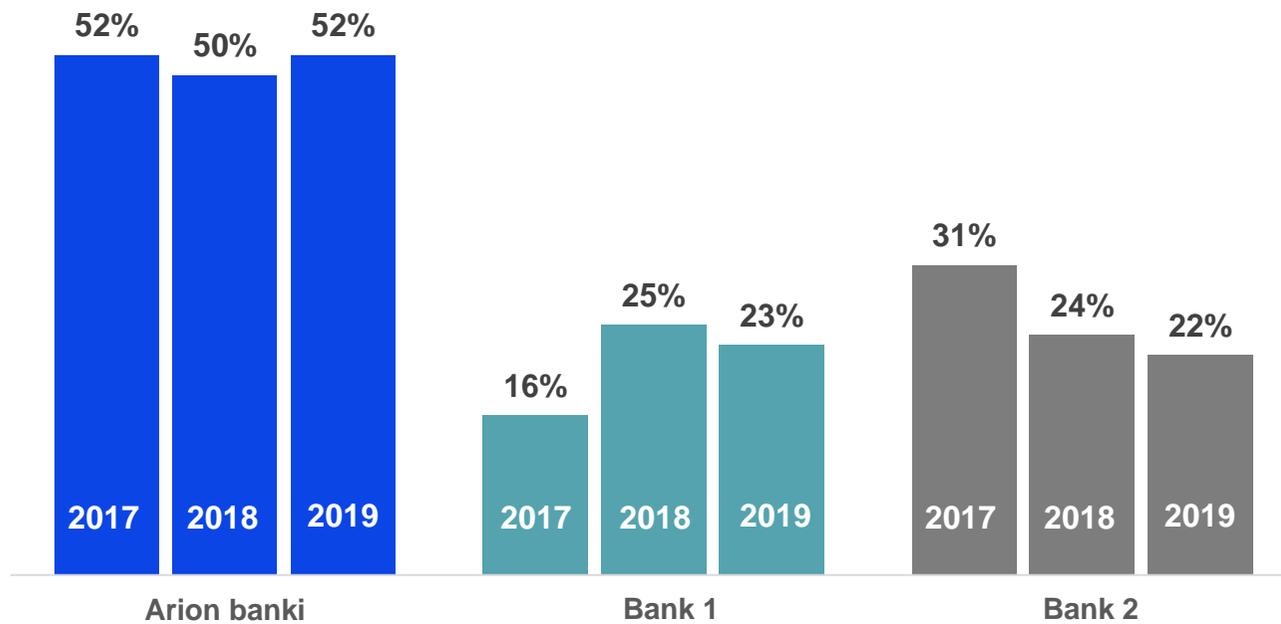
Second wave was about more advanced solutions



# The Arion app is the best banking app in Iceland

Question: What do you think is the best mobile banking solution in Iceland?

## Comparison of apps





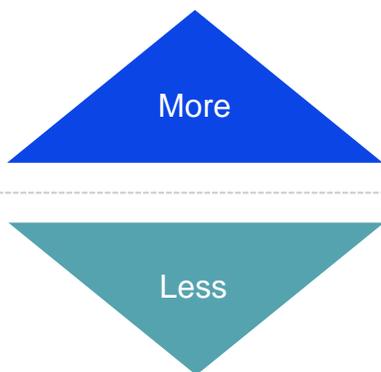
# Branch network

Focus on increased efficiency and digital development



# Simplification and streamlining of branch network

Introduction of new branch concepts in 2017 and 2018

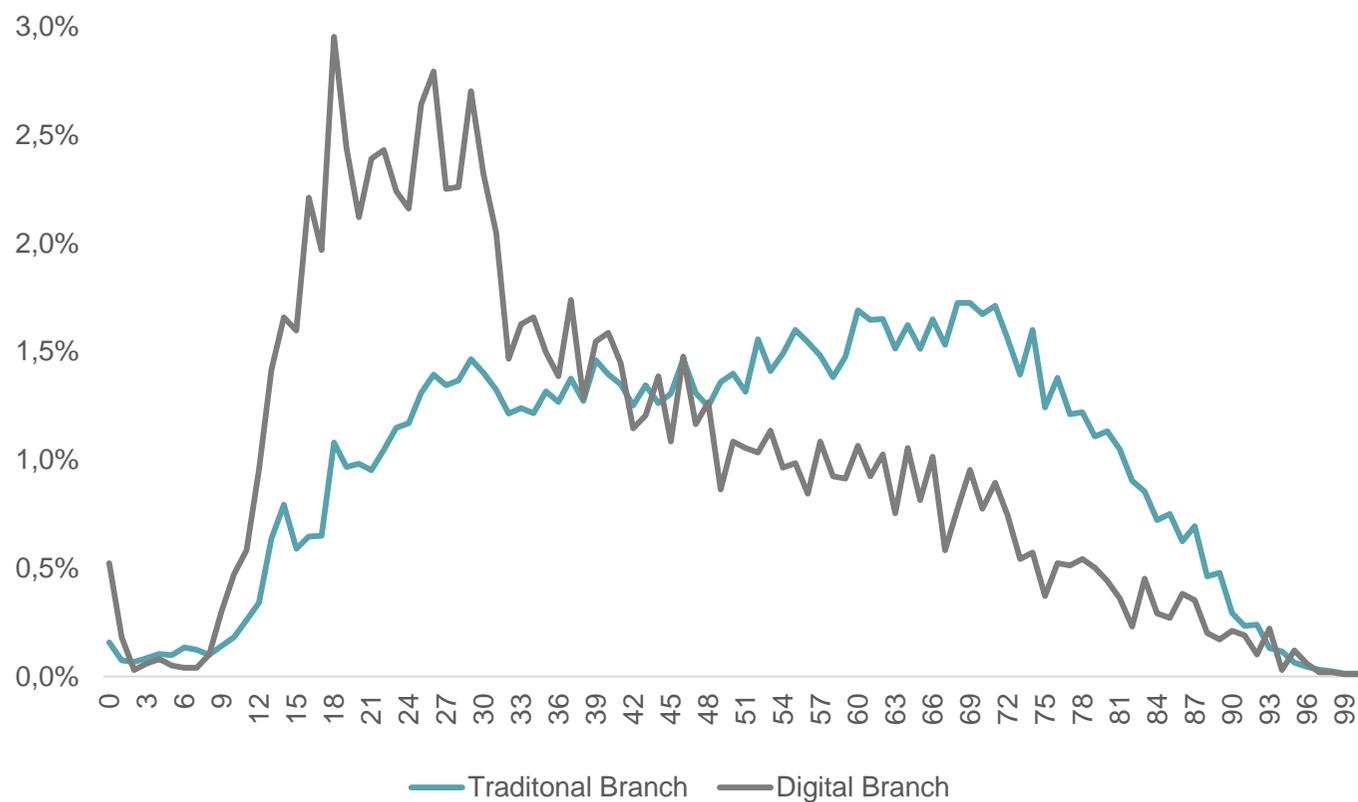


- Better access to banking service
  - Simplicity
  - Digital banking solutions
  - Advice and education
  - Uplifting customer service
- 
- Queuing
  - IT legacy and work processes
  - Square meters and barriers
  - Branch space
  - Cost

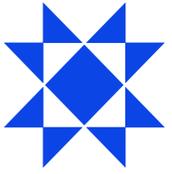
# Banking habits are changing

There is an obvious preference between age groups of how to use the branches

**Age distribution of video conference in Digital Branches vs. visits in traditional branches by age**



**Results video**



# Results

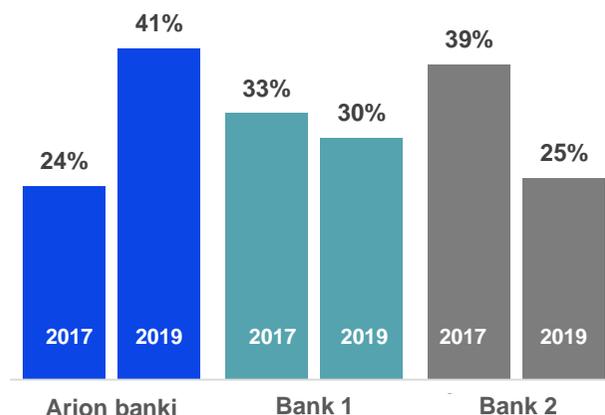


# We are considered industry leaders in banking innovation

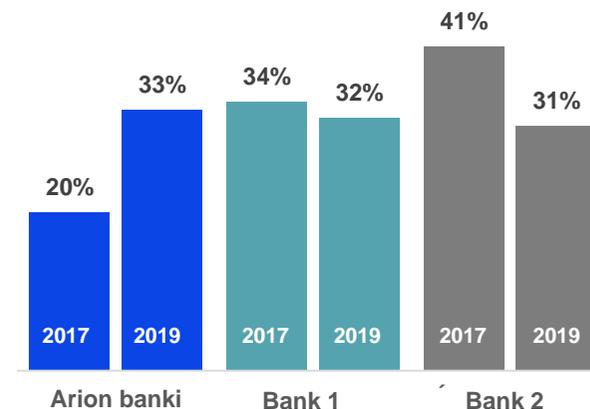
Market share has increased, especially in our main target group

- Arion Bank has taken the lead in the banking market in the opinion of people aged 18-44, and managed to regain some of the advantage of the other banks in the older target group.
- Market share as measured here is relatively stable.
- The development of market share has quickened after Arion Bank began to emphasize the digital route
- Churn in the banking market in Iceland is still low. Which is why this development is important.

