



Aðalfundur Arion banka hf. 2019

17. mars 2020



The Economic Environment

Impact from COVID-19 and economic fundamentals

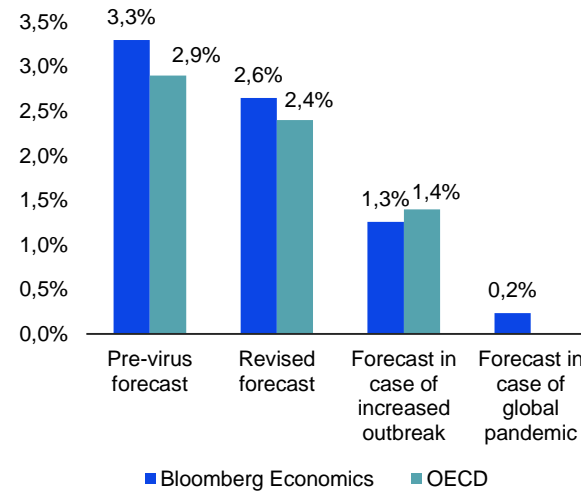


From stagnation to recession

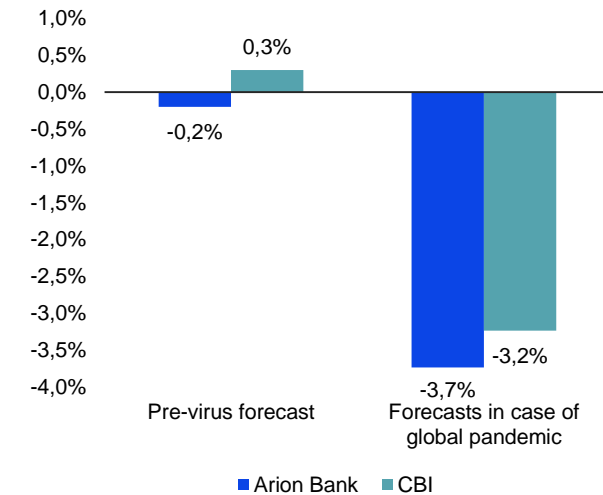
Forecasts expected stagnation beforehand – the COVID-19 virus renders those forecasts obsolete

- On March 11, the World Health Organization defined the spread of COVID-19 as a pandemic. Based on foreign forecasts, a global pandemic could shave 3 percentage points off global GDP growth.
- Applying those results to Iceland would mean 3-4% GDP contraction this year. However, the economic impact on Iceland could be proportionally greater as the economy is particularly vulnerable to shocks to tourism.
- Few developed countries are as dependent on tourism as Iceland. In 2019 the direct contribution of tourism to GDP was just over 8%, despite the industry contracting that year.
- Based on IATA's analysis of COVID-19's impact, tourist arrivals could drop by 17% this year. Considering the strict measures of governments around the world, such as closing borders and implementing a travel ban, it's likely that the 17% drop is an underestimation.

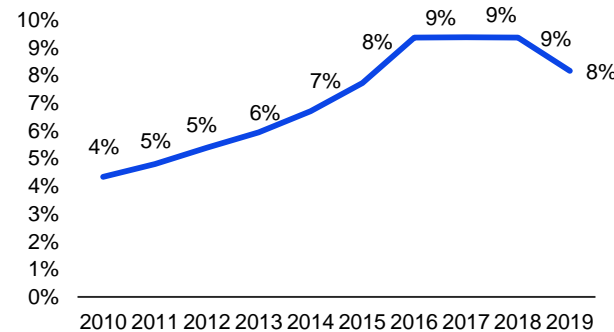
Global growth forecasts for 2020



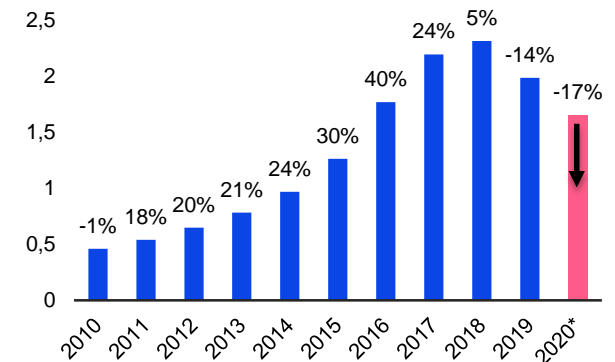
GDP growth forecasts for Iceland in 2020



Tourism direct contribution to GDP – Arion Bank estimates



Tourist arrivals – millions annually and YoY %-change

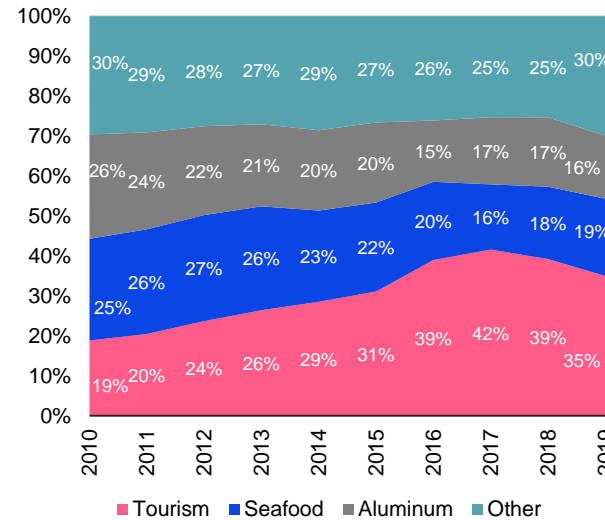


Tourism in Iceland

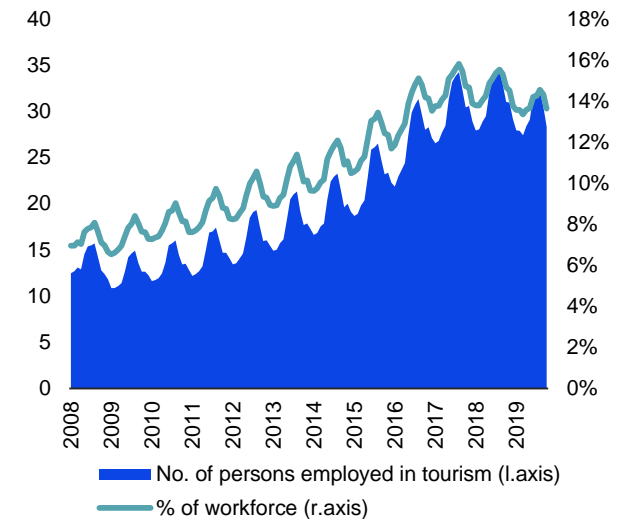
Tourism has become one of the basic industries of the economy

- In a short time, tourism has become the country's largest FX generating industry. In 2019, the industry accounted for more than a third of the country's export revenues, or as much as the seafood sector and aluminum production combined.
- In 2019, nearly 30,000 people worked in tourist related jobs, or 14% of the nation's workforce. The industry has been the main driver behind job creation in recent years.
- For the past years the industry has been focused on building infrastructure, investing in the industry in order to strengthen and increase capacity. From 2010, at least 12% of business investment has been in tourist related industries.
- Substantial infrastructure development within the industry will support its recovery later on. In addition, public investment, such as in the country's road network, will also benefit the industry.

