

**Arion Bank Mortgages
Institutional Investor Fund**

Financial Statements 2013

Contents

Endorsement and Signatures of the Board of Directors and the Managing Director	3
Independent Auditor's Report	4
Income Statement	5
Balance Sheet	6
Statement of Changes in Net Assets	7
Investment Statement	8
Notes	9

Endorsement and Signatures of the Board of Directors and the Managing Director

The Financial Statements of ABMIF are included in part B of the Financial Statements of Stefir hf. which contains the Financial Statements of UCITS, investment funds and institutional investors' funds under management. They have been prepared in accordance with law on Financial Statements and rules on the Financial Statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority.

The fund reported profit of ISK 2,176 million according to the income statement and the profit is recognized as an increase in units in the fund's accounts. The net asset of the fund at the end of the period totalled ISK 43,450 million according to the balance sheet.

The Board of Directors and CEO of Stefir hf. hereby confirm the fund's Financial Statements for 2013 with their signatures.

Reykjavik, 11 March 2014

Board of Directors:

Steind Rindabaldur
Snyjólfr Ólafsson *Laura Bjarnell*
Jóhann L. Mjósam
Kjetill Þórunnsson

CEO:

Þórhildur Hannardóttir

Independent Auditor's Report

To the unit holder of ABMIIF.

We have audited the accompanying financial statements of ABMIIF, which comprise the endorsement and statement by the board of directors and the managing director, income statements, balance sheet, changes in net assets, statement of investments and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Icelandic Annual Financial Statements Act, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of ABMIIF as at 31 December 2013, and of its financial performance and changes in net assets for the year then ended in accordance with the Icelandic Financial Statements Act and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 11 March 2014



Margrét Pétursdóttir
State Authorized Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Income Statement 2013

	Notes	2013	2012
Financial income and (expenses)	4-6		
Interests, indexation, dividends and currency exchange rate difference		11.956	11.103
Interest expense		(9.669)	(10.639)
Reversal of impairment on loans	8	64	1.377
Net financial income		2.351	1.841
 Operating expenses			
Administration fee	7	173	169
Other operating expenses		2	11
		175	180
 Profit transferred to units		2.176	1.661

Balance Sheet at 31 december 2013

	Notes	2013	2012
Assets			
Securities with fixed income	8	118.493	119.945
Total investments		<u>118.493</u>	<u>119.945</u>
Foreclosed assets	9	104	501
Cash	10	47.015	52.661
Total other assets		<u>47.119</u>	<u>53.162</u>
Total assets		<u><u>165.612</u></u>	<u><u>173.107</u></u>
Liabilities			
Units	12	43.450	41.274
Loan from financial institutions	13	122.148	131.804
Liabilities with management- og custody company		14	29
Total other liabilities		<u>122.162</u>	<u>131.833</u>
Total liabilities		<u><u>165.612</u></u>	<u><u>173.107</u></u>
Net assets		43.450	41.274
Number of units		23.200	23.200
Exchange rate of units at the end of the year	12	<u>1,87</u>	<u>1,78</u>

Statement of Changes in Net Assets 2013

	Notes	2013	2012
Operating activities			
Profit transferred to units		<u>2.176</u>	<u>1.661</u>
Financing activities			
Units sold		<u>0</u>	<u>23.000</u>
		<u>0</u>	<u>23.000</u>
Changes in net assets		2.176	24.661
Net assets at the beginning of the year		<u>41.274</u>	<u>16.613</u>
Net assets at the end of the year	12	<u><u>43.450</u></u>	<u><u>41.274</u></u>

Investment Statement 2013

	Market value	Asset 2013 %	Asset 2012 %	Asset Change %	Investment policy	
					Minimum %	Maximum %
Mortgages	118.493	100	100	0	0	100
Total assets	118.493	100	100	0		

Notes to the Financial Statements

Accounting methods

1. Basis of preparation

The purpose of the ABMIIF Fund is to invest in residential real estate loans from Arion Bank and its subsidiaries, in accordance with the terms of the issuance of Covered Bonds. And to guarantee the payment of all amounts due under any Covered Bonds issued by the Issuer under the Programme, subject to the term of the Covered Bond Guarantee.

2. Basis of preparation

The Financial Statements of Arion Bank Mortgages Institutional Investor Fund have been prepared in accordance with the Financial Statements Act and rules on the financial statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority. They are prepared on the historical cost basis and according to the same accounting methods as last year. The Financial Statements have been prepared in Icelandic krónur (ISK) rounded to the nearest million. The fund is a part of Stefnir hf. which is a subsidiary of Arion Bank hf. The Financial Statements form part of the consolidated financial statements of Arion Bank hf.