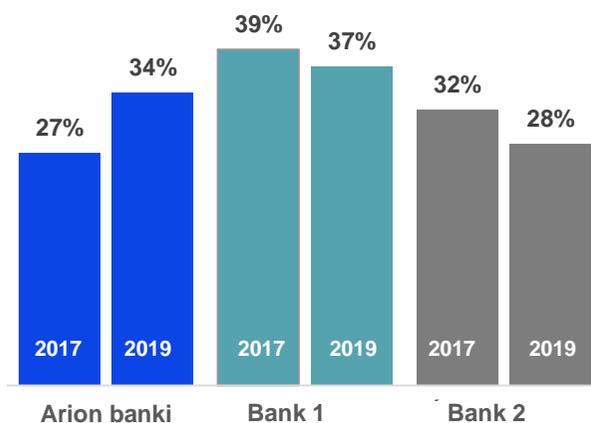
Bank at the forefront, age group: 18-44



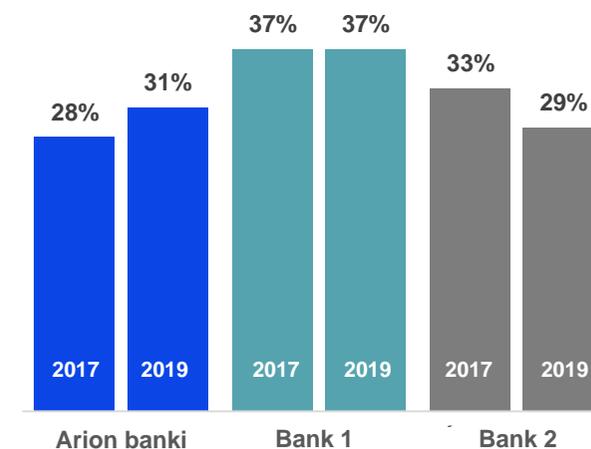
Bank at the forefront, all age groups



Market share, age group: 18-44



Market share, all age groups

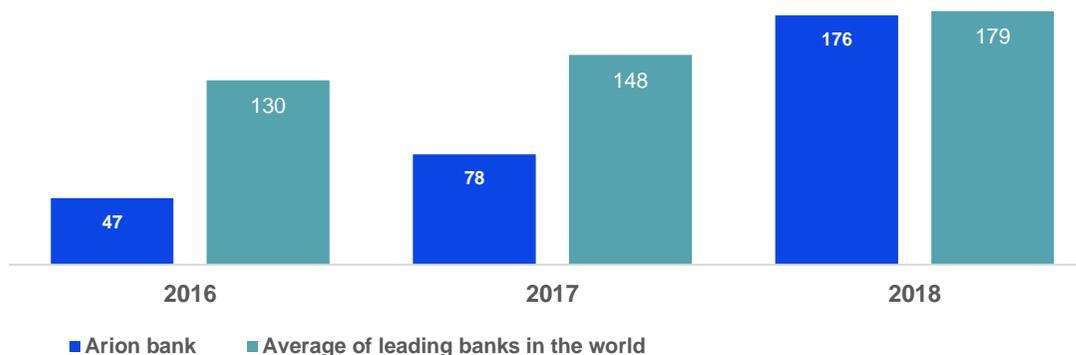


# Online sales has increased dramatically in the past two years

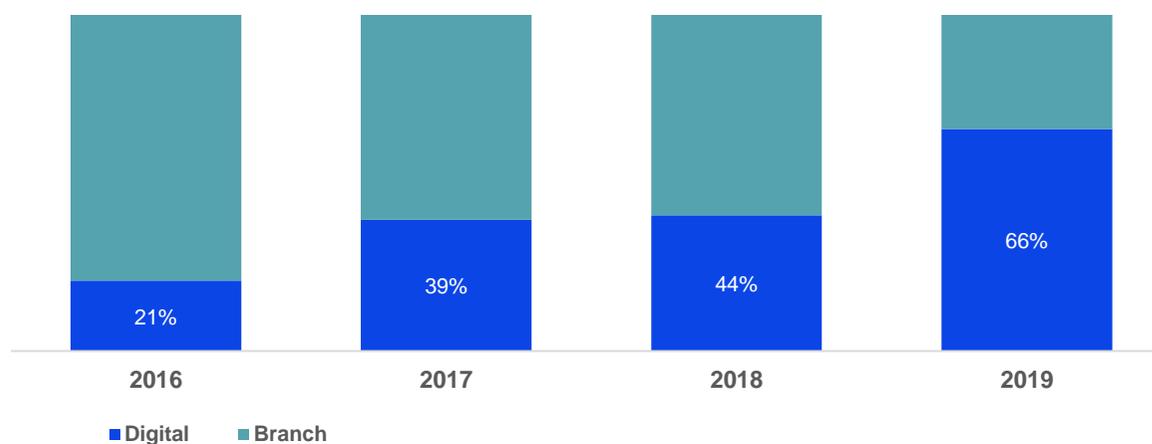
We are now amongst the leading banks in digital sales in the world

- Digital sales have increased steadily. As a percentage of total sales, they have increased by 276% between 2016-2018
- The results show Arion Bank is now one of the digital leaders among the world's banks.
- Digital sales ratio 66% for credit cards, current accounts and savings accounts
- Please note that mortgages are not included in this figure although 65% of mortgage loan are granted through an electronic process and 94% of customers use digital credit assessment

**Digital sales increased by 276% in 2 years<sup>1</sup>**



**Online sales as % of total (savings accounts, current accounts & credit cards)<sup>1</sup>**



<sup>1</sup> Calculated as the number of products sold through digital distribution channels relative to total active customers. The figures are comparative figures from the research firm Finalta (McKinsey), which conducts standardized research annually in this field worldwide.

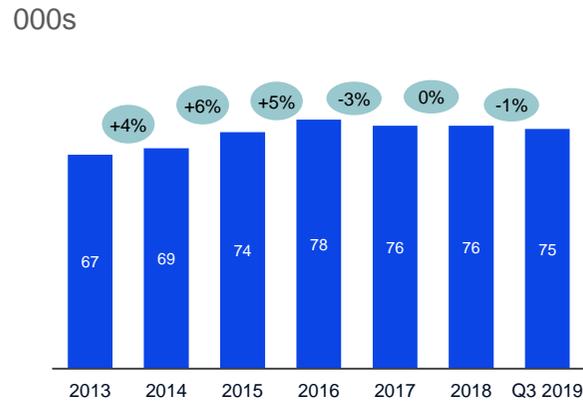


# Digital services are changing customer behavior

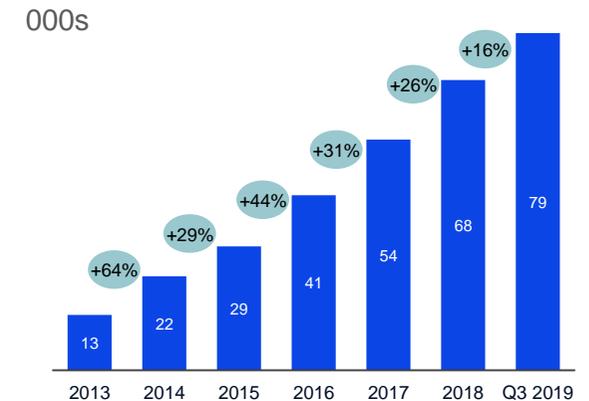
The Bank's digital journey has produced outstanding results

- 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

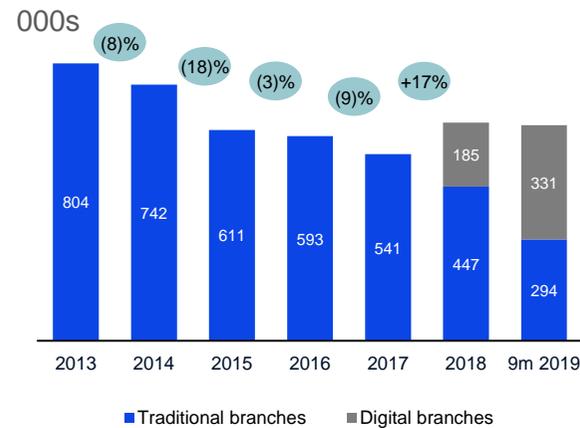
### Active online bank users<sup>1</sup>



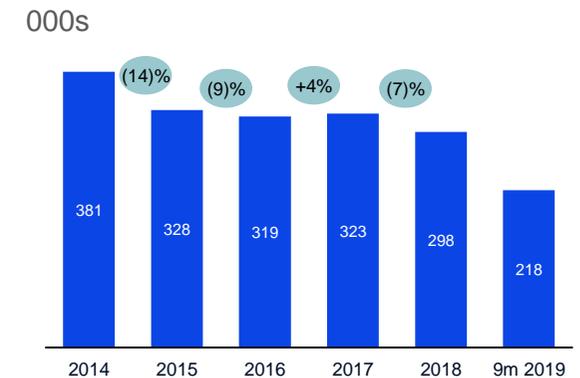
### Active Arion app users<sup>1</sup>



### Number of visits to branches<sup>2</sup>



### Number of calls to the call centre



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.

