

Arion Bank Mortgages
Institutional Investor Fund
Financial Statements 2011

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

The annual Financial Statements of AMIIF are included in part B of the annual financial statements of Stefnir hf. which contains the annual 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 an annual profit of ISK 289 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 year 2011 totalled ISK 16,613 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 were made previously to meet the costs of these measures and the loss provision account is reduced by this amount. This is now 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 the 31st of December 2011 this special provision as part of the depreciation account was ISK 1.664 million.

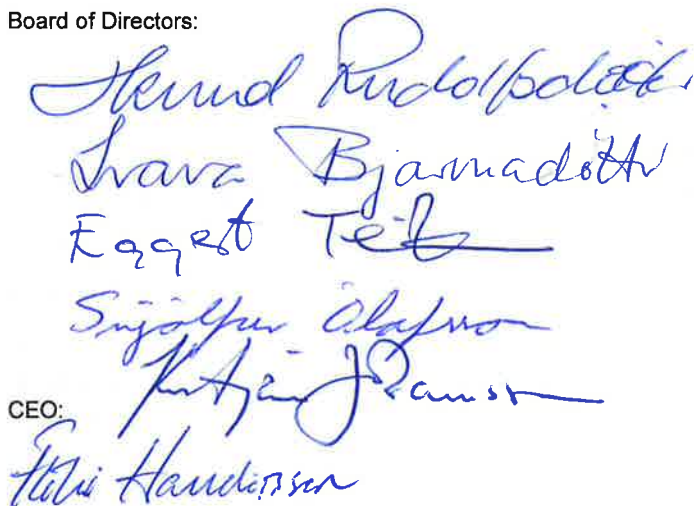
Additionally the general reduction is part of the depreciation account. In the calculations of the general reduction the default possibility is obtained from the credit rating system of Arion Bank hf., the recovery rate of 65% which originates from the Basel standards for accounting procedures of financial 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 the 31st of December the general provision as part of the depreciation account was ISK 1.474 million.

In 2011 claims totaling ISK 1,029 million were written off completely.

The Board of Directors and CEO of Stefnir hf. hereby confirm the fund's Financial Statements for 2011 with their signatures.

Reykjavik, 20 March 2012.

Board of Directors:


Stefnir hf.
Stefnir hf.
Egget Tef
Stefnir hf.
CEO: Stefni Handerson

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 2011, and of its financial performance and changes in net assets for the year then ended in accordance with the Icelandic Financial Statements Act.

Reykjavik, 20 March 2012.



Margrét Pétursdóttir

State Authorized Public Accountant

Ernst & Young ehf.

Borgartúni 30

105 Reykjavík

Income Statement 2011

	Notes	2011	2010
Financial income and (expenses)	2-5		
Interests, indexation, dividends and currency exchange rate difference		11.849	8.836
Interest expense	(11.166)	(7.844)
Impairment on loans	14	(247)	(1.797)
Net financial income		<u>436</u>	<u>(805)</u>
 Operating expenses			
Administration fee	6	142	141
Other operating expenses		<u>6</u>	<u>32</u>
		<u>148</u>	<u>173</u>
 Profit (loss) for the year transferred to units		<u><u>288</u></u>	<u><u>(978)</u></u>

Balance Sheet at 31st December 2011

	Notes	2011	2010
Assets			
Securities with fixed income		121.096	120.046
Total securities	7,14	<u>121.096</u>	<u>120.046</u>
Reposessed assets	8	444	347
Cash	9	<u>23.514</u>	<u>20.100</u>
Total other assets		<u>23.958</u>	<u>20.447</u>
Total assets		<u><u>145.054</u></u>	<u><u>140.493</u></u>
Liabilities			
Units	13	<u>16.613</u>	<u>16.325</u>
Liabilities with management- og custody companies		19	10
Issued bonds	15	<u>128.422</u>	<u>124.158</u>
Total other liabilities		<u>128.441</u>	<u>124.168</u>
Total liabilities		<u><u>145.054</u></u>	<u><u>140.493</u></u>
Net assets		16.613	16.325
Number of units		<u>9.637</u>	<u>9.637</u>
Exchange rate of units at the end of the year		<u><u>1,72</u></u>	<u><u>1,69</u></u>

Statement of Changes in Net Assets for 2011

	Notes	2011	2010
Operating activities			
Profit (loss) for the year transferred to units		288	(978)
Changes in net assets		288	(978)
Net assets at the beginning of the year		16.325	17.303
Net assets at the end of the year	13	<u>16.613</u>	<u>16.325</u>

Investment Statement 31 December 2011

ABMIIF	Market value	% of assets
Icelandic bonds		
Kaupthing hf., property loans	121.096	100,0%
Total assets	121.096	100,0%
Issued bonds	(128.422)	(106,1%)
Appropriated assets	444	0,4%
Other assets	23.514	19,4%
Other liabilities	(19)	(0,0%)
Total net assets	<u>16.613</u>	<u>13,7%</u>

Notes to the Financial Statements

Accounting methods

1. Basis of preparation

The purpose of the Fund ABMIF (previously KMIIF) is to invest funds available to the Fund in, *inter alia*, the purchase of Loans and their Related Security from Arion Bank (previously Kaupthing bank) and the Issuer's subsidiaries, all in accordance with the terms of the Transaction Documents. 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 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 annual financial statement, the management is required by the Annual Accounts Act to assess and make decisions on important components of the annual 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 year, 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 of the relevant fund. Funds with foreign currency as a basis currency are published in that currency.

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 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 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 year 2011, 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 this depreciation had been reserved to reduce the effects of these special measures and the impairment charged to the income statement is lower by that amount. This is now done by a general provision and a special provision. On 31st December 2011 total provision for losses amounts to ISK 3,138 million. The Depreciation account has been deducted from Securities with fixed income in the Balance sheet.

Notes, contd.:

8. Repossessed assets

The fund has repossessed 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 31st December 2011.

		Return
Last 3 months	(1,26%)
Last 6 months	(2,97%)
Last 12 months	(3,29%)

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

	Book value	Exchange rate
31 December 2011	16.613	1,72
31 December 2010	16.325	1,69
31 December 2009	17.303	1,80

14. Securities with fixed income are specified as follows:

	2011	2010
Property loans before impairment	124.234	123.966
Impairment at the beginning of the year	(3.920)	(2.123)
Write-offs during the year	1.029	(75)
Impairment during the year	(247)	(1.723)
Property loans at year end	121.096	120.046
Account for impairment losses as a ratio of total loans	2,53%	3,16%

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	128.422
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Repayments on issued bonds at the end of the year are broken down as follows:

Repayments 2012	3.365
Repayments 2013	2.378
Repayments 2014	2.470
Repayments 2015	2.565
Repayments 2016	2.664
Repayments later	114.980
	<u>128.422</u>

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

	Assets 2011 %	Assets 2009 %	Investment policy	
			Minimum %	Maximum %
Mortgage bonds	100	100	0	100

17. Segmentation of investments and proportional division:

	Other		Total	
	ISK	%	ISK	%
Mortgage bonds	121.096	100	121.096	100
	<u>121.096</u>	<u>100</u>	<u>121.096</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.