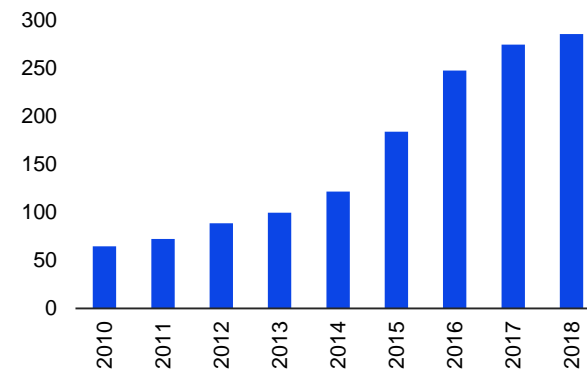
Share in total exports



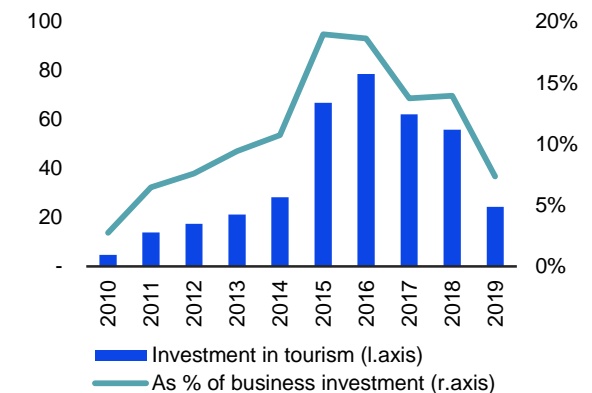
No. of persons employed in tourism – thousands



Fixed assets – tourism industries (bn. ISK at 2018 prices)



Investment in tourism industries* - bn. ISK at 2019 prices and % of business investment

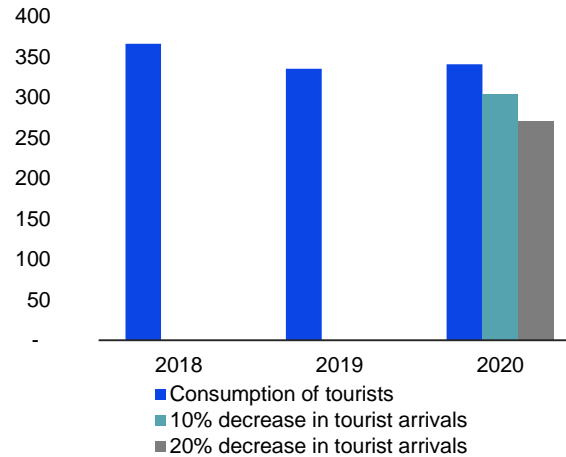


Tourism is hard hit by COVID-19

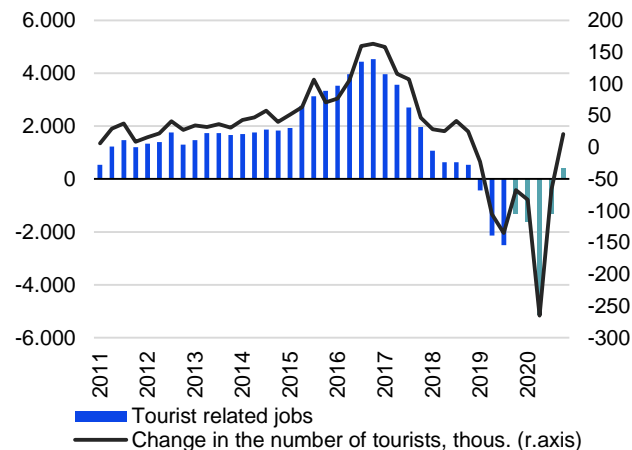
A great number of companies may be forced to lay off employees

- It is impossible to quantify the impact of the Coronavirus on the Icelandic economy at this time. To the left is one possible scenario, where tourist arrivals drop by 20% between years.
- In 2019, foreign tourists spent 335 bn. ISK. during their visits to Iceland. Based on certain assumptions regarding consumption per tourist, which has increased in the past year, tourism revenues could decrease by 70 bn. ISK. in 2020 if tourist arrivals drop by 20%. This figure does not include air transport revenues.
- The depreciation of the ISK in recent days reflects, to some extent, the uncertainty faced by the largest export industry.
- If tourist arrivals drop by 20% in 2020, primarily in the second quarter, the number of tourist related jobs could be temporarily reduced by 5,000 in the first half of the year pushing unemployment close to 8%.

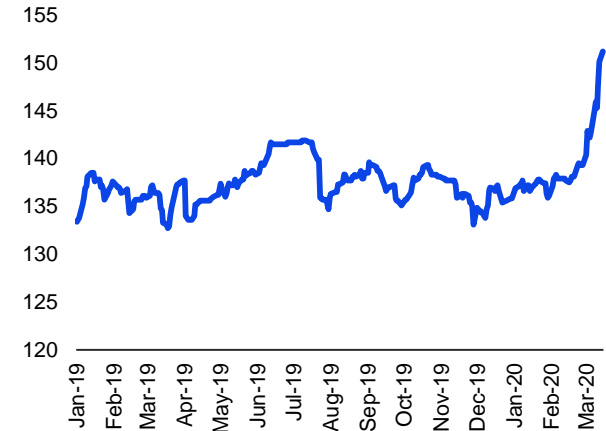
Consumption of tourists – bn. ISK at 2019 prices



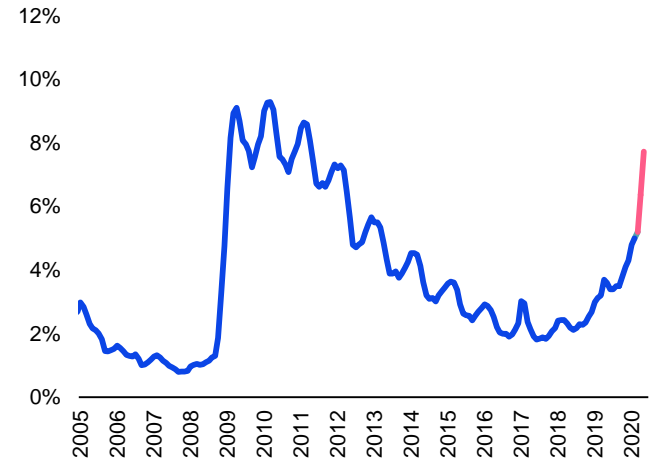
Change in tourist arrivals and the number of tourist related jobs – change between years, quarterly data