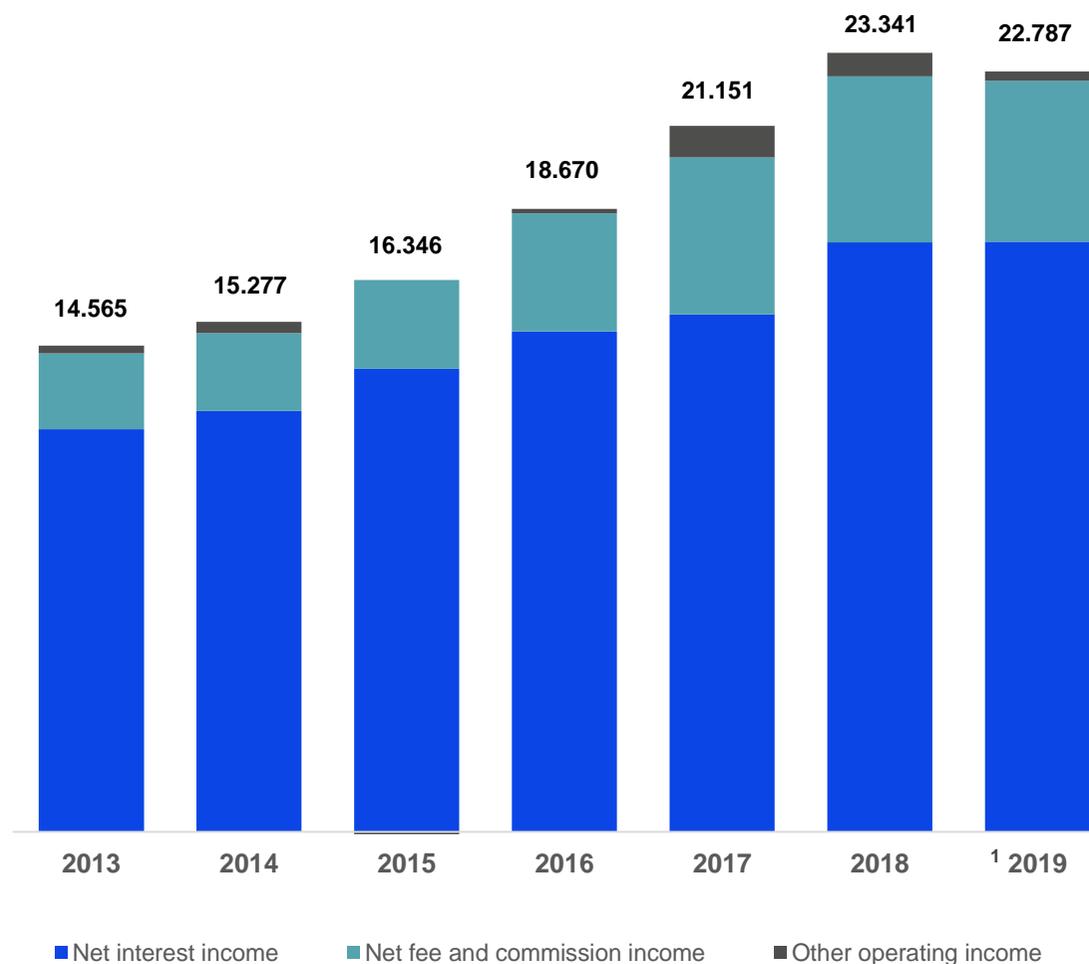


## Steady growth in operating income since 2013

Increase in net interest income in 2019 despite transfer of ISK 1 billion in net interest income to Corporate Banking division at beginning of the year

- Strong focus on increased profitability has resulted in substantial increase in operating income
- CAGR of 7.7% during period
- Branch at Keflavík International Airport opened in 2016 which is partly reason for growth in commission income
- At beginning of 2019 ISK 54 billion of corporate loans were transferred from Retail Banking to Corporate Banking. This resulted in ISK 1 billion decrease in net interest income.
- Net interest income nevertheless grew in 2019

Operating income 2013-2019 (ISK million)



<sup>1</sup> 2019 Operating income are for the first nine months of 2019 and calculated to an annual basis

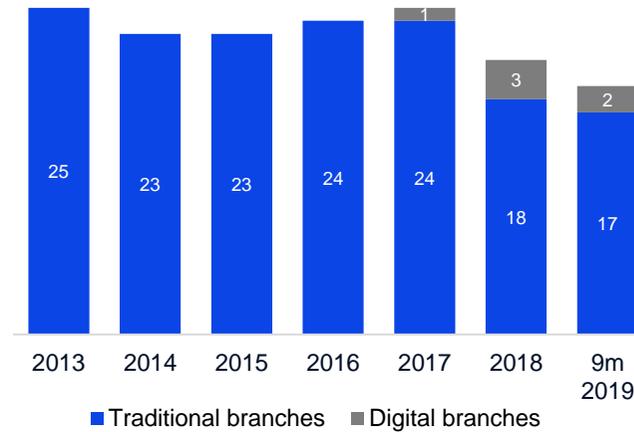


# Improved operating efficiency

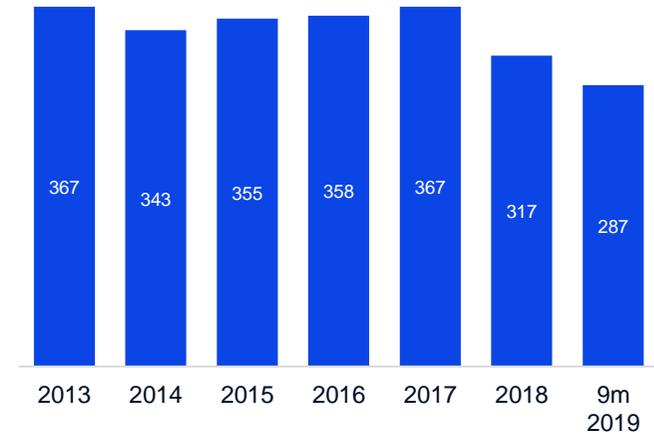
Mostly because of Bank's digital journey

- Strong emphasis on digital solutions has led to more use of the Bank's self-service channels
- This approach has created opportunities to reduce the number of branches and FTEs which represent the main operating expenses in the division
- Due to more automation FTEs are down by 80 in Q3 2019 than at year-end 2017
- Resulted in a lower cost to income ratio
- The increase in expenses from 2017 is mainly due to the opening of the Keflavik International Airport branch (mainly housing cost), offset by higher fee income

### Number of branches

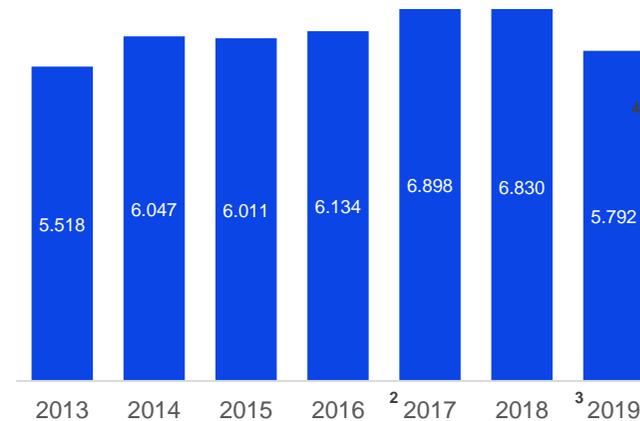


### FTEs in Retail Banking

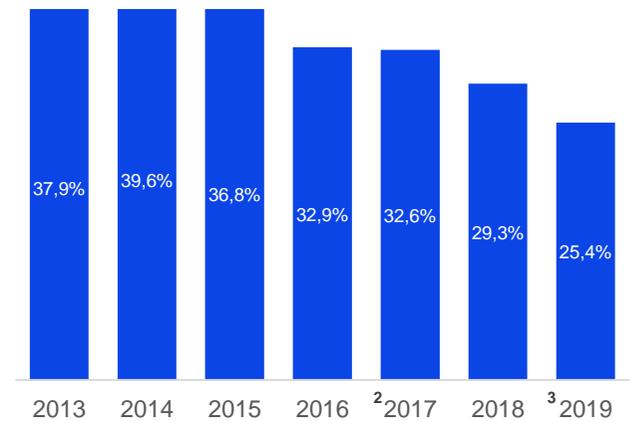


### Operating expenses in Retail Bank<sup>1</sup>

ISK million

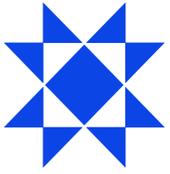


### Cost to income<sup>1</sup>



<sup>1</sup> Without Allocated expense, Bank levy and Net impairment  
<sup>2</sup> Without reversal of expense with Depositors' and Investors' Guarantee Fund of ISK 1.8 billion in 2017  
<sup>3</sup> 2019 Operating expense and income are for the first nine months of 2019 and calculated to an annual basis. Without JCC cost which was allocated cost previous years





