ANNUAL GENERAL MEETING 2014

Chairmans Address

Íslandsbanki 2014 - Annual General Meeting

Friðrik Sophusson, Chairman of the Board

Solid platform for sustainable growth

2013 was a good year in the history of Íslandsbanki. The Bank‘s infrastructure strengthened as a result of the strategies executed, and decisions taken, over the last few years.

Íslandsbanki’s balance sheet is robust and provides a solid platform for sustainable future growth. The Bank’s market share in Iceland is over 30% amongst individuals and even higher in the corporate market. The equity ratio is at a strong 28.4%. Seen from that perspective one can conclude that the Bank’s ROE is easily adequate.

Dividend payment

A special holding company, ISB Holding, holds 95% of shares in Íslandsbanki on behalf of Glitnir Bank and the Icelandic State Financial Investments holds the remaining 5%. At the 2013 Annual General Meeting it was decided to pay out a dividend to the Bank‘s shareholders for the first time, a total of 3 billion Icelandic Kronur. The Board of Directors has decided to propose a dividend payment amounting to 40% of last year’s profit.

According to the proposal a dividend payment amounting up to 4 billion Icelandic Kronur will paid to shareholders immediately after the Annual General Meeting. However it also provides for a shareholder meeting to be held later in the year that can decide on further dividend payments within the scope of the Board of Director’s proposal. The dividend payment will be in Icelandic Kronur.

Íslandsbanki‘s Risk Book

Íslandsbanki‘s Risk Book has today been published for the fourth time. The Bank emphasises transparency and disclosure regarding its operations and was the first bank in Iceland to publish a special Risk Book.

The Risk Book has always been well received and other banks have now followed Íslandsbanki‘s precedent. The report provides a comprehensive overview of the Bank‘s Risk Management as well as the regulatory environment that the bank operates in. The Risk Book includes important information, especially for investors, analysts and other interested stakeholders who want to understand the Bank’s risk management structure.

Taxes and levies

Last year, the Bank paid a total of 12.4 billion Kronur in taxes and public levies, including the FME supervision levy. The special Bank Tax, which was imposed last year, amounted to 2.3 billion Kronur. The Government has stated that the new levies would only be temporary to cover costs related to its new Debt Relief programme, which was presented recently.

It is important that the Government sticks to its word as this extraordinary taxation scheme, based on the bank’s source of income, total debt and wages, greatly reduces the efficiency of the banking system and furthermore counters the various actions and initiatives, taken by Íslandsbanki over during the last few years, to reduce costs and streamline operations.

The special Bank Tax distorts significantly the competitive environment in which the bigger commercial banks operate, not just in Iceland but also how they can compete with foreign parties.

Domestic institutions that compete with the banks in the housing market, the state's Housing Financing Fund and the pension funds are exempt from such taxation and smaller financial institutions are also exempted. This tax also weakens the competitive position in favour of foreign Banks who finance Icelandic corporates, and it can provide the foreign competitors with an opportunity to offer poorer credit terms than they otherwise would have.

Since 2008, Íslandsbanki has paid a total of 37 billion Kronur taxes and public levies. Corporate tax weighs most heavily in this regard followed by the special Bank Tax. The effective tax rate grew to 26.2% in 2013 compared to 23.7% in 2012.

Remuneration Policy

According to Íslandsbanki's Remuneration Policy the Bank can pay its employees and management performance-based payments based on a special Performance Payment Scheme, which the Board of Directors approved.

In 2013, Íslandsbanki started implementing the performance payment scheme so that it would apply to a larger number of employees than only the Management Board. Today, the scheme applies to around 100 employees. It is based on the strict framework provided by the Financial Supervisory Authority (FME). According the framework the performance based payment may not be higher than 25% of the employees' annual salary, but in 2013, the framework was not fully utilised as the average performance payment amounted to 14% of annual salaries. Furthermore, the Bank must defer payment of 40% of bonuses for three years. Also, the bank can reclaim against an employee for up to five years after payment is made, if it appears that the employee's performance has deviated significantly from those used as a basis for incentive payments.