EUR/ISK



Registered unemployment

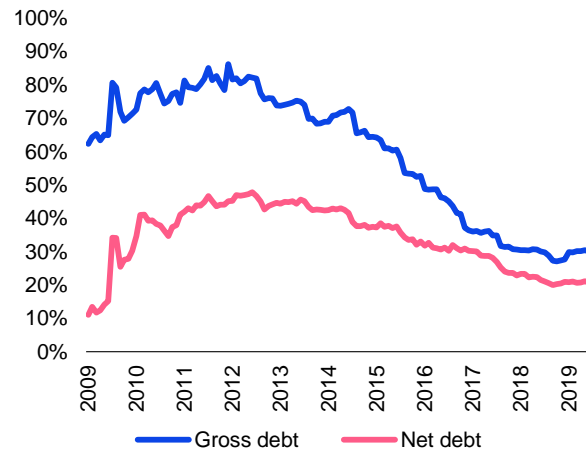


The foundations are strong

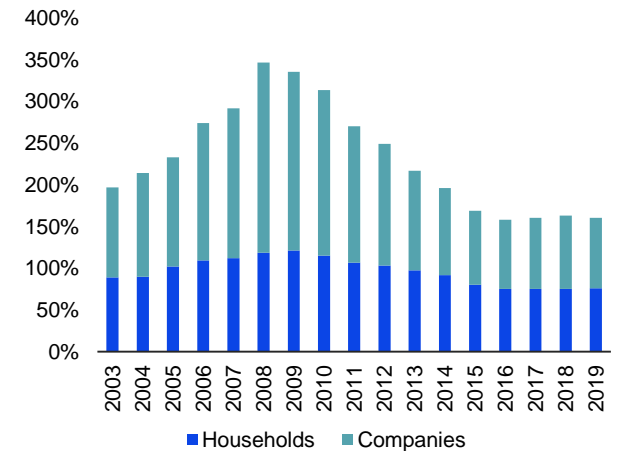
Both fiscal and monetary policy are in a good position to support the economy

- The Icelandic economy has seldom been as well equipped to handle a downturn as at this time. The last upswing was export driven, not credit driven, and households, companies and the government have deleveraged, pushing debt levels to historical lows.
- The central government has been running a surplus for the past years, which has been used to pay down debt. As a result, the Treasury is in a strong position to support businesses and stimulate the economy anew through infrastructure investment when the pandemic is on the decrease.
- In addition, unlike many central banks, the CBI still has firepower to support the economy. Although interest rates have never been lower in Iceland, they are high in international comparison. Therefore the CBI has considerable scope for further interest rate cuts. The Bank can also reduce capital buffers on the banking system.
- Furthermore, the CBI's FX reserves, which amount to 6.2 bn. EUR, last year's hefty current account surplus and the positive NIIP of the economy mean that balance of payments worries are limited, unlike the financial crisis of 2008.

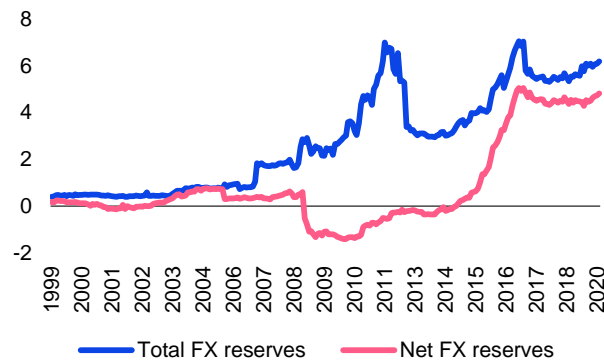
Central government debt - % of GDP



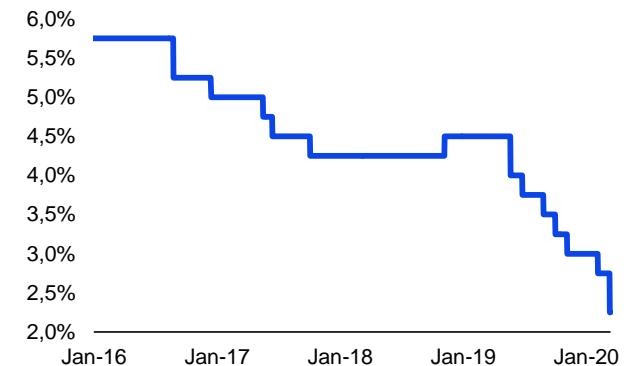
Household and non-financial corporate debt - % of GDP



CBI's FX reserves – bn. EUR



Key interest rates – seven-day term deposits

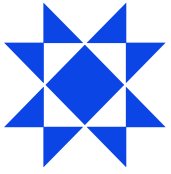


Corporate sector overall equity ratio still high

Slower growth in asset prices, growth in revenue and lower interest rates could lead to increased debt

	2002	2004	2007	2008	2012	2015	2017	2018
Equity ratio	29%	31%	32%	13%	31%	42%	43%	43%
Total debt / EBITDA	7,2	7,3	9,3	12,2	8,5	6,9	7,0	8,0
Long-term debt / EBITDA	4,2	4,4	6,3	8,5	6,3	5,0	5,0	5,8
Working capital ratio	1,2	1,4	1,5	1,3	1,7	1,9	1,8	1,9
Liquidity ratio	0,9	1,1	1,3	1,1	1,4	1,6	1,5	1,5
EBITDA / Equity	34%	30%	23%	53%	26%	20%	19%	16%
Profit / Equity	17%	22%	19%	-201%	15%	16%	15%	10%