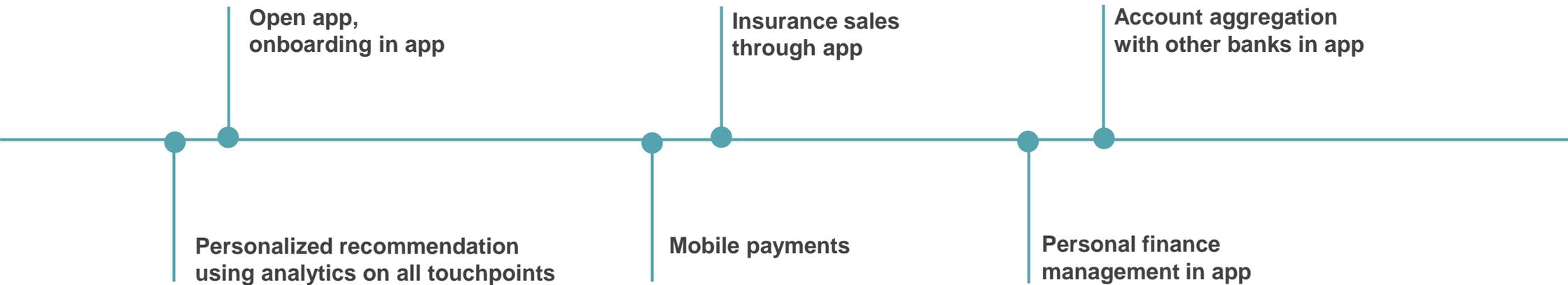
# Preparing for open banking

Orchestrator of ecosystems



# Integrate into broader customer journeys in 2019

Preparation for Open Banking and the opportunities ahead with broader value ecosystems



**Rós video**

# Going forward:

We are ready for the open banking environment



Development and deployment of API strategy to be ready for PSD2 and the era of open banking



Increased co-operation with third party to source and implement solutions for our customers and further develop new revenue streams



Further deployment of data & analytics for service, sales & marketing, as we do with credit decisions



Further streamlining and development of branch network to meet changed requirements of our customers and increase cost efficiency



Focus on SME with increased digital service



Maintain our leadership status as the best digital bank in Iceland, integrate into broader customer journeys and become ecosystems orchestrator in open banking environment





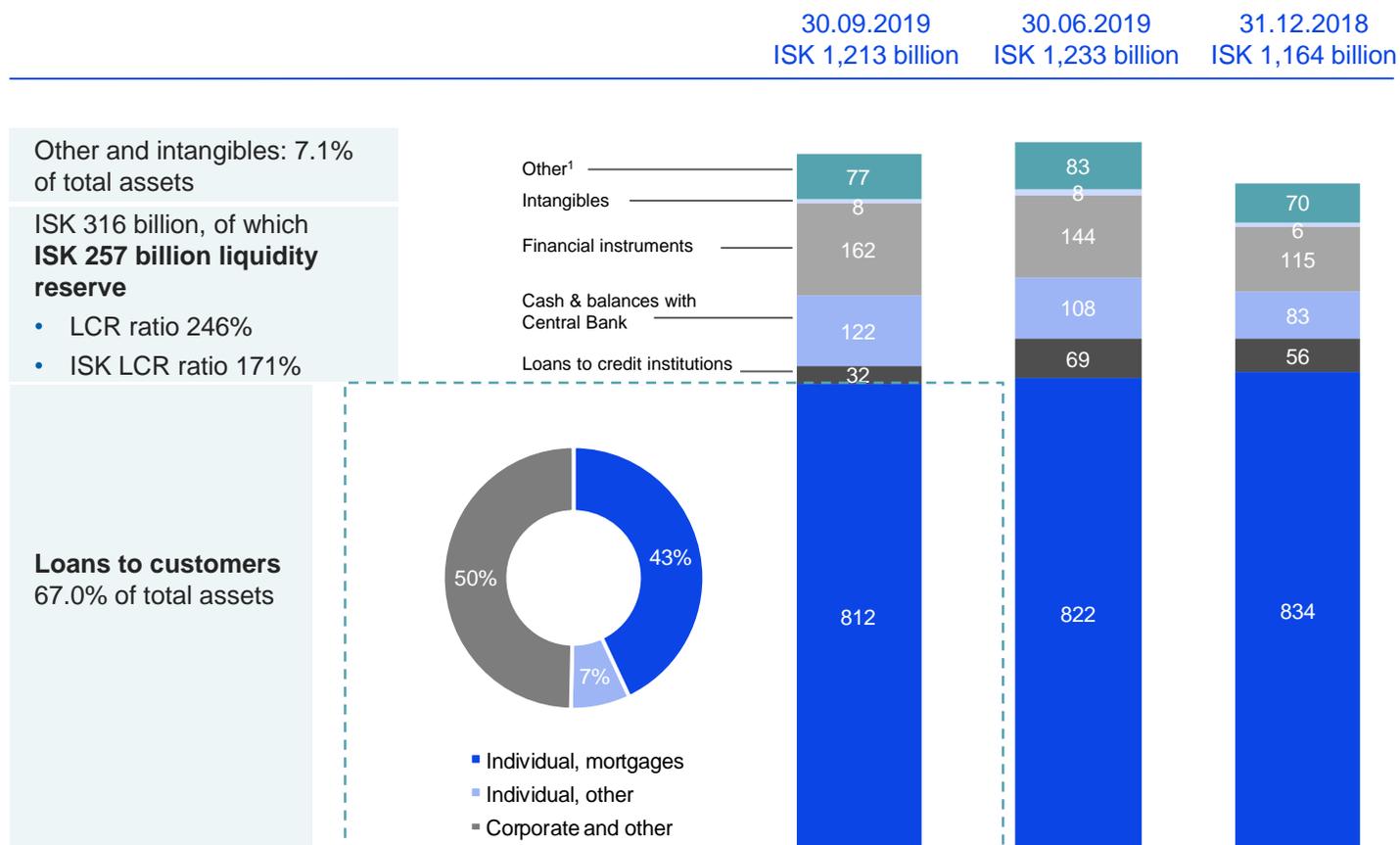
# Arion Bank Financials: a new trajectory

Stefan Petursson  
CFO

12 November

# Balance sheet - Assets

Strong and simple

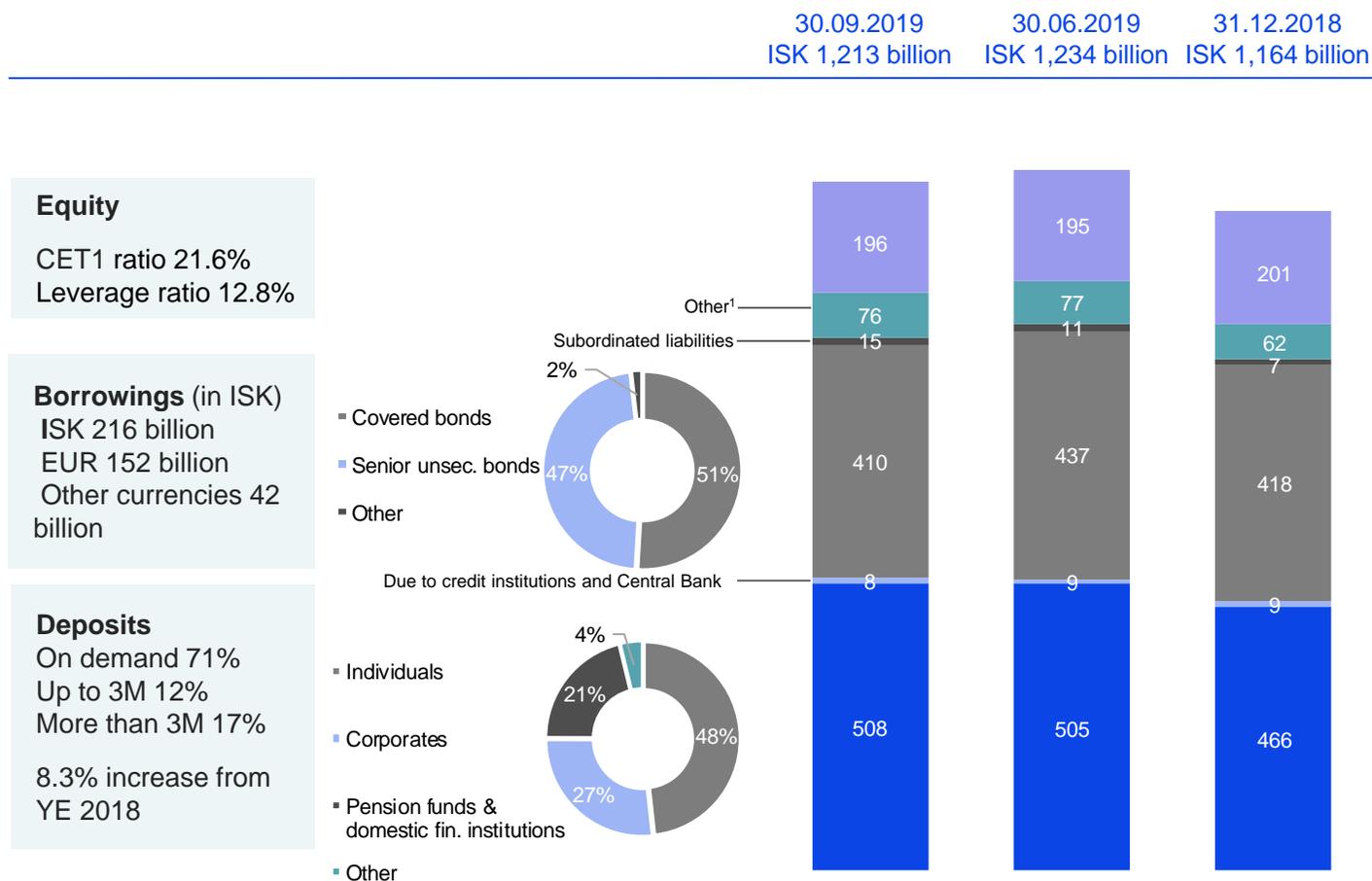


<sup>1</sup>Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets



# Balance sheet – Liabilities and equity

Very strong capital position with a Capital Ratio of 23.6% and well balanced funding



