

ANNUAL GENERAL MEETING 2015
Chairmans Address

Íslandsbanki Annual General Meeting 2015

Fridrik Sophusson, Chairman of the Board

Ladies and gentlemen

2014 was a good year for Íslandsbanki. In recent years, the Bank has made targeted efforts to strengthen its core operations through cost control and steady income growth, so as to reduce its dependence on irregular operational items. In my opinion, the positive attitude towards the Bank, as shown both in surveys and in awards it has won, has brought increased business and market share.

Íslandsbanki's after-tax profit amounted to ISK 22.8bn. Roughly a third of that profit is due to irregular items, such as changes in loan valuations and profits on discontinued operations, which derive primarily from the sale of assets in unrelated activities. The Bank's profit from regular operations was ISK 14.8bn. Profits can be assumed to contract somewhat in coming years, as the weight of the irregular items declines over time.

Return on equity and dividends paid

Íslandsbanki's capital adequacy ratio was 29.6%, which is very high in international context. Its return on equity was 12.8%, which must be considered strong in view of the fact that the Bank's capital has been rising.

The return on equity from regular operations is in line with the recent trend among Iceland's 100 largest firms, according to an analysis carried out by the Confederation of Icelandic Employers.

The holding company ISB Holding administers Glitnir's 95% stake in Íslandsbanki, and the Icelandic State Financial Investments administers the State's 5% holding. The Bank's dividend policy assumes that owners will receive up to 40% of the profit for the year in the form of dividends. Since its establishment, however, the Bank has only paid about ISK 7bn in dividends. As a result, its equity has grown, which makes it harder for the Bank to achieve strong returns on equity in the long run. Before the meeting is a proposal to pay dividends in the amount of ISK 9bn, which is just under 40% of the profit for the year.

Interest rate spreads and further streamlining

Public discussion has often been dominated by criticism about the banks' profits. References are made to excessive profits and abnormal lending activities, and the Icelandic banks' interest rate spreads are said to be extremely high in international context. But in order for such a comparison to be significant, it must take into account the size of the markets in which the banks operate. Capacent's financial consultancy team carried out an analysis of the Icelandic banking market over the period from 1997 to 2014. The analysis revealed that no bank in Iceland has reached the size that has been considered most economical in banking operations. Banking is characterised by significant economies of scale, as the required framework is more or less the same, no matter whether a bank serves 100,000 customers or 1,000,000. According to the Capacent analysis, Iceland's interest rate spreads were at its lowest point just before the crash, when the banking system was at its largest, and spreads were at their highest when the banking system was smallest. Moreover, further examination reveals that Iceland's interest rate spreads are not substantially larger than those of comparable banks elsewhere.

Íslandsbanki has made an effort to realise these economies of scale by merging with Byr, Kreditkort, and Framtíðaraudur. There is every reason to consider whether the market offers other opportunities as well. Additional mergers would result in streamlining that would ultimately benefit customers. The Bank has also participated in increasing RB's (the Icelandic Banks' Data Centre) share of services for the banks in those areas that can be streamlined without causing competitive clashes.

Public levies and increased competition

One factor leading to larger interest rate spreads is increased taxation. Levies unconnected with income have also increased significantly in recent years. Íslandsbanki will pay an estimated ISK 10bn in temporary bank tax over the four years that the tax is to remain in effect. The Bank has now paid nearly ISK 50bn in public levies since its establishment.

When taxes and other public levies are decided, consideration must be given to the competitive position of Icelandic banks, which are pitted increasingly against Nordic banks in the competition for loans to the country's largest firms. Iceland's special tax does not affect foreign competitors; therefore, it is critical that it remain only temporary, as has been announced.

One factor that places limitations on Iceland's competitiveness compared with other countries is our weak sovereign and corporate credit ratings. Although our borrowing terms abroad have improved, we still have much ground to cover before we can be considered competitive. And now, when wage negotiations are gaining momentum, it is important that the Government and the social partners

understand that a broad-based consensus on responsible fiscal policy, capital controls liberalisation, and improved terms of employment based on productivity growth are not only the preconditions for economic stability but also the foundation for better borrowing terms, which translates to an improved standard of living for the people of Iceland.

New bill of legislation

A bill of legislation amending the Act on Financial Undertakings was recently presented before Parliament. The bill is intended to incorporate part of the EU's Capital Requirements Directive, CRD IV, into Icelandic law. It proposes the legalisation of provisions on four of the five capital buffers introduced in the Basel III standards. The bill also discusses governance, employment terms policies, risk monitoring systems, and other topics. All of these amendments are rooted in the experience gained from the global financial market collapse. They place increased obligations and responsibilities on financial institutions' executives and boards of directors. The main purpose of the amendments is to bolster confidence in the financial system and prevent financial institutions' difficulties from landing on taxpayers' shoulders. But they also entail a much heavier staff workload and increased reserve requirements, both of which will inevitably increase the expense resulting from the banks' operations.

