



Report of the Board of Directors

23 March 2023

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Dear Shareholders,

I will now deliver the report of the Board of Directors for the year 2022. Afterwards, our CEO, Lilja Björk Einarsdóttir, will review the Bank's operation in the previous year.

This is my seventh time delivering the report of the Board at Landsbankinn's annual general meeting. In preparation, I reviewed my previous reports on this same occasion. There is a common thread in all these reports - we are always facing large challenges, external conditions are always demanding and requiring our close attention. Just over a year ago, we were dealing with the aftermath of Covid-19. Now we are facing other challenges. Russia's invasion of Ukraine has been devastating for that nation and has had a considerable, wider economic impact, mainly in the energy market. Getting inflation under control is proving to be a trying task, both domestically and abroad, interest rates have risen and there is considerable unrest on international capital markets, which I'll address in more detail later. Competition in the banking market remains hard and the situation undergoes constant changes. The external environment has long been challenging and will almost certainly remain so. It is important that the Bank's operation is stable and sound, and that we are successful. All of this certainly applies to Landsbankinn.

Good results

Landsbankinn achieved good results in 2022 and we attained most of our goals. Net interest income grew by 19% and net fee & commission income by 12%. Increased activity, good results in corporate banking and corporate finance, along with sound asset management are the largest drivers of success.

We have gained many new customers on both the retail and corporate side and the Bank's market share in the retail market has never been higher. We also topped the Icelandic Performance Satisfaction Index in the banking market, for the fourth year in a row. There is great momentum in the Bank and we have launched several new solutions and approaches to our services, most recently our own merchant acquiring service. Customers are happy with more varied and improved services. This allows us to strengthen our fee and commission income base - our aim is to increase fee and commission income considerably.

The Bank's profit in 2022 was ISK 17 billion after tax and return on equity was 6.3%. We achieved good results from core operations but the decreased fair value of the Bank's shareholding in Eyrir Invest hf., in the amount of ISK 10.5 billion, puts profitability below target.

Sound operation over the past several years has resulted in Landsbankinn's strong position, by any measure. At the turn of the year, the Bank's equity amounted to ISK 279 billion and its total capital ratio was 24.7%, well above regulatory requirements.

This position allows us to pay dividend to shareholders and, in line with the Bank's dividend policy, the Board of Directors has proposed that the AGM approve payment of ISK 8.5 billion in dividend for the year 2022, or 50% of the year's profit. If the proposal is approved, the Bank's dividend payments in 2013-2023 will amount to ISK 175 billion.

Service our customers want

Landsbankinn is at the forefront when it comes to development of technical infrastructure and digital solutions for our customers. Landsbankinn's app has been a hit and we are pleased to see a great increase in its use by corporate customers. But even though banking service has changed and is increasingly taking place on web-based platforms, the need for personal advice and service remains. One of the things that make Landsbankinn unique is that we are where our customers are. It has been our policy to continue to operate branches and outlets in communities around the country, where the conditions provide for such activities. We are part of the community and follow through on our words.

New technology has not only changed banking practices on the customer side, it has also led to changes in how we provide personal service and advice. Landsbankinn utilises technology to enable employees all around the country to attend to customers regardless of geographies, using the channels that are best suited to needs and purposes at each time. This allows us to draw much more effectively on the great expertise of our team, jobs in branches become more varied, the wait for advice and services is shortened and service improved.

We have aligned our activity with the fact that fewer customers visit branches and outlets by reducing housing space and adapting opening hours to changing demand. We have sold the old Landsbankinn buildings in Selfoss, Ísafjörður and most recently in Akureyri, as they had become unnecessarily large for our operation. These buildings are all closely knit to the Bank's history and are undeniably a regret. The fact remains that with our removal from these old and venerable bank buildings, they can be revitalised and get a new lease on life. I am confident that the same will apply to the building we stand in now. It is as yet unclear what will replace us here in Austurstræti 11. The State requested a dialogue for the possible purchase of the building last fall. We were happy to oblige but no conclusion has been forthcoming. We consider it important that the building receive a worthy purpose for the future.

Growing importance of sustainability

The Bank has amassed a great deal of knowledge about sustainability and is strongly focused on the issues. Work on sustainability at Landsbankinn is based on its ambitious Sustainability Policy, revised in 2021. It is our experience that customers, both individuals and companies as well as our employees, are increasingly aware and mindful of sustainability.

The focus point of sustainability work in financial institutions has in recent years been on measuring CO2 emissions from operations. In 2022, the COP15 conference resulted in the Montreal Pledge on actions to safeguard biodiversity. Financial undertakings obviously have an important role to play but, as in the case of emissions, there is a need for methodology to measure the impact of financial undertakings on biodiversity. We determined to participate from the start and, in 2022, joined the Partnership for Biodiversity Accounting Financials (PBAF) who are working on developing this methodology. We are leading in sustainable development and aim to continue on that path.