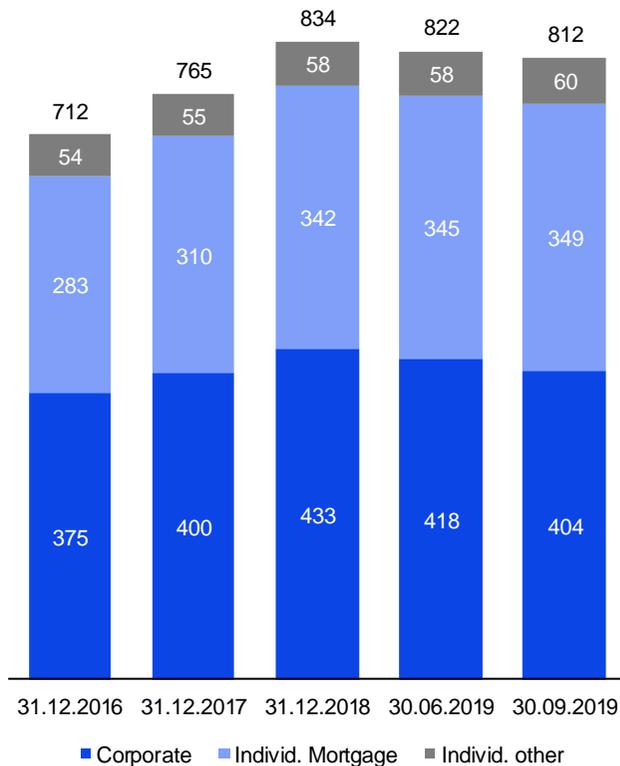
<sup>1</sup> Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities



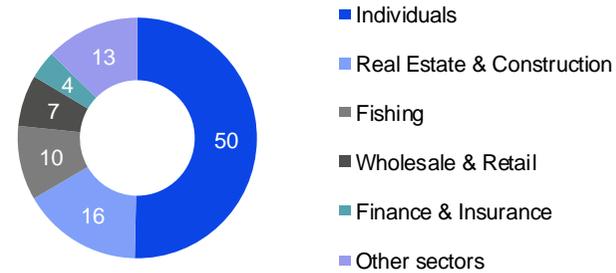
# Loans to customers are well balanced and well diversified

6.9% reduction in corporate loans since YE 2018 in line with strategy has released SK 48 billion of RWA's

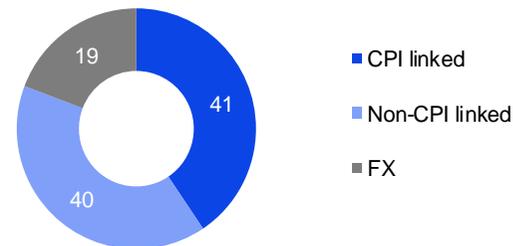
**Loans to customers**



**Loans to customers by sector (%)**



**Loans to customers by type (%)**



# Income statement Q3 2019

Arion Bank is already on a new trajectory with core operations performing better and a substantial improvement in earnings from continuing operations

	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%
<b>Operating income</b>	<b>12,344</b>	<b>11,904</b>	<b>4%</b>	<b>12,220</b>	<b>1%</b>
Salaries and related expenses	(4,130)	(3,129)	32%	(3,805)	9%
Other operating expenses	(2,810)	(2,864)	(2%)	(2,813)	(0%)
<b>Operating expenses</b>	<b>(6,940)</b>	<b>(5,993)</b>	<b>16%</b>	<b>(6,618)</b>	<b>5%</b>
Bank levy	(809)	(937)	(14%)	(912)	(11%)
Net impairment	484	(2,650)	-	(988)	(149%)
<b>Net earnings before income tax</b>	<b>5,079</b>	<b>2,324</b>	<b>119%</b>	<b>3,702</b>	<b>37%</b>
Income tax expense	(1,278)	(973)	31%	(891)	43%
<b>Net earnings from continuing operations</b>	<b>3,801</b>	<b>1,351</b>	<b>181%</b>	<b>2,811</b>	<b>35%</b>
Discontinued operations, net of tax	(3,040)	(202)	-	(715)	325%
<b>Net earnings</b>	<b>761</b>	<b>1,149</b>	<b>(34%)</b>	<b>2,096</b>	<b>(64%)</b>

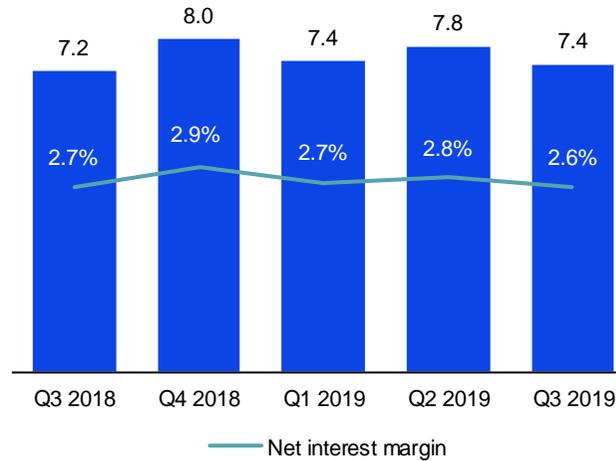


# Net interest income

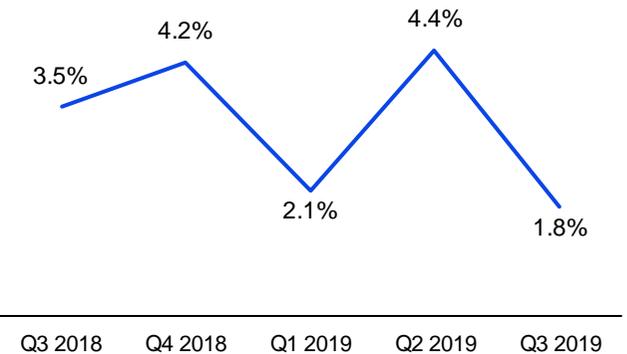
Holding up at time of base rate reduction and T2 issuance

- 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)

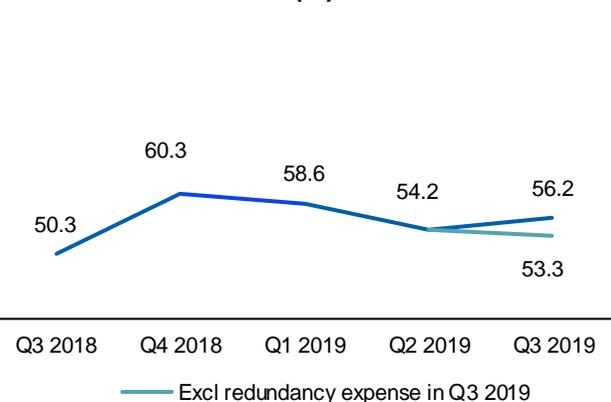


# Total operating expenses

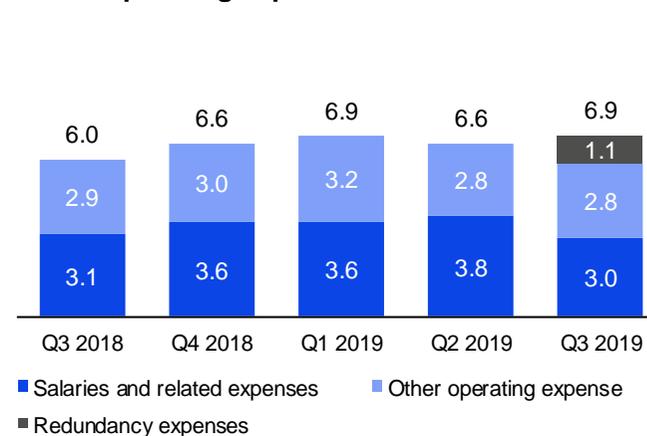
Positive development in cost-to-income excluding cost relating to redundancies at the end of third quarter