Credit risk

and credit exposure to tourism industry



Collateral for loans to customers

From Pillar III risk report

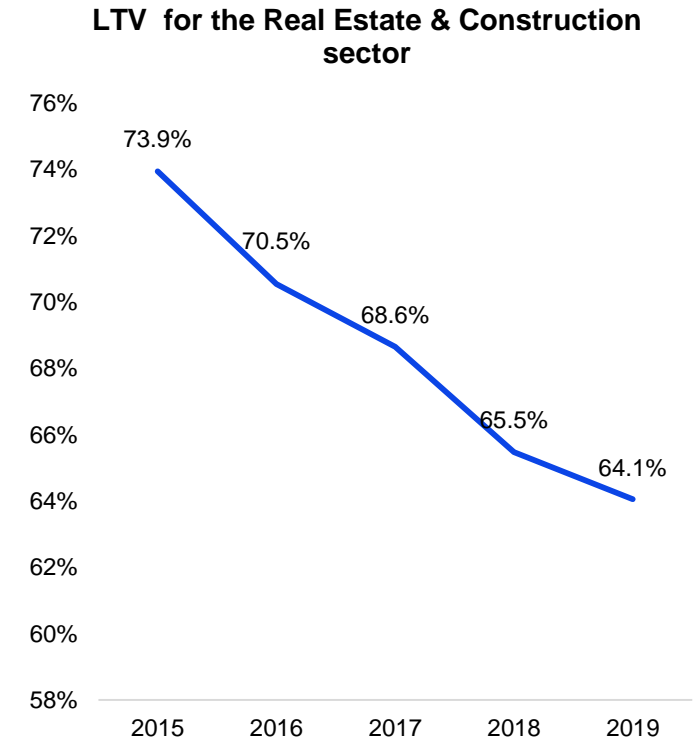
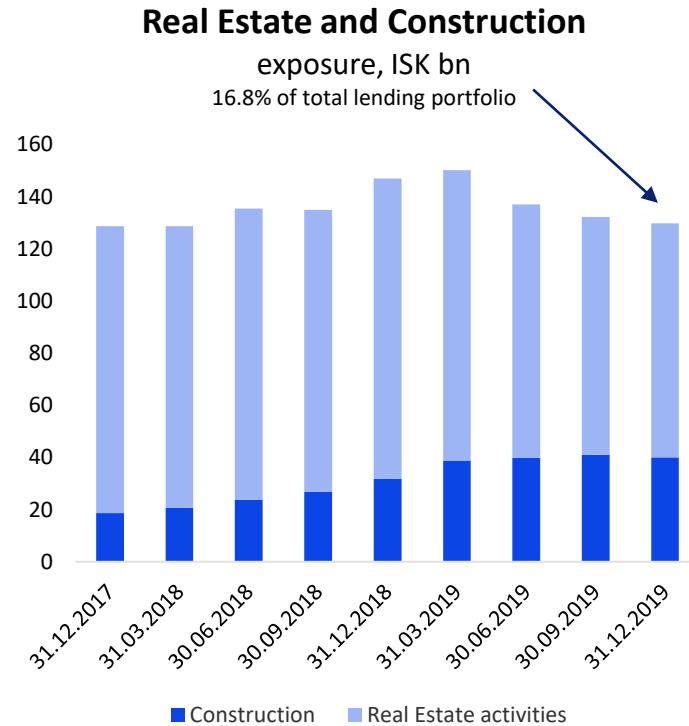
31 December 2019 [ISK m]	Cash and securities	Real estate	Fishing vessels	Other collateral	Total collateral	Unsecured ratio % 2019	Unsecured ratio % 2018
Individuals	198	328,243	13	10,996	339,450	7.9%	6.2%
Real estate activities and construction	1,972	113,465	55	8,022	123,514	4.9%	4.3%
Fishing industry	17	12,365	54,121	9,946	76,449	7.8%	7.0%
Information and communication technology	375	3,529	-	4,308	8,212	57.0%	48.0%
Wholesale and retail trade	375	32,508	7	15,98	48,870	11.1%	10.6%
Financial and insurance services	17,726	7,254	-	7,622	32,602	3.2%	4.3%
Industry, energy and manufacturing	60	28,183	0	6,711	34,954	12.4%	11.4%
Transportation	0	1,048	313	3,285	4,646	58.0%	74.5%
Services	61	9,137	92	5,669	14,959	14.9%	26.7%
Public sector	4	2,194	-	289	2,487	71.1%	65.6%
Agriculture and forestry	4	6,797	-	263	7,064	7.7%	2.7%
Total	20,792	544,723	54,601	73,091	693,207	10.2%	9.4%



Real estate and construction exposure

Exposure in Real Estate and Construction decreased by 13.5% over the past 12 months

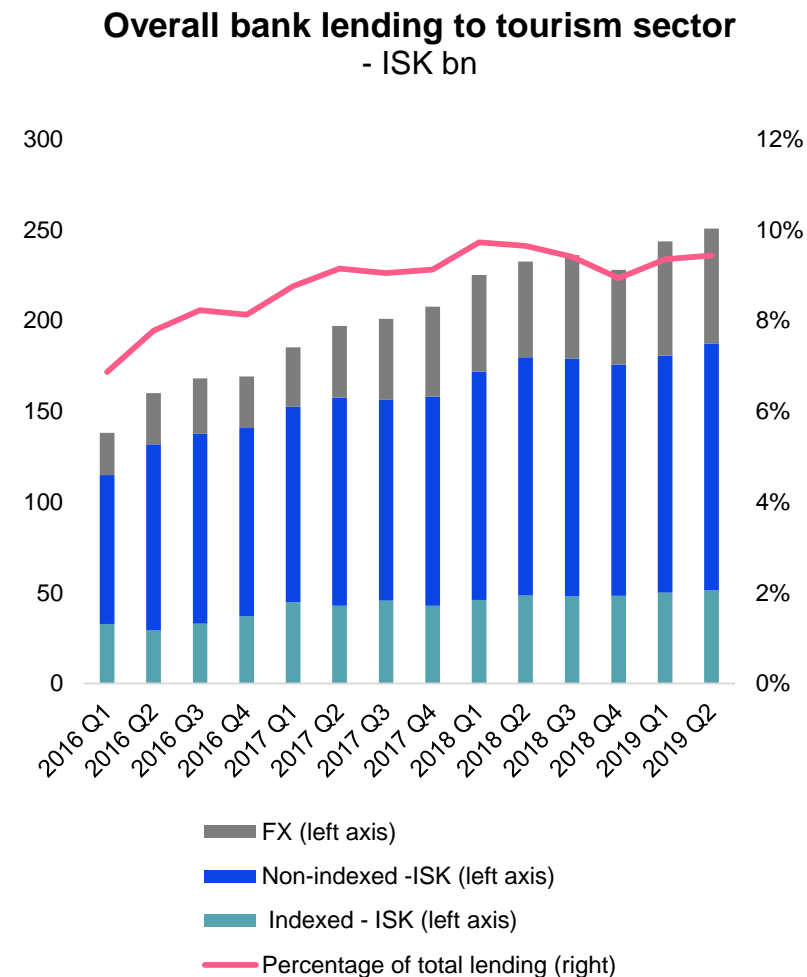
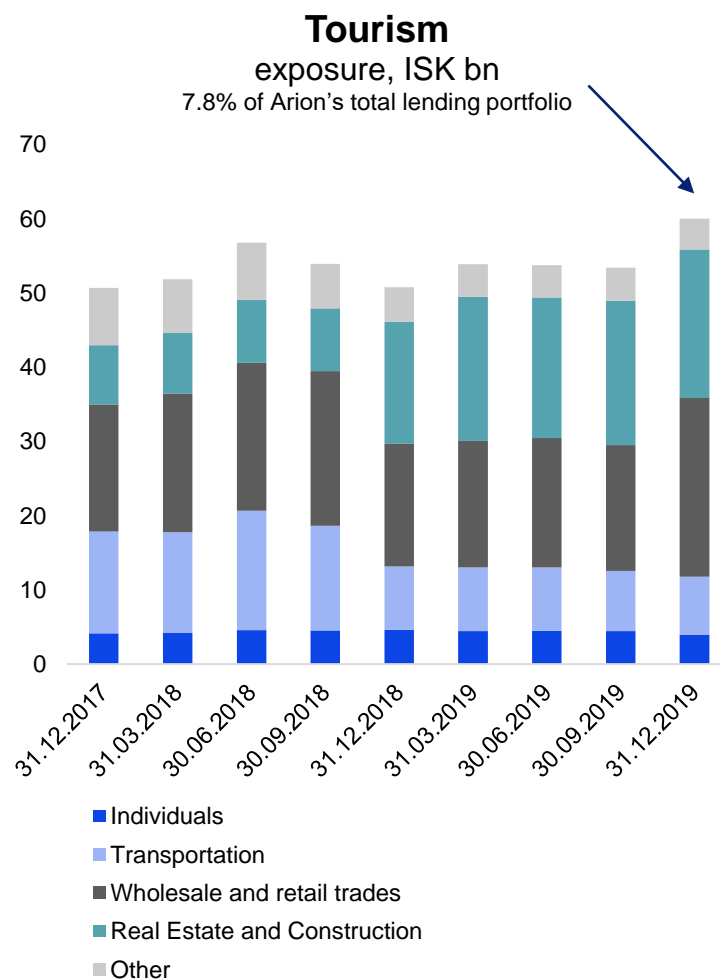
- Around ISK 37,9 bn. or 10.7% of the corporate loan portfolio is allocated to hotels (4,9% of total loans to customers)
- Arion's hotel exposure is mainly in Reykjavik and southern part of Iceland where tourism is likely to be less affected by falling tourism rates
- Tourism can affect real estate prices as demand fluctuates