Even though most of the rules are rather onerous, we hope to be successful in implementing them, but it is imperative that Parliament ensures that the operational framework for Iceland's financial institutions is neither more stringent nor more costly than in other countries.

Reorganisation complete

The Bank now publishes a Pillar 3 Report. The report attempts to provide a clear and concise view of the Bank's governance practices as regards internal audit and risk management. It contains an interesting analysis of developments in non-performing loans. According to the commonly recognised definition of non-performing loans – those that are more than 90 days in arrears or are impaired – the report shows that the Bank has improved rapidly in recent years. In fact, according to data from the European Banking Authority (EBA), Íslandsbanki is comparable to banks in the top third of the European banking system. Based on this, the Bank considers it safe to declare that the restructuring of its loan portfolio, which began in 2009, is now complete, and the cases still outstanding will be processed concurrent with other cases that may arise at any time in banking operations. This very satisfying outcome is the fruit of Íslandsbanki employees' hard work and dedication.

In the section on operational risk, the report also states that the Bank has become increasingly aware of cyber-attacks. Most commonly, such attacks are attempts by unscrupulous parties to trick customers into revealing passwords and other personal information so as to gain access to their online bank accounts. Íslandsbanki's online bank is sound and secure, but special measures are called for if customers are tricked into revealing personal information to cyber attackers. The Bank has managed to avoid losses from this source and is constantly working to ensure that communications with the Bank are secure, by implementing security standards, conducting tests of network security, and adopting other measures. It is of vital importance that the Icelandic authorities respond swiftly and decisively to such risks by elevating the status of this function in public administration and by viewing the financial system as it does other indispensable information infrastructure; for instance, by developing Cert-IS, Iceland's Computer Security Incident Response Team.

Ownership

Speculation on the possible sale of Íslandsbanki has been seen and heard in the media. It is clear to all that the Bank's current owners are not its long-term owners. For this reason, the sale of the Bank has been in preparation in recent years, as has its listing on the stock market. I wish to stress yet again how important it is that Íslandsbanki be owned by private entities dedicated to conducting sound, responsible financial activities in Iceland, with the long-term view and the customer's interests as their guidepost. It is important that the Bank continue to participate in shaping and developing a new financial market, as well as promoting innovation and the economy as a whole.

Proposals for the Annual General Meeting

In addition to ratifying the Bank's audited financial statements and making a decision on dividend payments and distribution of reserves, this Annual General Meeting must elect a new auditing firm for the Bank. By law, a given firm may not work for the same financial institution for more than five years. Deloitte has been Íslandsbanki's auditing firm for the past five years, and I wish to

take this opportunity to extend the company's auditors my sincere thanks for a particularly smooth and satisfying professional relationship during this period. Also before the meeting is a proposal to increase the remuneration to the Board of Directors, which has not changed in five years. And finally, it is proposed that the Bank's remuneration policy remains unchanged.

Conclusion

In 2014, the members of the Bank's Board of Directors reduced from nine to seven, when María E. Ingvadóttir and Dr. Daniel Levin resigned at the end of the summer. I would like to thank them for collaborating with us and for their work on behalf of Íslandsbanki. At this meeting, there will be another change in the Board, as John Mack, who has been the Vice-Chairman for the past five years, is leaving the Board at his own request. I wish to thank John in particular for his valuable work, which is based on decades of experience in the global financial sector. John and his wife, Janne, have been frequent visitors to Iceland, and I sincerely hope that they will continue to visit us in the future, even though his tenure with the Board is coming to a close. I also offer my sincere thanks to my fellow Board members, and I want to thank ISB Holding and Icelandic State Financial Investments, the Bank's shareholders, for their cooperation in recent years.

Íslandsbanki's employees have worked hard and worked well in the past year. Our strong performance is the fruit of their labour. The operating results that CEO Birna Einarsdóttir will present in a few moments say all that needs to be said on that score. On behalf of the Board of Directors, I would like to thank the Bank's management and employees for an excellent year. All employees, wherever they are in the Bank – in the front lines or in the back office – work together as a team to offer our customers outstanding services, no matter whether they want to invest their savings, take out a mortgage, or conduct other business. Íslandsbanki's main social obligation is to carry out sound operations based on healthy business practices. The Bank is in the important position of being able to act as a catalyst for investments, private initiatives, operations, and innovation. By performing its role in a spirit of attentiveness, professionalism and aspiration, Íslandsbanki can make its contribution to the greater welfare of coming generations and promote progress in the society, by showing a sense of responsibility and by being a role model for other firms and institutions in Iceland.