- 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

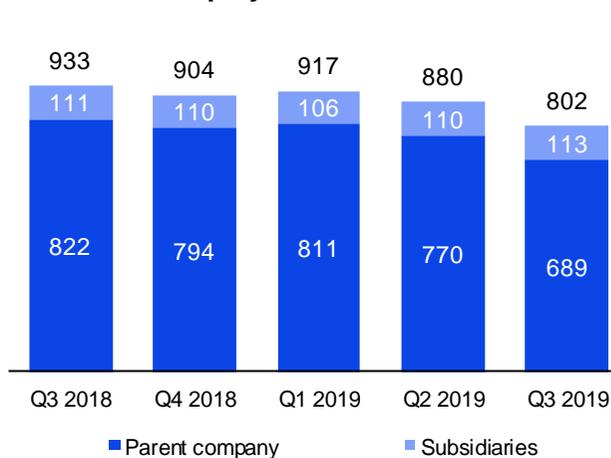
**Cost-to-income ratio (%)**



**Total operating expenses**



**Number of employees**



# Digitalization and other IT development has increased costs

Key issue as regards cost development

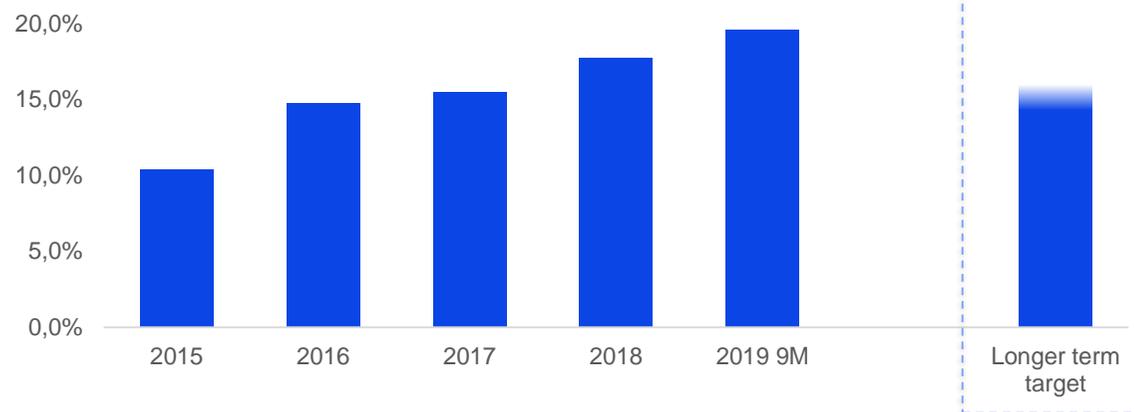
## IT cost in “Grow” category elevated

- Digitalization efforts began in 2016
- SOPRA implementation elevates IT cash spend in 2019-2020
- IT costs will normalize going forward
  - IT investments can hugely improve C/I
  - New projects needed (MIFID, AML etc.)

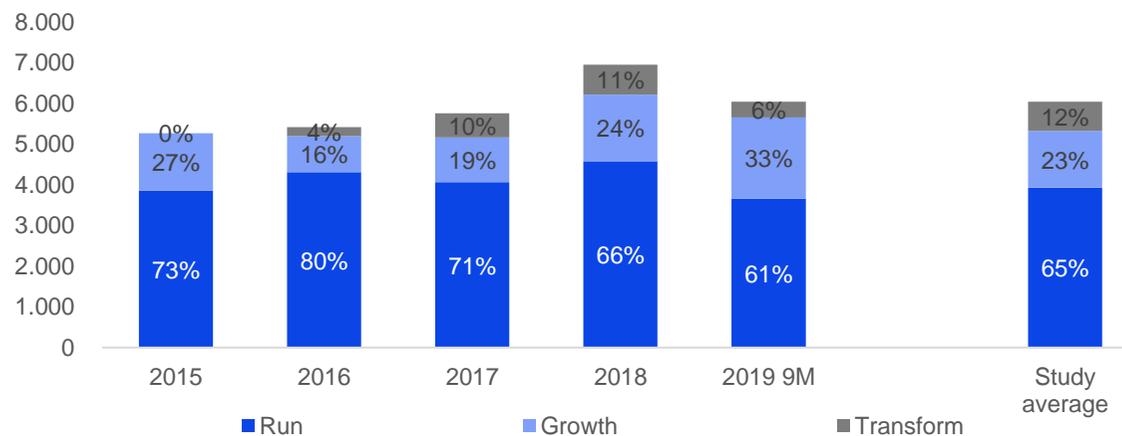
## Other themes in opex going forward

- Branch network
- Property services
- Outsourcing
- FTE development

## IT cost to operating income (IT C/I)



## Total IT cash spend (ISKm) – split by type<sup>1</sup>



## Arion Bank was IPO'd in June of 2018

Medium term targets at the time reflected expectations about the development of the Icelandic financial market over time



### Return on Equity

Exceed **10%**



### Cost to Income Ratio

Reduce to **circa 50%**



### Loan growth

Prudent lending in line with economic growth



### CET 1 Ratio (Subject to regulatory requirements)

Reduce to **circa 17%** (Subject to regulatory requirements)



### Dividend Policy / Share buy-back

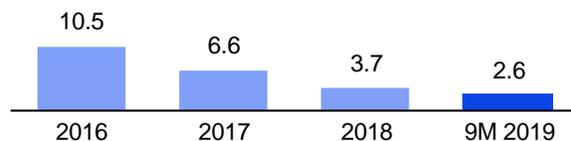
Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above the minimum requirements set by the regulators in addition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



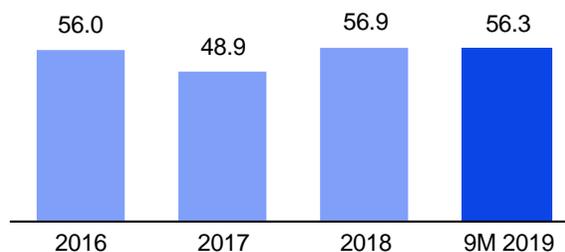
# Development of key financial indicators

Single name events have affected net earnings but core performance has been deteriorating until recently

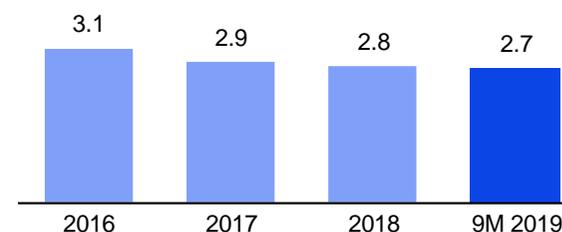
Return on equity (%)



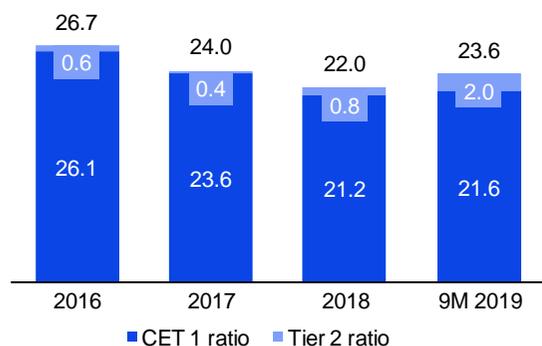
Cost-to-income ratio (%)



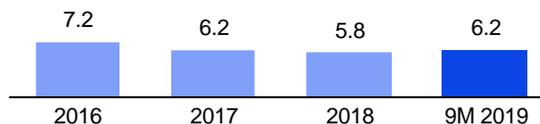
Net interest margin (%)



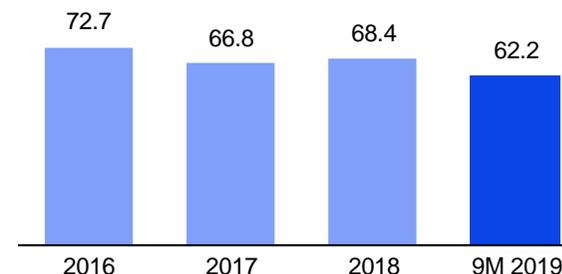
Capital ratio (%)



Revenues on RWA



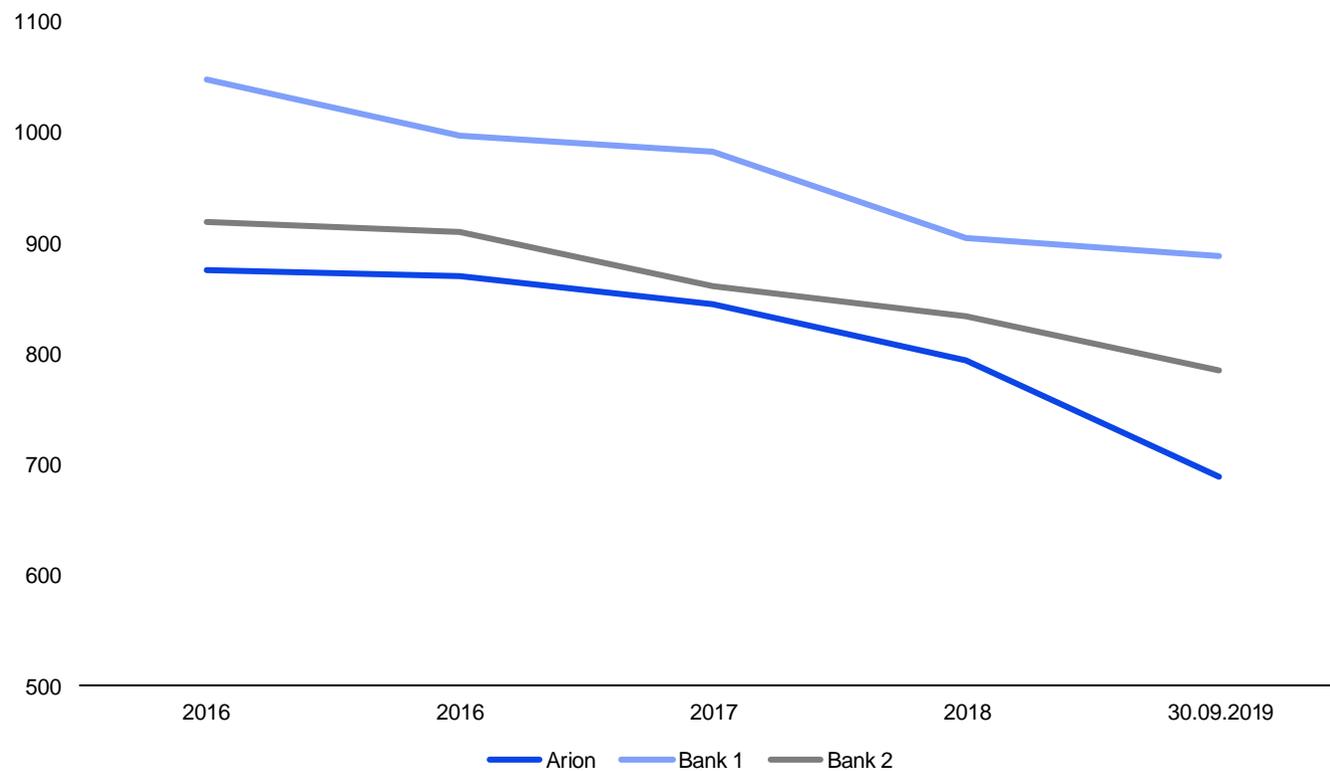
Risk weighted assets / Total assets (%)