The system was approved by the BoD after consideration by the Remuneration Committee and it considers a range of factors, including those that contribute to good business practices, leadership skills, service and customer satisfaction and staff engagement.

The Remuneration Policy is further described in the Bank's Risk Book.

The framework for performance-related pay is much stricter in Iceland than in our neighbouring countries, such as Norway, Sweden and Denmark. It is however reasonable, seen in the light of the Icelandic Financial Meltdown in 2008. However, we should not dismiss the positive influence such a scheme can have on behaviour if it is designed with intrinsic measures that reduce undesirable risk-taking behaviour, and encourages healthy business practices.

Risk and supervision

In the wake of the global financial meltdown, the risk appetite of financial institutions was widely condemned. This reaction was quite normal – especially due to the fact that governments and taxpayers in different countries were severely hit by the crisis. It should though not be forgotten that appropriate risk appetite can be an important catalyst in societies that desire economic progress and prosperity. The main issue here in Iceland, like in any other country, is that the ones who seek the risk should also bear the responsibility for it.

Supervision and consumer protection is necessary in a modern society. What is important is that companies and their employees are trained and engaged in conducting good business based on internal rules and work procedures. Expensive public supervisory institutions will never replace the trust and the responsibility which are part of healthy business practices. It's also clear that independent and well educated individuals are the best check on companies and public bodies that do not engage in good corporate governance or work practices.

More and more new trees are being planted in the government’s regulatory jungle. Company boards are using more and more time to discuss regulatory and supervisory issues, which means that less time is spent on important strategic issues. Increasingly, work-hours are spent on servicing the requirements of supervisory bodies. Even the European Union, which is without a doubt a record holder in regulatory forestry is aware of this problem and has taken measures to cut back its undergrowth by 25%. Some legislators have even decided not to adopt new regulations without first abolishing old ones.

The current government in Iceland agrees on this view. Hopefully they will walk the talk, even though we see indications of the opposite.

Corporate Governance

Íslandsbanki’s Board of Directors and management team have put a lot of emphasis on improving and promoting good corporate governance and decision making processes. Recently Íslandsbanki received an acknowledgement from the Icelandic Research Institute of Corporate Governance for being an exemplary company in terms of good corporate governance. This acknowledgement is a delightful confirmation of the extensive work which has been accomplished within the bank.

It is our objective that the Bank’s operations be made as solid and robust as possible, and the best way to attain that objective is to practice good corporate governance and healthy business practices.

This acknowledgment confirms that we are on the right path. It is based on a detailed audit of practices and work procedures of the BoD and the Bank’s management team conducted by KPMG in January 2014. According to the Research Institute the audit provides a clear picture of the Bank’s corporate governance and shows that Íslandsbanki can be held up as a good example for other companies when it comes to good corporate governance.

Political Risk and Financial Stability

Having had several discussions with foreign investors one reaches the conclusion that political risk in Iceland is considered to be very high, and that it is effectively deterring foreign investment in Iceland.

This appraisal is the result of numerous government interventions, which are often unforeseen and implemented without notice and can have sudden and deleterious effects on the operational environment of companies. The special Bank Tax is an example of such an intervention. It is vital that the government considers issues like this more carefully when they take such measures if they really mean to attract foreign investment to Iceland. This is something which our neighbours in Ireland are well aware of. Foreign investors in Ireland can trust that taxation is not changed overnight. Based on my experience I know that a stable tax policy is crucial when countries want to attract foreign direct investment.

Financial stability is of highest importance, for banks and society as whole. Stronger financial institutions and improved economic conditions have provided a more solid base for financial stability over recent years. We must continue on that path and make sure that the current stability will be permanent. Changes that affect the economic and regulatory framework of financial undertakings should always be considered from this point of departure. This applies to possible changes in the mortgage lending market, the abolition of currency controls and changes to the indexation of housing loans, to name a few important issues which have been debated recently.

Experience has taught us that that the interests of society and the financial system are important, complex and interwoven and it is therefore important to take great care before making drastic changes.