Tourism sector exposure

Growth in the tourism sector is slowing down. Exposure has grown by 11.3% over the past 12 months

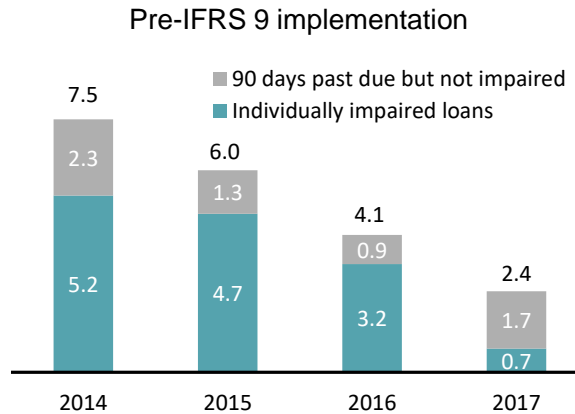
- Growth in tourist arrivals has declined markedly in 2019 after a long period of double digit growth
- The real exchange rate presents a challenge to Iceland's competitiveness as an affordable tourist destination
- Lower growth, high prices, growing operating costs and lack of infrastructure make the sector less resilient in the event of shocks. Streamlining and consolidation in the sector is expected
- Since WOW air's bankruptcy, spending per tourist has increased significantly, both in FX and ISK. One of the reasons for this is that each tourist is staying longer, on average, than before



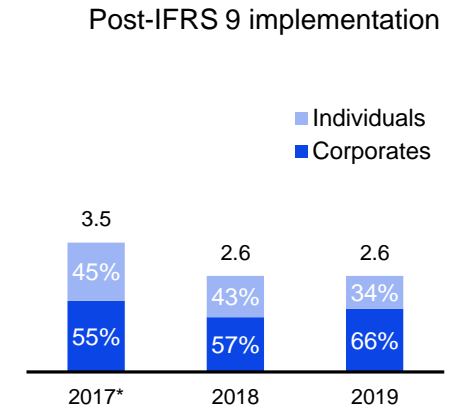
Improving asset quality

- Problem loans is defined as loans in Stage 3 and the Problem loans ratio is calculated based on the gross carrying value of loans
- Problem loans had steadily decreased since its peak in 2010 until 2018 but has plateaued
- Problem loans constitute 2.6% of loans to customers at YE 2019, as in YE 2018

Problem loans – gross (%)



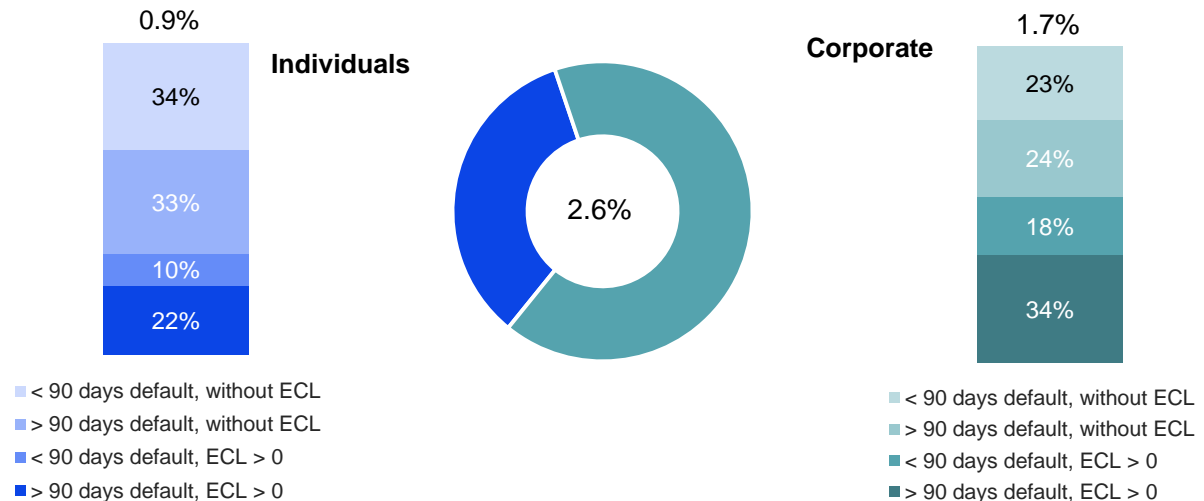
Gross carrying value of loans that are either individually impaired or are over 90 days past due but not impaired as % of total gross value of loans to customers (YE figures)



Gross carrying value of Stage 3 and POCI (Risk class 5 (DD)) loans as % of total gross carrying value of loans to customers

*Represents data as on 01.01.2018

Problem loans by status YE 2019





Financials 2019



Highlights of the year 2019



Arion Bank is on a new trajectory after having undergone significant management and organizational changes and improvement measures in Q3



Earnings from continuing operations are ISK 14 billion and improve significantly. ROE from continuing operations improves YoY from 4.3% to 7.2%



Negative developments in businesses held for sale, reduce net earnings to ISK 1 billion but are not reflective of future performance



The balance sheet was decreased in a tactical manner



Return on assets under management was very good and the Bank has retained its number one position in equities trading for the 4th year in a row



The Bank has substantial surplus capital which allows it to pay a dividend of ISK 10.0 billion. This corresponds to a dividend yield of 6.4% on market cap year end



The Bank adopted a new environmental strategy and will put increased emphasis on such matters both in operations and lending



The Bank issued USD 100 million AT1 in February 2020



Arion Bank focuses on sustainable and responsible banking



International and domestic commitments

- A founding signatory of the **UN PRB** and will strategically align its business with the **Sustainable Development Goals** and the **Paris Agreement** on Climate Change
- UN Principles for Responsible Investment, **UN PRI**
- **UN Global Compact**
- Festa and City of Reykjavík's **Declaration on Climate Change**



Arion Bank's Environment and Climate Policy

- Adopted in December 2019
- Contribute to Iceland's efforts to meet its **international agreements**
- Focus on financing projects on **sustainable development and green infrastructure**
- We will **evaluate our loan portfolio** according to green criteria, set ambitious targets and adopt a policy on loans to individual sectors **and evaluate our suppliers**



Gender Equality

- First bank in Iceland to gain the **equal pay symbol** from the Ministry of Welfare
- **UN Women and UN Global Compact** Women's Empowerment Principles
- **Albright:** In **25th place** out of 333 listed companies in Sweden which are setting a good example in terms of **gender diversity in management teams and at board level**