# The sector has rationalized mainly through FTE reduction

A leadership in digitalization has allowed Arion Bank to reduce FTE's by 16% since Q3 2018

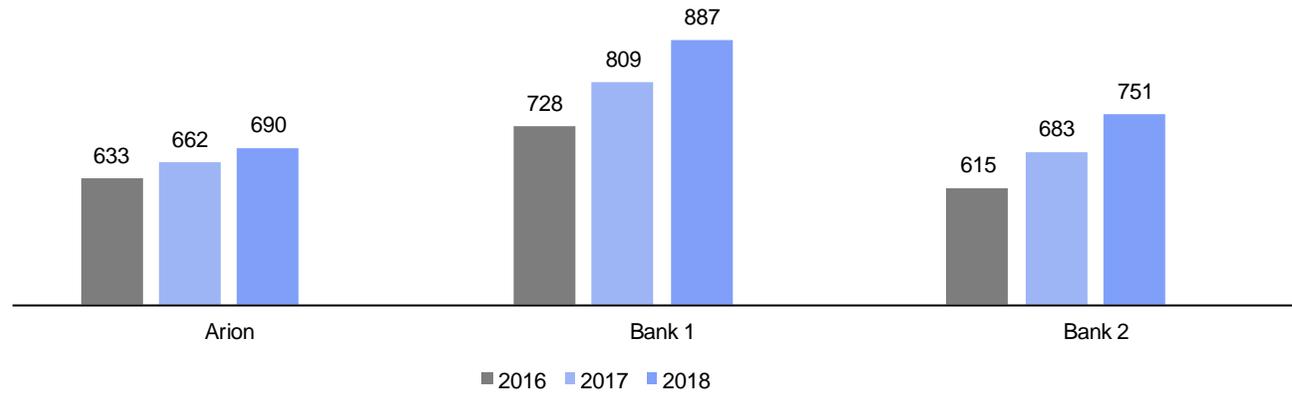
Number of FTE's at parent company



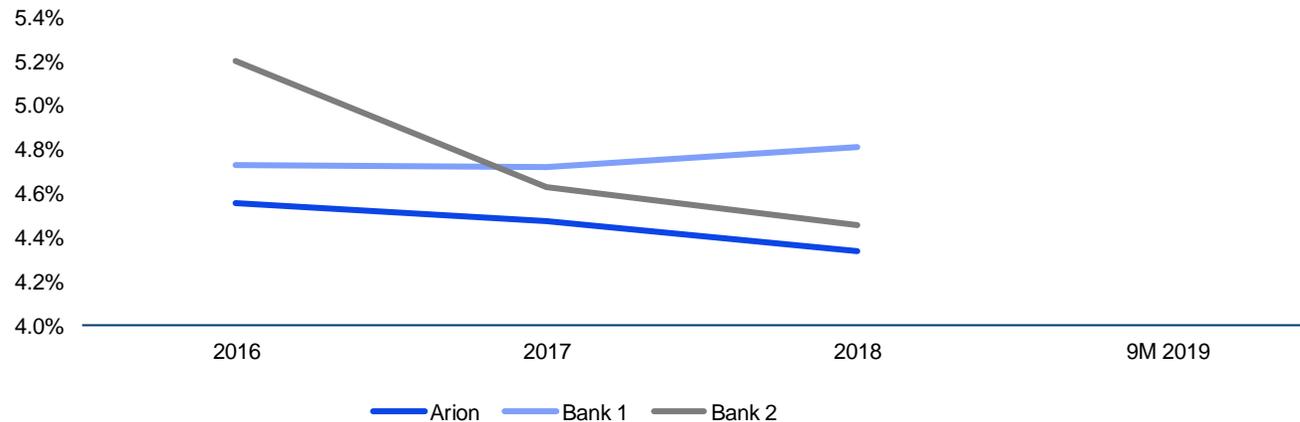
# Arion Bank is on a different trajectory

Strategy as regards focus on returns rather than loan growth began in Q3 2018

## Credit risk (ISK billion)



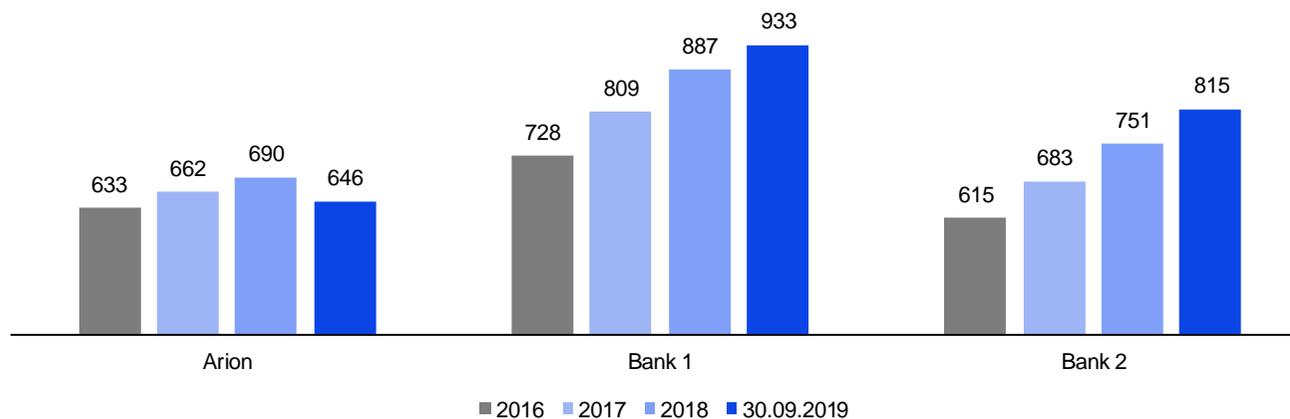
## Net interest income / Credit risk (%)



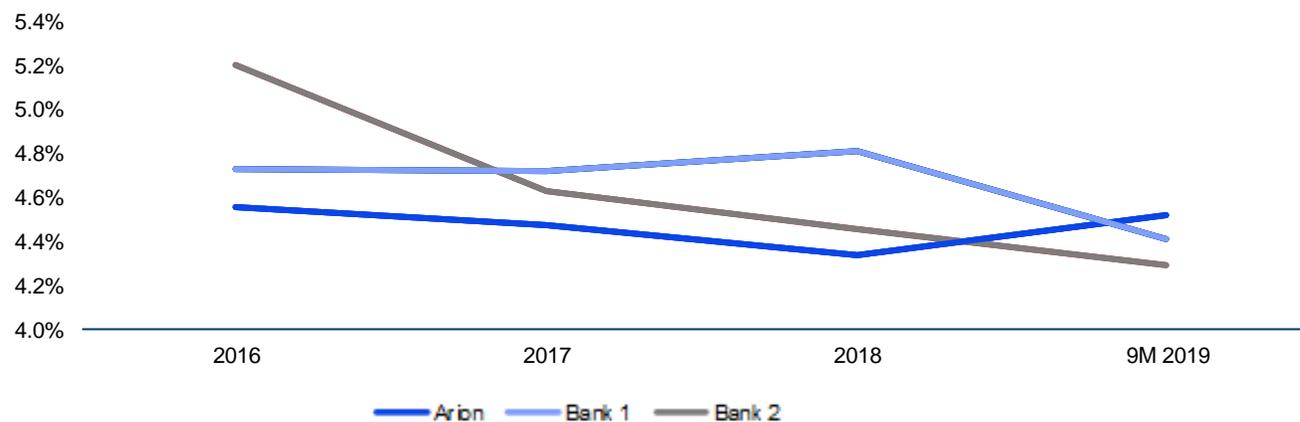
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## Credit risk (ISK billion)