Future structure of the housing market
Recently a working group on the future of the Icelandic housing market delivered a report, which was a welcome contribution to the debate on this important issue. I hope that this report will speed up changes and make it possible to reduce the structural uncertainty around the future of the market – particularly the destiny of the the Housing Financing Fund. Many of the proposals are sound, however it is important to consider the possible cost of making the proposed changes. It is reasonable to ask whether it is possible to achieve the set objectives without increasing operational costs by imposing on the mortgage market the establishment of new financial companies to service it.

Ownership
At the last annual meeting I addressed the ownership of ISB. It is clear that the current owners of Íslandsbanki are not the future of the Bank and their objective is to sell their stake when conditions are appopriate. I would especially like to emphasis that the current owners have never tried to influence any decicion making of Íslandsbanki‘s BoD on the cost of other stakeholders. Glitnir Bank, which owns 95% stake in the bank, has expressed interest to seek a listing of the Bank on the stock exchange.

It is vital that Íslandsbanki will remain in private ownership, either by domestic or foreign owners, and that these owners will have an interest in conducting financial activities in Iceland, are focused on the long run prosperity of the bank and society, are interested in working with Icelandic businesses and participating in the development of Icelandic commerce and industry. Foreign ownership of Íslandsbanki could have positive effect on the countries balance of payments, open access for foreign capital and create favourable conditions for abolishment of capital control.

Íslandsbanki has a long history and deep roots in Icelandic society. In 1990 the name Íslandsbanki was acquired from the Bank‘s predessor, when that bank merged with three other privately owned banks.

The current board and managment team have prepared the Bank for an IPO and sale proces during the recent years. Three enteties, Byr, savings Bank, Kreditkort and Framtíðarauður, have been merged with Íslandsbanki. The Bank‘s equity- and liquidity position is strong and the bank has been awarded for different activities in Iceland and abroad. What is most important is to ensure that the interests of its customers, employees and the whole Icelandic nation will be put in first place, no matter what the new ownership structure will be.

Changes in the Board of Directors
Today, Íslandsbanki complies with recent legislation on gender quotas. In September last year, a shareholder meeting approved changes to the Board when Helga Jónsdóttir Valfells and Þórunn Jónsdóttir were appointed Board Members. Changes were also made in the Board standing committees that deal with specific issues. The Special Credit Committee of the Board was wound up, but that committee dealt with the larger credit cases related to debt restructuring of larger companies, and therefore has now served its purpose. A special Strategy Committee, which deals with the policies and objectives of the Bank, has replaced the Special Credit Committee. This change reflects the strong position of the Bank, where more emphasis is placed on operations and strategy for the future rather than solving the problems of the past.

Increased optimism
In recent months, the results of a survey among managers of the 400 largest companies in the country were published. It shows that managers are more upbeat than they have been in recent years. They furthermore expect lower inflation rates in the coming months, and forecasts indicate that inflation will be at an all time low in the coming months. The managers who participated in the survey

also expect increased investment, especially in construction, transport and tourism, which is particularly pleasing as those industries have a direct impact on the Bank's activities.

Recognitions and final remarks

2013 was a good year for Íslandsbanki and saw sound results based on the hard work and the diligence of the Bank's employees in recent years. I want to thank the Board of Directors for their pleasant co-operation during the past year. Many interesting projects have come before us during this time. I would also like to thank Íslandbanki's employees and management team for their dedication to that has resulted in the success of the Bank. I would furthermore like to thank our shareholders, ISB Holding and ISFI for your co-operation.

I would l especially like to thank Birna Einarsdóttir, CEO, for her work for the bank. She and her team have been met with many challenges in the recent years and done a great job, resulting in a strong and robust Bank.

Optimism is growing in our country and ahead are numerous interesting projects relating to the ownership of the bank and the future monetary policy framework of Iceland. Íslandsbanki wants to be a catalyst for positive change in this regard and to work with businesses, the government and civil society to further the interests of the community at large.

Íslandsbanki's most important duty is to ensure that its profits are soundly based and that its practices are correct in every respect. That way, Íslandsbanki can best fulfil its role in providing capital for industry and families in the country.

Thank you.