

Arion Bank Mortgages  
Institutional Investor Fund  
Financial Statements 30 June 2012

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

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The Financial Statements for the period 1 January - 30 June 2012 of ABMIIF are included in part B of the financial statements of Stefnir hf. which contains the financial statements of UCITS, investment funds and professional investor funds of the management company. They have been prepared according to the same accounting methods as last year. This presentation of the financial statement is in accordance with regulations on the financial statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority and the Financial Undertakings Act.

The fund reported profit of ISK 1.071 million according to the income statement and the profit is recognized as an increase in units in the fund's accounts. The net assets of the fund at the end of the period totalled ISK 40,684 million according to the balance sheet. In December 2011 it was proposed that the arrangement for Kaupthing covered bonds, which the fund is party to, be restructured. It was proposed that Arion Bank take over the obligations and liabilities of Kaupthing. The proposal was approved on 20 January 2012. The fund will continue to act as a guarantor for the issue but for Arion Bank instead of Kaupthing.

In response to the conditions created by the collapse of the financial sector in Iceland in the autumn of 2008, banks and financial companies have resorted to a range of measures to tackle clients' debt. In late 2009, Arion Bank gave its customers the option of adjusting the principal on the loans to 110% of the market value of the property. This option was available to customers until 30 June 2011. Provisions for losses have been made previously to meet the costs of these measures. Now provisions are done by a general provision and a special provision. By a special provision the expected loss is evaluated from the loans with the highest risk of loss is calculated. By 30 of June 2012 this special provision as part of the depreciation account was ISK 594 million.

Additionally a general provision is part of the depreciation account. In the calculations of the general provision the default possibility is obtained from the credit rating system of Arion Bank hf. The recovery rate of 65% is estimated based on the Basel standards for accounting procedures of financial undertakings. The calculations assumes that six months will elapse from default which the general provision refers to and that it will be examined by credit control and a special provision will be made should this be required. By 30 June 2012 the general provision as part of the depreciation account was ISK 976 million.

During the period claims totaling ISK 149 million were written off.

The Board of Directors and CEO of Stefnir hf. hereby confirm the fund's Financial Statements for the period of 1 January - 30 June 2012 with their signatures.

Reykjavik, 22nd August 2012.

Board of Directors:

CEO:

# Report on review of interim financial statements

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## **To the unit holder of ABMIF.**

We have reviewed the accompanying interim financial statements of ABMIF, which comprise the income statements, balance sheet, changes in net assets, statement of investments, a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of these interim financial statements in accordance with Icelandic Financial Statements Act. Our responsibility is to express a conclusion on these interim financial statements based on our review.

## **Scope of review**

We conducted our review in accordance with the International Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## **Conclusion**

Based on our review nothing has come to our attention that causes us to believe that the accompanying Interim Financial Statements are not prepared, in all material respects, in accordance with Icelandic Financial Statements Act.

Reykjavik, 22nd August 2012.

Margrét Pétursdóttir  
State Authorized Public Accountant

Ernst & Young ehf.  
Borgartúni 30  
105 Reykjavík

# Income Statement 1 January - 30 June 2012

	Notes	01.01. -30.06. 2012	01.01. -30.06. 2011
<b>Financial income and (expenses)</b>	2-5		
Interests, indexation, dividends and currency exchange rate difference .....		6.506	6.796
Interest expense .....		( 6.919 )	( 6.421 )
Impairment on loans .....	14	1.568	185
Net financial income		1.155	560
 <b>Operating expenses</b>			
Administration fee .....	6	83	70
Other operating expenses .....		1	5
		84	75
 <b>Profit for the period transferred to units .....</b>		1.071	485

## Balance Sheet at 30 June 2012

	Notes	30.06. 2012	31.12. 2011
<b>Assets</b>			
Securities with fixed income .....	7,14	121.283	121.096
Total securities		<u>121.283</u>	<u>121.096</u>
Foreclosed assets .....	8	698	445
Cash .....	9	50.481	23.514
Total other assets		<u>51.179</u>	<u>23.959</u>
<b>Total assets</b>		<u><u>172.462</u></u>	<u><u>145.054</u></u>
<b>Liabilities</b>			
Units .....	13	40.684	16.613
Liabilities with management- og custody companies .....		31	19
Issued bonds .....	15	131.747	128.422
Total other liabilities		<u>131.778</u>	<u>128.441</u>
<b>Total liabilities</b>		<u><u>172.462</u></u>	<u><u>145.054</u></u>
Net assets .....		40.684	16.613
Number of units .....		23.200	9.637
Exchange rate of units at the end of the period .....		<u>1,75</u>	<u>1,72</u>