Corporate Governance

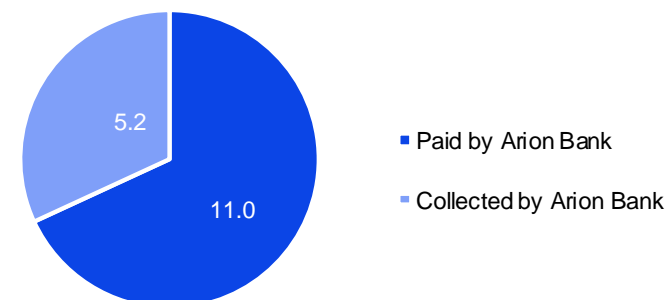
- Center for Corporate Governance's recognition of **Excellence in corporate governance**
- Since 2015 Arion Bank has been recognized as a company which has achieved excellence in corporate governance following a formal assessment based on **guidelines on corporate governance issued by the Icelandic Chamber of Commerce**

Reporting

- Global Reporting Initiative standard, **GRI Core**
- **ESG reporting guide** for the Nasdaq Nordic and Baltic exchanges
- UN Global Compact **progress report**
- Sustainalytics **ESG rating**
- UN **sustainable development goals**

Tax footprint 2019 (ISK billion)

Arion Bank's (parent company) total tax contribution in 2019 amounted to **ISK 16.2 billion** which equals around 2% of the government's total income in 2018¹



¹Source: Arion Bank data and Icelandic Government accounts 2018



Arion Bank Group

Diversified business model and strong market position

Retail Banking

- Digital leader in the retail market
- Large private provider of residential mortgages in Iceland
- ~ 29% market share¹
- Wide range of financial services for individuals and SMEs²

CIB

- Corporate banking and strategic advisory
- Use of own capital and increased capital market intermediation
- Managed c. 2/3 of all IPOs in Iceland since 2011

Markets

- Largest asset manager in the Icelandic market
- A leading capital markets house
- Largest custody service provider in Iceland



Arion Bank's subsidiary **Stefnir** is a leading fund management company in Iceland

ROE for 2019: 38.6%

Insurance

- The Bank's subsidiary Vördur is the largest life insurance and the 4th largest universal insurance company in Iceland
- Has been a growing contributor to Arion Bank's operating income mix in the last three years
- ROE for 2019: 24.9%



Business profile:

Retail Banking

CIB

Markets

VALITOR

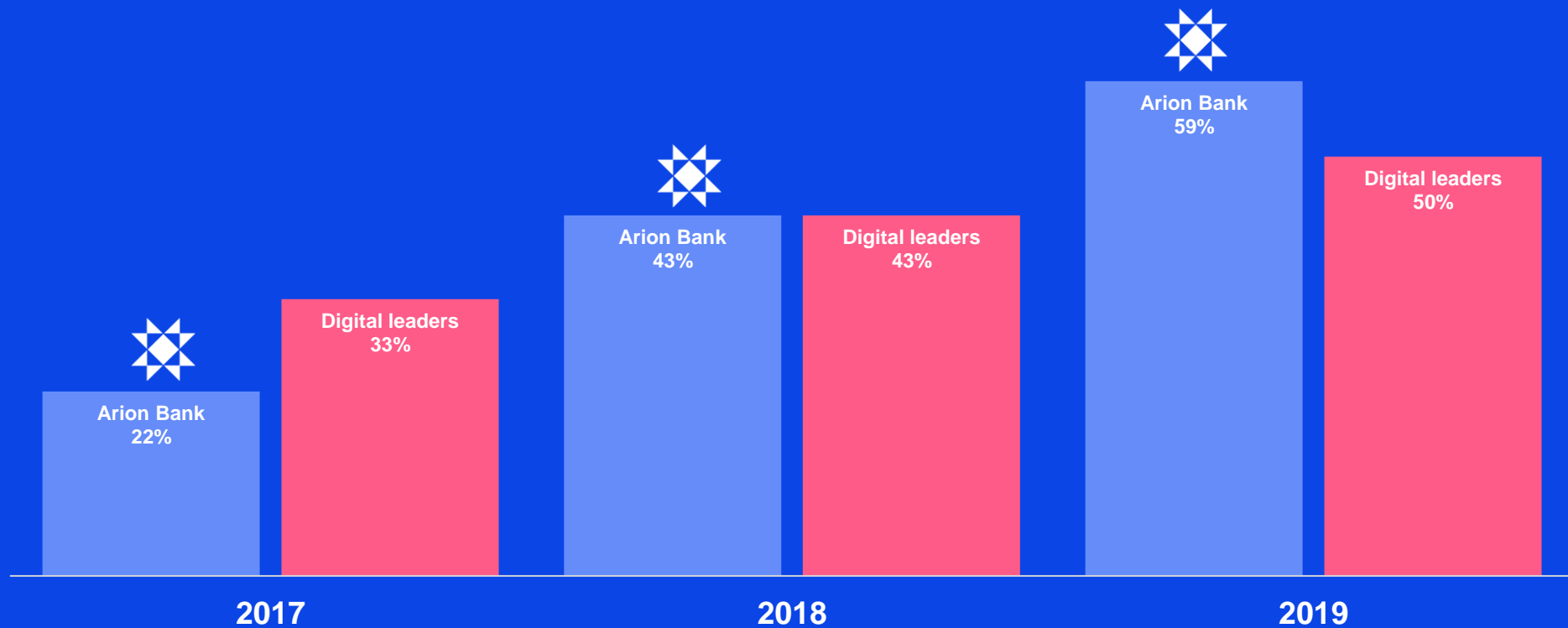
	Retail Banking	CIB	Markets
Client lending	ISK 470 billion	ISK 303 billion	-
RWA allocation	ISK 266 billion	ISK 324 billion	ISK 14.4 billion
Assets under Management	-	-	ISK 1,013 billion

- Largest card payments company in Iceland based on operating revenues³
- **Valitor is currently in a sales process** and defined as held for sale in the accounts



World leader in digital sales

Digital sales as % of total sales - Arion Bank compared to international digital leaders



Market leader in digital banking

Launched 7 customers facing products in 2019

Open App



Launched in February 2019

Everyone can use the Arion app by logging in through digital authentication, without having prior business with the Bank. The following products were made available for direct purchase in app:

Credit cards

Debit cards

Savings account

Consumer loans

Apple Pay and Mobile Wallet*



Launched in 1h 2019

Customers can link their credit and debit cards to Apple Pay or Mobile Wallet* directly through the Arion app and use their phone to pay in shops that have contactless card machines

Vördur Insurance



Launched in July 2019

Customers can get a quote for car and home insurance and complete the purchase within a few seconds in the Arion app. The insurance offering is personalized to each customer based on data & analytics

Personal Finance Management



Launched in July 2019

In the Arion app customers now have an insights option giving them an overview of their spending by period in specified categories

Aggregation of Accounts



Launched in July 2019

In partnership with Meniga you can now see your accounts and transactions at other banks in the Arion App securely and conveniently

Rós concept introduced



Launch in Q4 2019

Machine learning models are deployed to identify appropriate products and recommend to individual customers.

