

CHAIRMAN'S SPEECH TO THE SHAREHOLDERS OF

ARION BANKI – AGM 12th MARCH 2025

Kæri fundarstjóri, hluthafar, dömur mínar og herrar.

Last year when you elected me for the first time as Chairman of Arion Banki, I promised you that one of my tasks for the year would be to try to improve upon my minimal capabilities in the Icelandic language.

My first year as Chairman of Arion Banki has been an eventful one on several levels: for Arion, for the financial sector here in Iceland, for the Icelandic nation and, of course, for the wider world.

I think it fair to say that, during this time, whilst I have made some progress with your beautiful language, the bank's development in business during the year has considerably outperformed my own development in learning Icelandic. I therefore hope that you will understand and forgive me if I switch now to English, in order to deliver my address more clearly and efficiently.

An almost unprecedented year of elections across the Western World over the past twelve months, has resulted in new governments being elected in a significant number of countries, including of course, here in Iceland. The reverberations of political change and turmoil are being felt across Europe, in countries including Germany and the United Kingdom and, of course, across the Atlantic with the re-election of Donald Trump as President of the USA. However things turn out over the months and years ahead, some things are already clear: we are moving in a more turbulent geo-political landscape where cherished alliances and certainties may be challenged and territorial expansionism and protectionism may come to the fore; economic protectionism also seems to be re-emerging, creating new potential challenges for established orthodoxies and for certain cherished business practices.

Despite the tight monetary stance adopted by the Central Bank of Iceland, six separate volcanic eruptions on the Reykjanes peninsula and a certain amount of political turmoil, the Icelandic economy successfully navigated turbulent waters during 2024. An important milestone was reached when the private labour market managed to strike a deal, resulting in a four-year contract which acted as a framework for subsequent agreements. Inflation continued to recede, creating leeway for long-awaited interest rate cuts. At the beginning of 2024, the main interest rates of the Icelandic Central Bank stood at 9.25%, but following two rate cuts late in the year, interest rates ended at 8.5% and have continued to decrease in early 2025, now standing at 8%.

Nevertheless, this still represents a very high interest rate level, on a through-the-cycle basis, and poses considerable challenges, for consumers and for companies alike. According to preliminary figures from the National Accounts, the economy grew only by half a percent in 2024, – something that we are keen not to see repeated, though there is, of course, a trade-off which we all understand, to deploy higher interest rates, as part of a tight monetary policy in order to combat the threats of high inflation. We feel optimistic that inflation in Iceland will continue to recede, and the main interest rates will follow suit in the coming months, though we remain alert to the economic and geo-political headwinds which still persist.

Slower economic activity and the high-interest-rate environment have somewhat impacted the Bank's operations as was to be expected. After a rather muted first quarter, Arion Bank performed strongly overall during the year. At year-end the Bank was on a strong footing, with a capital ratio of 22.6%, and an equity level of 207 billion krónur. We were pleased to conclude dividend payments and share buybacks totalling 25.5 billion krónur.

Arion Bank's share price was initially rather subdued during the first part of 2024, before gaining traction in the second half of the year; this pattern broadly reflected the performance of the overall Icelandic equities market. The

Bank's share price on Nasdaq Iceland ended the year 9.9% up, while SDRs on Nasdaq Stockholm climbed by 22.1%. Taking into account dividends during the year, Arion Bank's share price climbed by 16.6%, and SDRs in Stockholm rose 29.5%, a pleasing trend which we believe underlines the Bank's very solid operating progress and performance.

During his speeches to our AGM meetings in the past, my predecessor, Brynjólfur Bjarnason, often reflected upon the prevailing structure and competitive environment within the Icelandic financial market. He observed that the Icelandic government still holds around half of the ordinary share capital of the main Icelandic commercial banks and spoke in favour of the Government seeking to reduce this ownership level over time. Brynjólfur wasn't just talking about the sale of the government's 42,5% stake in Íslandsbanki, which is now understood to be imminent, but also about future prospects for the State to reduce its interest in Landsbankinn, which currently remains effectively fully owned by the Government of Iceland. I endorse Brynjólfur's view and would like further to observe that in any economy, but perhaps especially in a small market such as Iceland, the competitive environment can become unbalanced, or perhaps even distorted over time, when the biggest commercial participant in that market, effectively, is the government itself.

Last month, we members of the Board and Executive Management Team of Arion expressed our interest in initiating talks on a merger with Íslandsbanki. This was considered by many to be a bold move; perhaps also, it took many people by surprise.

In recent years, there have been many discussions upon the perceived importance of reorganising the Icelandic financial system. However, up until now, there have been fewer concrete ideas or proposals as to how such a reorganisation could be brought about.