Important to gain control of inflation

Volatility has characterised both the Icelandic and international economies recently. The situation is different and better here in Iceland than in most other countries; even so, we still face significant economic challenges, dominated by the struggle with inflation. The Central Bank of Iceland has raised the policy rate quite a lot in an attempt to counteract inflation, most recently yesterday by 1 percentage point. Thankfully, most of Landsbankinn's customers are well placed, with loans past due at a historic low, both on the corporate and retail side. This year, but primarily in 2024 and 2025, the fixed-rate term will end for many of our customers who fixed non-indexed rates when they were at their lowest. All things remaining equal, it is clear that many borrowers will face considerably higher debt service once the fixed-rate term ends.

Our customers are variously well positioned to shoulder this increase. For those who recently entered the housing market and who took on high mortgages without having similarly high incomes, the interest rate hikes will certainly be challenging. At Landsbankinn, we wish to work with our customers to find ways to get through difficulties. And there are various options available. It will be enough for some borrowers to extend the term of loan to reduce the debt service. Others may need to refinance, applying inflation-indexation to part or even the entire loan to lighten debt service. Once the interest rate level recedes, it will be possible to again transition to non-indexed loans.

We monitor developments closely and will support our customers in so far as possible. There are various options for those facing increased debt service. We will continue to offer our customers professional advice, competitive terms and solutions as and when necessary.

Landsbankinn has strict demands on the payment capacity of housing loan applicants. We do not use the official maintenance benchmarks in our credit assessment; rather, we apply higher benchmarks that we deem a better reflection of reality. As the applied for loan amount increases, so does our requirement of the applicant's payment capacity. We also demand a larger down-payment in real estate transactions. These requirements apply equally to all applicants for housing mortgages. It can be assumed that these strict demands are a factor in our low rate of past-due loans, despite recent and significant interest rate hikes.

Successful bond issue

In recent weeks, there has been some turmoil on international capital markets which can be attributed to the fall of Silicon Valley Bank in the US. When such news reaches us, it is good to keep in mind that the Icelandic banking system is especially strong. The main effect of this turmoil on Iceland is the deterioration of terms on international capital markets, leading financial undertakings to limit issuance of new bonds.

In light of these conditions, it is important that Landsbankinn finalised issuance of EUR 300 million covered bonds on 9 March. The issuance was of premium covered bonds and was the inaugural European Covered Bond (Premium) issuance of any Icelandic bank. Being premium bonds, the terms achieved on the issuance can be expected to be more favourable. This was the case here, and the Bank achieved good terms.

The Bank had not previously issued bonds in this class because of restrictions in the legal environment, restrictions which were removed with a new Act on covered bonds. This Act finally entered into force on 1 March and the Bank's employees are to be commended for managing to prepare and execute issuance in the short time since the Act entered into force.

Landsbankinn also recently concluded issuance of ISK 12 billion secured subordinated bonds, intended to improve the Bank's capital structure, especially having regard for new minimum requirements for own funds and eligible liabilities (MREL) determined by the Resolution Authority of the Central Bank of Iceland for systematically important banks.

100 years between moves

Next year, 100 years will have passed since the Bank moved into Austurstræti 11 again following the destruction of the first Landsbankinn building in the Great Reykjavík Fire of 1915. This building proves the importance of doing things well, both in the design and construction process, not least when building in prominent places in cities and towns. When this house was built, it was built for the future. The same applies to Landsbankinn's new headquarters at Reykjastræti. The building is beautiful, a fine addition to this important part of the cityscape and once construction is completed, it finalises the extensive development that has taken place in the area. The new headquarters will contribute to the harbour area and help activity flourish with its open spaces and lively operation. It will strengthen the Bank's operation in that it offers a much better work environment than current facilities in Kvosin and Borgartún, which are both impractical and inefficient.

Construction is going well and the first groups are moving in these days. From the beginning, we have planned for utilisation of around 60% of the building's square measure (around 10,000 square metres) by the Bank itself while other parts of the building would be sold or rented. In fall, an agreement was reached with the State for the purchase of the so-called North Wing of the building to house the Ministry of Foreign Affairs and part of the activity of the National Gallery of Iceland. Sale of the North Wing to one large and trusted buyer was both simple and efficient. The activity the State intends to house in the building harmonises well with our own operation and provides several options for joint operation. Both parties stand to gain from this arrangement.

Leading bank

Landsbankinn will clearly still have to contend with challenges in its external environment as well as competition, as financial services are developing at break-neck speed. The Bank's strong financial position, combined with its team of ambitious and hard-working employees all around Iceland, will enable us to continue to be a leading domestic bank. The Bank is committed to work for the benefit of its customers and owners, having regard for the interests of employees and society in general. On behalf of the Board of Directors, I thank Lilja Björk Einarsdóttir, CEO, other executives and the Bank's employees for their excellent performance and for pleasant and effective collaboration in 2022.

Building new headquarters every 100 years is a testament to long-term thinking. I want to end my report with a short video from the construction of the new building. The Bank acquired the plot for a good price in 2014, the final decision to build there was taken in 2017 and construction commenced in 2019. We, the Directors of the Board, are extremely proud of this building and look forward to going to work there.