To make the recommendation personal and compelling we introduce a bot concept "Rós" that delivers the recommendations to our customers



Income statement 2019

The positive effect of the Bank's revised strategy in Q3 is not fully reflected in the full year numbers

- Strong growth in net interest income despite lower inflation mostly due to higher (average) interest bearing assets (1.8%) during most of 2019
- Other revenue items relatively strong and operating income increases by 4% from last year
- Operating expenses are under control as increase in salaries and related expenses is primarily due to redundancies in Q3 (ISK 1.1. billion)
- The impairment line is volatile YoY. Impairments are modest in 2019 as the release of discount relating to a sale of a mortgage portfolio in Q4 partially offsets the loss from the bankruptcy of WOW air in Q1 and TravelCo in Q2. Impairments in 2018 were high, mainly due to bankruptcy of Primera Air in Q3 2018
- Effective tax rate is 21% compared with 31% in 2018, due to more favorable revenue distribution
- Net effects of discontinued operations are unusually extensive, mainly due to valuation changes at Stakksberg and operation and changes at Valitor. The effect of these on the Bank's capital position is minimal

	2019	2018	Diff	Diff%
Net interest income	30,317	29,319	998	3%
Net commission income	9,950	10,349	(399)	(4%)
Net insurance income	2,886	2,590	296	11%
Net financial income	3,212	2,302	910	40%
Share of profit of associates	756	27	729	-
Other operating income	877	1,584	(707)	(45%)
Operating income	47,998	46,171	1,827	4%
Salaries and related expenses	(14,641)	(14,278)	(363)	3%
Other operating expenses	(12,222)	(12,000)	(222)	2%
Operating expenses	(26,863)	(26,278)	(585)	2%
Bank levy	(2,984)	(3,386)	402	(12%)
Net impairment	(382)	(3,525)	3,143	-
Net earnings before income tax	17,769	12,982	4,787	37%
Income tax expense	(3,714)	(4,046)	332	(8%)
Net earnings from continuing operations	14,055	8,936	5,119	57%
Discontinued operations, net of tax	(12,955)	(1,159)	(11,796)	-
Net earnings	1,100	7,777	(6,677)	(86%)

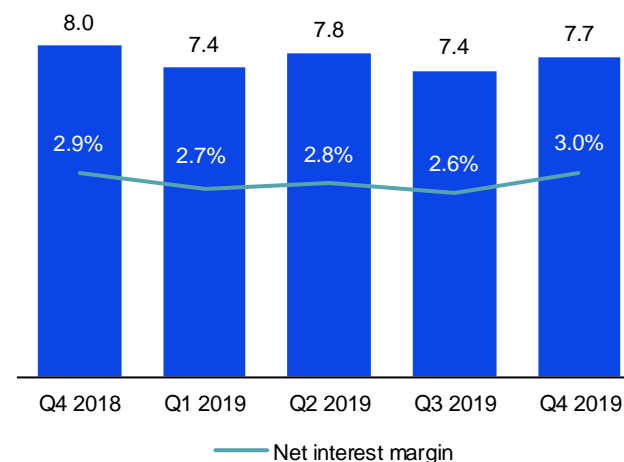


Net interest income

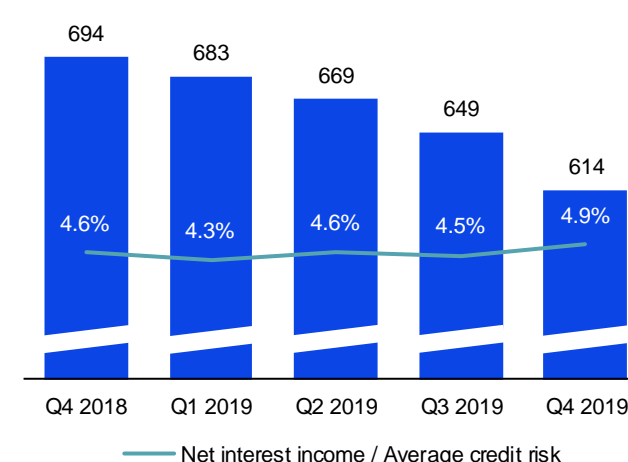
Revised strategy reflected in positive development in NIM as well as ratio of net interest income to credit risk

- Net interest margin increases to 3% in Q4 in line with revised strategy of increased focus on returns rather than loan growth. Strong performance in light of:
 - Historically low policy rate
 - Lower inflation during the quarter (2.3% vs 4.2% in Q4 2018)
 - Issuance of Tier 2 subordinated bonds in 2019
- Reduction of wholesale funding in ISK and FX have positive effect on NIM as well as increased proportion of ISK in liquidity buffer
- Net interest income decreases 3% from Q4 2018 mainly due to 8% decrease in interest bearing assets
- Favorable development in Net interest income to average credit risk following increased focus on capital management and return on loan book
- Lower interest income from loans to customers and lower effect from inflation on Net interest income is largely offset by lower funding cost in deposits and borrowings
 - Prepayment of expensive funding and strong liquidity management supports NIM

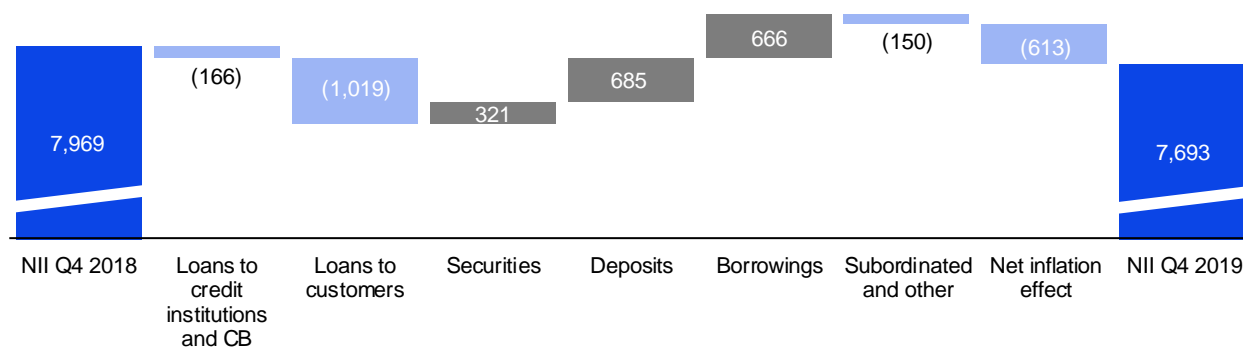
Net interest income



Credit risk



Net interest income Q4 2018 vs Q4 2019 (ISK million)

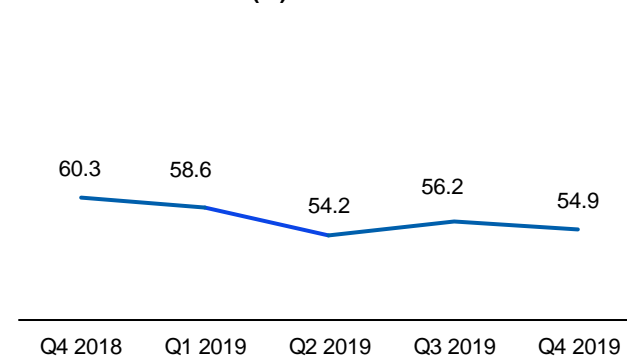


Total operating expenses

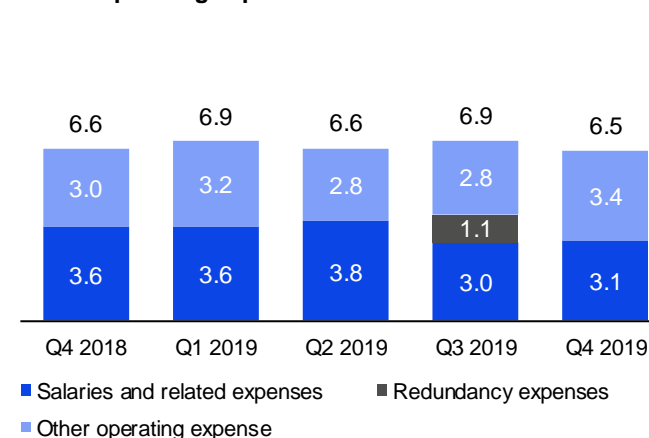
Cost-to-income is trending towards target