Some more operational aspects of rationalisation within the industry have been mooted: for example, the potential for

financial institutions to share aspects of their infrastructure more, in areas which do not confer a potential commercial competitive advantage: one instance of this would be in combatting money laundering. However, to date such discussions have yielded few concrete results, partly because there are substantial legal constraints on the extent to which banks or other financial institutions would be permitted to operate together in such ways in Iceland.

The fact is that we still have a relatively large, and in many ways inefficient, financial system, in an otherwise very small economy. It is a framework in which three “systemically important” banks need to operate in accordance with a highly complex and restrictive EU regulatory framework, designed of course for far larger entities, on top of legal requirements specific to Iceland which impose various obligations and taxes and entail a huge additional expense for the system. Indeed, the three main banks in Iceland, each of which is designated as “domestically systemically important” are among the smallest systemically important banks to be found anywhere in Europe. Each and every bank in Iceland has to maintain, individually, an expensive infrastructure, including costly anti-money laundering measures, extensive internal control units, with detailed and frequent reporting to the regulatory authorities. I should emphasise that none of us questions that this infrastructure is relevant and necessary: in order to function as part of an efficient, compliant and internationally regarded financial system, such a control infrastructure is an absolute necessity. However, by having to replicate this burden of control across a number of domestic financial institutions, each of which is domestically important in Iceland, but which are very small-scale by international comparisons, Icelandic institutions assume an individual cost burden which risks becoming both individually onerous and collectively difficult to sustain in the longer term for the Icelandic system as a whole.

And this proliferation of cost base amongst smaller domestically significant institutions comes with Iceland specific elevated costs for the system as a whole – costs which, ultimately, are borne by customers and by

shareholders in one form or another: higher bank levies and elevated surplus capital requirements are among the more visible manifestations of these higher costs.

We should remember also that shareholders' equity represents, in effect, capital which requires a competitive rate of return for shareholders, but that equity constitutes, in many instances, potentially one of the most expensive types of funding for a bank.

Quite often it has been stated that bank capital requirements in Iceland are on a par with the Nordic region. In my opinion, however, this can be a misleading comparison, as risk-weighted assets are calculated differently in Iceland: using the standardised rather than the internal rating-based methodology, which generally leads to a higher capital requirement. A comparison of leverage ratios across various jurisdictions indicates that Icelandic banks are required to maintain up to 70% more capital than systemically important banks in Norway, and up to 130% more than such banks in Sweden.

The Icelandic customers and bank shareholders who ultimately finance these extra costs are, of course, ultimately the people of Iceland, who currently own around half of the equity in the main commercial banks via the government shareholding, and who also (I must add) own much of the rest of the Icelandic financial system through shares in the banks held by Icelandic pension funds, so the people of Iceland own indirectly and directly almost three quarters of the Icelandic financial system.

Even if we were able to achieve a substantial increase in shared infrastructure within the domestic financial system, this of itself would not significantly drive down costs, especially relative to other nearby jurisdictions. It would represent a step in the right direction, but would not really achieve the substantial gains which we believe that our system and economy requires. This was our primary motivation when we announced our interest in incepting merger discussions with Íslandsbanki: to facilitate systemic change which would have a genuinely positive impact on consumers, companies and the economy as a whole.

Among our arguments for this merger proposal was that other methods are also possible to determine market competitiveness than the approach generally used in Iceland; we referred to European competition law, which permits mergers between two major companies if it can be demonstrated that such a merger would yield quantifiable benefits for consumers which could not be achieved by other means. The European telecoms market provides several examples of such mergers. Indeed, telecom companies and banks have a lot in common, such as expensive and socially critical infrastructure and a complex regulatory framework.

Although the board of Íslandsbanki eventually decided to decline the offer of further talks, the Board of Arion remains convinced that a merger between the banks would represent an important opportunity to bring change to the Icelandic financial system and would constitute a highly positive option for consumers, shareholders and the Icelandic economy, with substantial merger benefits accruing to those stakeholders. Of course, I wish to reiterate that I fully respect the Íslandsbanki Board's decision, and I thank them for having taken the time carefully to evaluate our proposal.

Bringing about positive change and getting things moving is integral to Arion's culture; it is within our DNA. At the moment our competitors are eagerly imitating our bancassurance model and Premía service. Arion has also transformed the Icelandic mortgage market on various occasions and we have played a key role in resurrecting the stock market after it was left in a parlous state following the Great Financial Crisis. We have also spearheaded the digital revolution in financial services by making our services widely available in online format, including via our Arion App. In all of these cases the Arion Bank has acted as a trailblazer. We hope that our initiative from last month in recommending the merger of Arion Bank with Íslandsbanki will act as a catalyst for further debate and restructure of Icelandic Financial Services, in a mindful, cost-effective and stakeholder friendly way