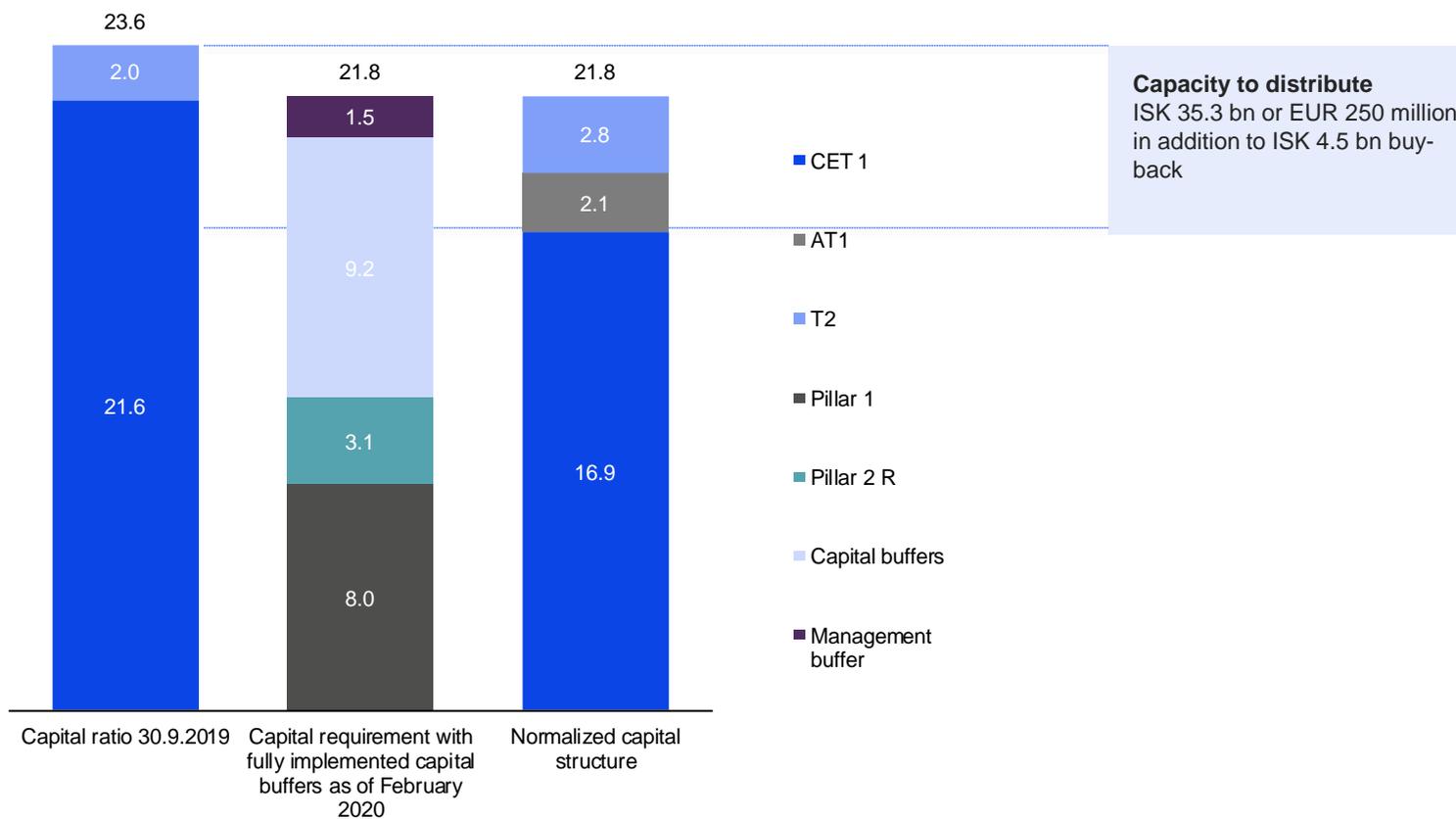


## Net interest income / Credit risk (%)



# Capital position is very strong and allows for substantial distributions

Fully in line with the Bank's Equity Story



# Arion Bank medium-term targets have been modified

The Bank is acknowledging new reality



## Return on Equity

Exceed **10%**



## Cost to Income Ratio

Reduce to **circa 50%**



## Loan growth

Prudent lending in line with economic growth



## CET 1 Ratio (Subject to regulatory requirements)

Reduce to **circa 17%** (Subject to regulatory requirements)



## Dividend Policy / Share buy-back

Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback 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



# Arion Bank is committed to its medium-term targets

New revenue target introduced and loan growth target amended



## Return on Equity

Exceed **10%**



## Revenues / RWAs

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



## Potential capital release in the near term

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

Distribution	2018	2019
Dividend pr. share	ISK 8.9	ISK 5.0
Share buy back pr. share.	ISK 8.6	ISK 2.5 <sup>1</sup>

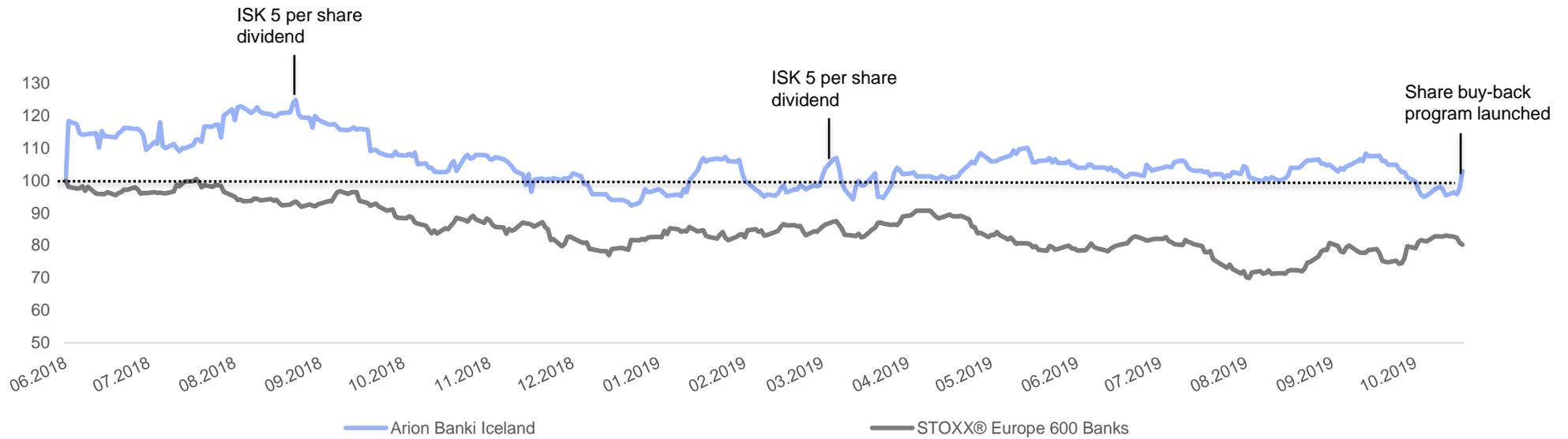
### Main levers under current RWAs, Pillar 2 and capital buffer requirements:

<b>Share buy-back</b>	Up to ISK 4.5 billion. Was launched 31 October in Reykjavík (Kvika Bank) and Stockholm (Nordea)
<b>Surplus capital</b>	Estimated ISK 13.3 billion in addition to dividend policy payout and share buy-back intention
<b>Tier 2 issuance</b>	The Bank has issued 2% of T2 capital but has room to issue up to an additional ISK 6 billion
<b>AT 1 issuance</b>	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
<b>Vördur capital</b>	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
<b>Valitor sale</b>	Valitor is in a sale process and all proceeds of the sale can be distributed to shareholders without any capital dilution at Arion Bank
<b>RWA reduction</b>	The Bank aims to lower RWAs 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

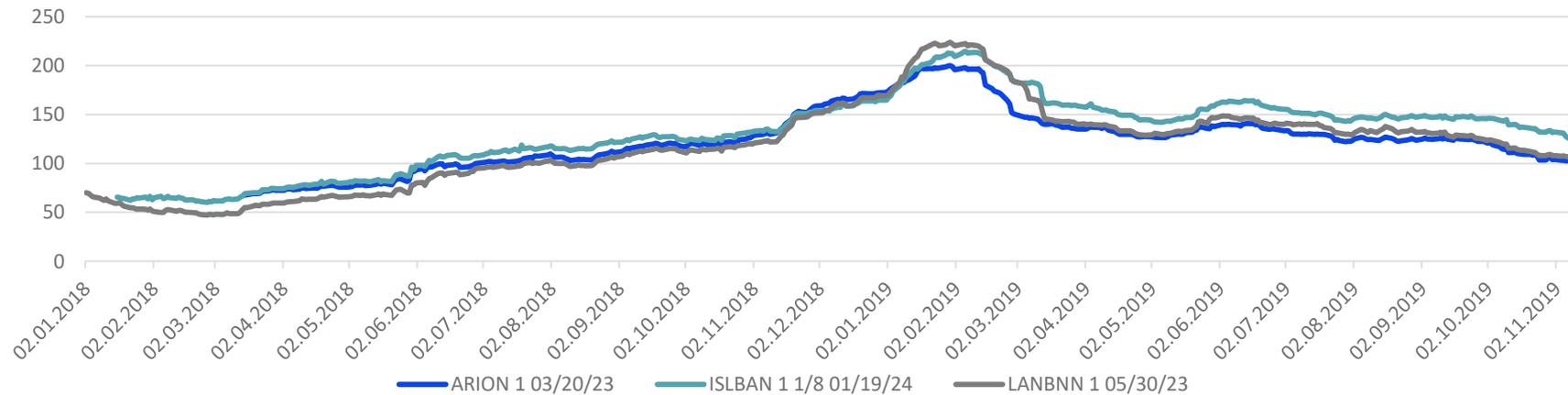


# Arion Bank performance in the capital markets

## Share/SDR relative performance since IPO



## Issued debt performance relative to local peers





# Q&A

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