3. Assessment and decisions

When preparing the financial statements, the management is required by the Annual Accounts Act to assess and make decisions on important components of the financial statements which are subjective by their nature. The assessment is based on experience and other relevant factors which are otherwise unavailable. Any changes according to this assessment are recognized during the period in which they occur.

4. Foreign currencies

Assets and liabilities in foreign currencies are translated into ISK at the exchange rate at year end, according to Reuter. Operating income and operating expenses in foreign currencies are translated at the exchange rate on the date of transaction. Foreign exchange difference related to translation of foreign assets is recognised in the income statement.

5. Indexed assets and liabilities

Indexed assets and liabilities are calculated on basis of indexes valid in January 2014. Accrued indexation on principal of assets and liabilities is recognised in the income statement.

6. Interest income and expenses

Interest income and expense are recognised in the income statement as they are incurred.

7. Administration fee

The fund pays Stefnir hf. administration fee which includes the following operating costs for the fund: salaries of employees of the management company, marketing costs and administration; included in the administration fee is a custody fee to Arion banki hf. Administration fees are 0.1% of the fund's total assets.

The fund also pays fees for official supervisory.

8. Securities with fixed income

- a. Mortgages are recognised with accrued interest and indexation at the end of the year. At the year end 54.2% of the fund's mortgages were calculated according to the index for mortgage payment adjustment.
- b. Because of circumstances following the fall of the Icelandic commercial banks in the fall 2008, banks and other financial institutions have taken actions to meet customer's debt conditions. Arion bank hf. offered late in the year 2009 ways for customers to adjust the principal of their debt to 110% of property market value. Customers were able to apply for this special resort until the 30th of June 2011. Provisions are done by a general provision and a special provision. Total provision for losses amounts to ISK 1,435 million, which of specific provision amounts to ISK 424 million and collective provision amounts to ISK 1,011 million. The provision account has been deducted from Securities with fixed income in the Balance sheet.

Notes, contd.:

8. Securities with fixed income, cont.

c. Mortgages are specified as:	2013	2012
Mortgages before impairment	119.928	121.527
Provision at the beginning of the year	(1.582)	(3.138)
Write-offs during the year	83	179
Reversal during the year	64	1.377
Mortgages at year end	<u>118.493</u>	<u>119.945</u>
Provision for losses as a ratio of total loans	<u>1,20%</u>	<u>1,30%</u>

9. Foreclosed assets

The fund has foreclosed real estate (residential property) following auctions of the relevant property to secure the fund's loans. These properties are valued by employees of Arion Bank. The valuation takes into account the condition and location of the property. The valuation is then reduced by 20% as a precautionary provision.

10. Cash

Cash consists of cash and deposits with credit institutions including accrued interests.

11. Taxation

The fund does not pay income tax; instead profit or loss from operations are taxed with the unit holders. Individuals pay capital gains tax on profits on their securities when redeemed. Profit and loss on unit shares owned by companies are treated as taxable income and expenses, regardless of redemption.

The fund is exempt from capital gains tax in Iceland but not in those countries where capital gains tax is imposed on income of foreign residents and when no double taxation agreement stating that such income should be taxed in Iceland exists between Iceland and the relevant country.

12. Units

a. Real return of the mutual fund ABMIIF as of 31 December 2013

	Return
Last 3 months	0,87%
Last 6 months	1,38%
Last 12 months	1,56%

b. Statement of book value and exchange rate of units.

	Book value	Exchange rate
31 December 2013	43.450	1,87
31 December 2012	41.274	1,78
31 December 2011	16.613	1,72

Notes, contd.:

13. Loan agreement

The fund and Arion banki hf. made Subordinated Intercompany Loan Agreements to finance the acquisition of the mortgages. The loan agreements are calculated taking into account accrued interest and the consumer price index. Interest on the loan agreements ranges from 3.75% - 4.00% p.a.

The fund's interest-bearing liabilities are:

Indexed loan agreements	122.148
Repayments on loan agreements at the end of the year are as follows:	
Repayments 2014	2.265
Repayments 2015	2.352
Repayments 2016	2.443
Repayments 2017	2.537
Repayments 2018	2.636
Repayments later	109.915
	<u>122.148</u>

14. Segmentation of investments and proportional division

	Other ISK	%	Total ISK	%
Other financial instruments, mortgages	118.493	100	118.493	100
	<u>118.493</u>	<u>100</u>	<u>118.493</u>	<u>100</u>

In the case of any discrepancy between the English and the Icelandic texts, the Icelandic versions shall prevail and questions of interpretation will be addressed solely in the Icelandic language.