# Statement of Changes in Net Assets

## 1 January - 30 June 2012

	Notes	01.01. -30.06. 2012	01.01. -30.06. 2011
<b>Operating activities</b>			
Profit for the period transferred to units .....		1.071	485
<b>Financing activities</b>			
Units sold .....		23.000	0
		23.000	0
<b>Changes in net assets .....</b>		24.071	485
<b>Net assets at the beginning of the year .....</b>		16.613	16.325
<b>Net assets at the end of the period.....</b>	13	40.684	16.810

# Investment Statement 30 June 2012

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		Market value	% of assets
<b>Icelandic bonds</b>			
Arion bank hf., property loans .....	14	121.283	100,0%
Total assets .....		<u>121.283</u>	<u>100,0%</u>
Issued bonds .....	15	( 131.747)	( 108,6%)
Foreclosed assets .....	8	698	0,6%
Other assets .....	10	50.481	41,6%
Other liabilities .....	11	( 31)	( 0,0%)
Total net assets .....		<u><u>40.684</u></u>	<u><u>33,5%</u></u>



# Notes to the Financial Statements

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## **Accounting methods**

### **1. Basis of preparation**

The purpose of the ABMIF 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 Statement of Arion Bank Mortgages Institutional Investor Fund has been prepared in accordance with the Financial Statements Act and regulations on financial statements of management companies of mutual funds. They are prepared on the historical cost basis. The Financial Statements are prepared 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 Stefir 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 statement, the management is required by the Annual Accounts Act to assess and make decisions on important components of the financial statement 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 the end of the period, 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. Interest income and expenses**

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

### **6. Administration fee**

The fund pays Stefir 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 Verdis hf. Administration fees are 0.1% of the fund's total assets.

### **7. Securities with fixed income**

- a. Property loans are recognised with accrued interest and indexation at the end of the year. At the end of the period, 48% of the fund's property loans 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. An amount to meet these special measures has already been charged to the income statement previously. Now provisions are done by a general provision and a special provision. On 30 June 2012 total provision for losses amounts to ISK 1,570 million. The provision account has been deducted from Securities with fixed income in the Balance sheet.

## Notes, contd.:

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### 8. 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.

### 9. Cash

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

### 10. Other assets

Other assets include unsettled trades and deviations in exchange translations of assets.

### 11. Other liabilities

Other liabilities include capital gains tax, unsettled trades and deviations in exchange translation of assets.

### 12. 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.

### 13. Units

#### a. Real return of the mutual fund ABMIIF as of 30th June 2012.

	<b>Return</b>
Last 3 months .....	1,69%
Last 6 months .....	( 1,73%)
Last 12 months .....	( 4,64%)

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

	<b>Book value</b>	<b>Exchange rate</b>
30 June 2012 .....	40.684	1,75
31 December 2011 .....	16.613	1,72
31 December 2010 .....	16.325	1,69

### 14. Securities with fixed income are specified as follows:

	<b>30.06.2012</b>	<b>31.12.2011</b>
Property loans before impairment .....	122.853	124.234
Provision at the beginning of the year .....	( 3.138) (	3.920)
Write-offs during the year .....	149	1.029
Reversal (impairment) during the year .....	1.419 (	247)
Property loans at year end .....	<u>121.283</u>	<u>121.096</u>
Provision for losses as a ratio of total loans .....	<u>1,28%</u>	<u>2,53%</u>

## Notes, contd.:

### 15. Issued bonds

The fund issued bonds to finance its acquisition of mortgages. The bonds are calculated taking into account accrued interest and the consumer price index. Interest on the bonds ranges from 3.75% - 4.00% p.a.

The fund's interest-bearing liabilities are:

Indexed bond issue .....	131.747
Repayments on issued bonds at the end of the period are broken down as follows:	
Repayments 2012 .....	1.197
Repayments 2013 .....	2.456
Repayments 2014 .....	2.551
Repayments 2015 .....	2.649
Repayments 2016 .....	2.751
Repayments later .....	120.143
	<u>131.747</u>

### 16. Statement of proportional division of assets and investment policy.

	Assets	Assets	Investment policy	
	30.06.2012	2011	Minimum	Maximum
	%	%	%	%
Mortgage bonds .....	100	100	0	100

### 17. Segmentation of investments and proportional division:

	Other		Total	
	ISK	%	ISK	%
Mortgage bonds .....	121.283	100	121.283	100
	<u>121.283</u>	<u>100</u>	<u>121.283</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.