

To: The Minister of Finance and Economic Affairs

From: Icelandic State Financial Investments

Date: 17 December 2020

Subject: Proposal for the Sale of Shares in Íslandsbanki hf.

Memorandum

In this memorandum, Icelandic State Financial Investments („ISFI“) sets forth further arguments in regards to the submission of a proposal concerning the sale process of the state’s holdings in Íslandsbanki hf. („Íslandsbanki“) and its arrangement, cf. paragraph 1 in Article 1 of Act no. 155/2012 on the sale process of the state’s holdings in financial undertakings. The proposal is as follows:

To sell shares in Íslandsbanki hf. with the intention of an initial public offering followed by a listing on a regulated domestic stock market.

On 4 March 2020, ISFI published a report, *Ownership and sale of Íslandsbanki hf.: Status report on proposed sale process.*¹ On the same day, ISFI submitted a proposal to the Minister. The proposal was as follows:

To sell a minimum of 20% of the shares in Íslandsbanki in a dual track sales process, with a primary aim of selling the shares through an initial public offering (IPO track) followed by a listing of the shares on a regulated market and a secondary aim to sell a part of or all the state’s shares in the bank through an auction (M&A track).

Because of major economic effects due to COVID-19, ISFI withdrew aforesaid proposal on 16 March 2020.

From the date of withdrawal, developments in both financial markets and Íslandsbanki’s results have been better than expected in mid March. From 16 March to 16 December this year, shares in Icelandic companies (ICEX main index) have risen by one half (50.0%) and shares in European banks (STOXX Euro 600 bank index) by almost one third (32.4%).² Furthermore, in this period, successful equity placements have been concluded domestically with strong retail demand. Also, year to date, results of Íslandsbanki have been better than implied by the Central Bank of Iceland scenario analysis published in *Financial Stability Report 2020/1* on 1 July this year. On the other hand, there have been very few examples of M&A activity in European banking during this period.

In light of these developments, ISFI considers it appropriate at this point in time to submit a sale proposal with the aim of offering the shares to the public, without the auction track, as in its proposal from 4 March. The sale process will be executed in accordance with provisions of Act no. 155/2012 and Act no. 88/2009 on ISFI, which emphasize strengthening the domestic financial market, active and healthy competition and active information disclosure to the general public, as well as objectives of efficiency, an open sale process, dispersed ownership, transparency and objectivity. Furthermore, the sale process will be in accordance with provisions stipulated in an agreement with the Icelandic Competition

¹ See http://www.bankasysla.is/files/Status%20report%20summary_992347094.pdf

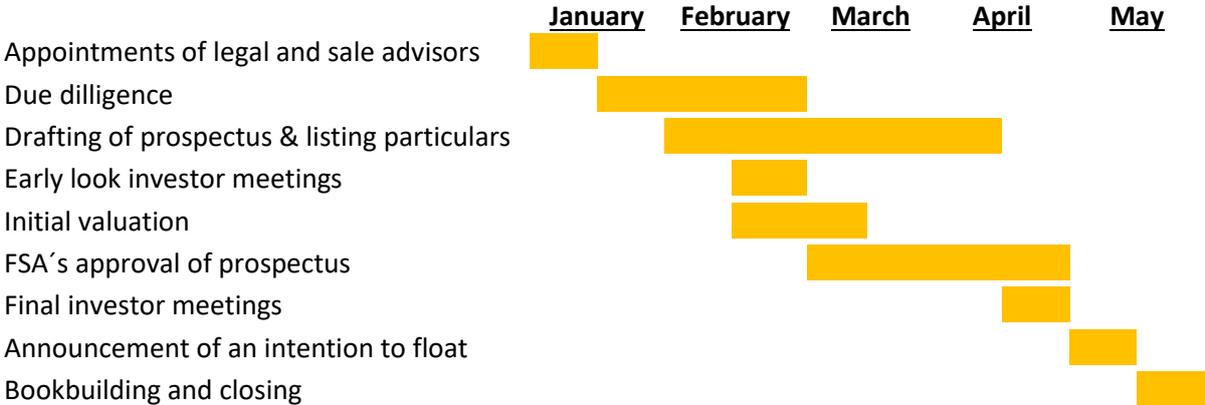
² During this period, the price-to-book multiple of Arion banki hf. has increased from 0.55x to 0.84x.

In case of any discrepancies, the Icelandic version of this proposal shall prevail.

Authority, cf. decision 9/2016. ISFI will also emphasize minimizing the government’s risks and costs associated with the sale process.

Table 1 outlines the steps necessary for the sale process with an IPO followed by listing on a regulated domestic market. The table shows the steps required, from the decision by the Minister to proceed with the sales process, cf. paragraph 2 in Article 2 of Act no. 155/2012, until the Minister makes a final decision on submitted offers, cf. paragraph 2 in Article 4 of the same act.³ The steps that appear in the table are in accordance with standard market practices and provisions of Act no. 155/2012 and Act no. 88/2009. ISFI anticipates that the sale process, which is complicated in execution, will commence with the appointment of international and domestic legal and sale advisors and will conclude five months later with the procurement of bids and share subscriptions.

Table 1: Sale process of an IPO followed by a domestic listing in 2021



ISFI believes that the size of the IPO tranche should not be determined at this point in time, since expected investor demand for shares in Íslandsbanki, both in regards to size and price, will only be known after investor presentations towards the end of the process. Investor demand will depend on Íslandsbanki’s results and developments in financial markets in the first half of next year. Since it is standard market practice to disclose the size of an IPO and initial price range in an intention to float announcement concurrently with the publication of a prospectus, ISFI recommends that the final size of the offering should not be determined until May next year.⁴ At that point, clearer information should be available about the dividend capacity of Íslandsbanki, which plans to publish its full year results on 10th of February and first quarter results on 5th of May next year, at which time monetization in the form of dividends rather than a sale of shares could be more appropriate, especially if development in financial markets are unfavorable. However, if developments in Íslandsbanki’s profitability are disappointing, so that neither an acceptable price for the shares will be obtained nor dividends can be disbursed, ISFI might propose to the Minister to cancel sale process and proceed to implement appropriate changes at the bank.

³ Before the Minister’s decision, he has to prepare a memorandum for two parliamentary committees, cf. paragraph 1 Article 2 of said Act.

⁴ Exchanges rules often contain provisions that the minimum float shall be 25% with 500 public shareholders, but ISFI considers that an exemption could be granted due to the underlying size of Íslandsbanki. See e.g., *Nordic Main Market Rulebook for Issuers of Shares*, dated May 1, 2020.

In case of any discrepancies, the Icelandic version of this proposal shall prevail.