- Number of FTE's reduced by 13.5% at the parent company from Q4 2018, mostly due to organizational changes at the end of Q3 with cost savings materializing in Q4
- Salaries and related expenses reduced by 14% from Q4 2018 while number of FTE's reduced by 11%. General wage inflation was 4.9% in the same period
 - Salaries and related expenses were affected by capitalized salaries which amounted to ISK 142 million in Q4 (nil in Q4 2018) relating to investment in the Sopra core system
- Other operating expenses increase year on year, due to IT and depreciation. Other items such as housing and office costs decrease

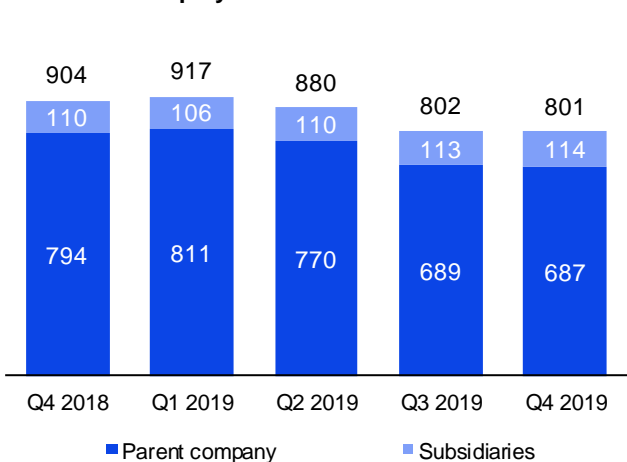
Cost-to-income ratio (%)



Total operating expenses



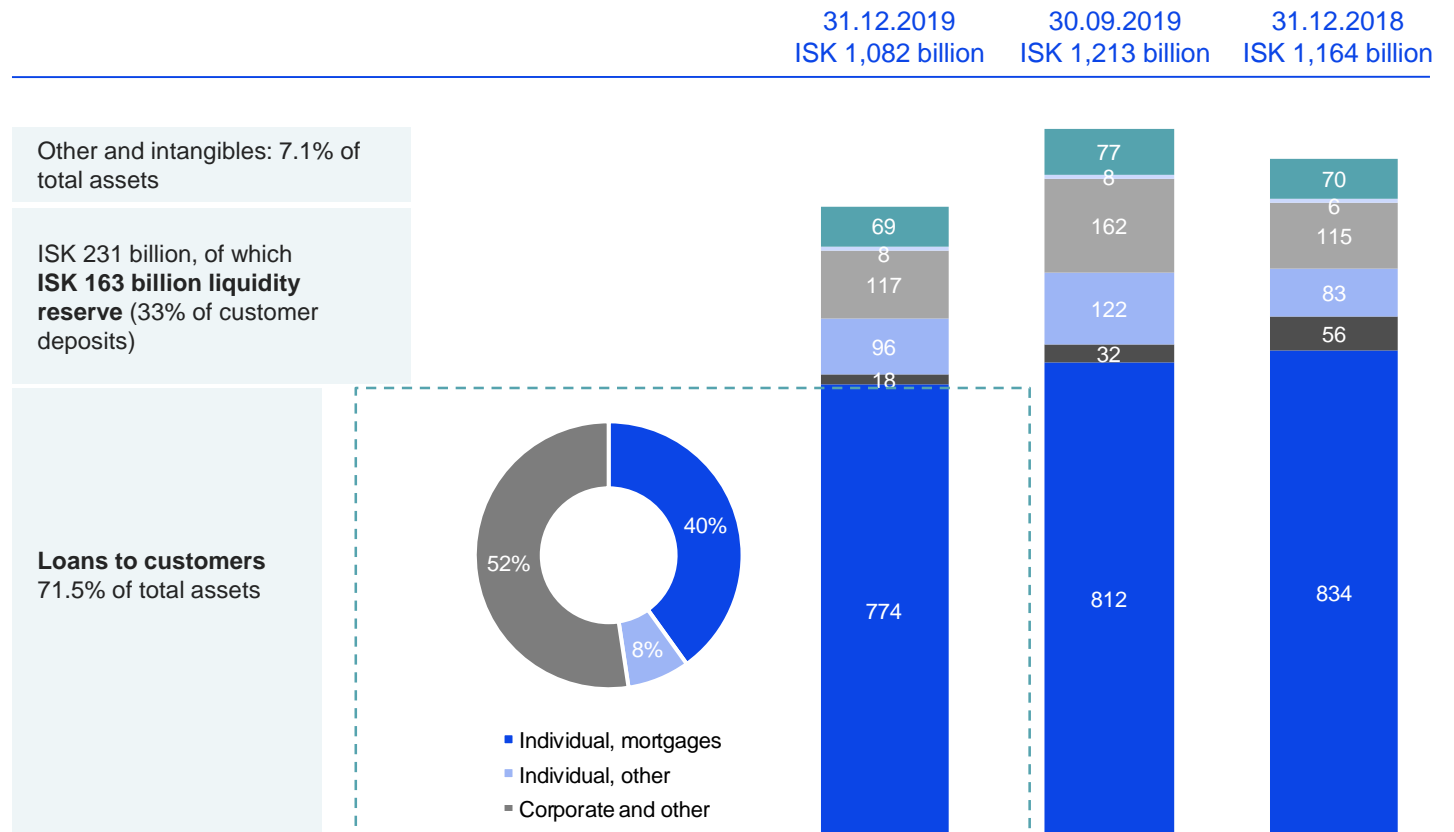
Number of employees



Balance sheet - Assets

Balance sheet brought down in line with strategy as both loans and liquidity decrease

- The Balance sheet decreases by 10.8% from 30.09.2019
- Loans to customers decrease by 4.7% from 30.09.2019 and 7.2% from year-end 2018 in line with strategy of focus on returns over loan growth
 - ISK 48 billion mortgage portfolio sold during the quarter
- Decrease in financial instruments due to sale of bonds with proceeds used to prepay wholesale funding
- Very strong liquidity position despite dividend payment during Q1 2019, share buyback during Q4 and large prepayments of borrowings
 - Total LCR ratio is 188% and ISK LCR ratio is 158%
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX



■ Loans to customers ■ Loans to credit institutions ■ Cash and balances with Central Bank ■ Financial instruments ■ Intangible assets ■ Other assets

¹Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets

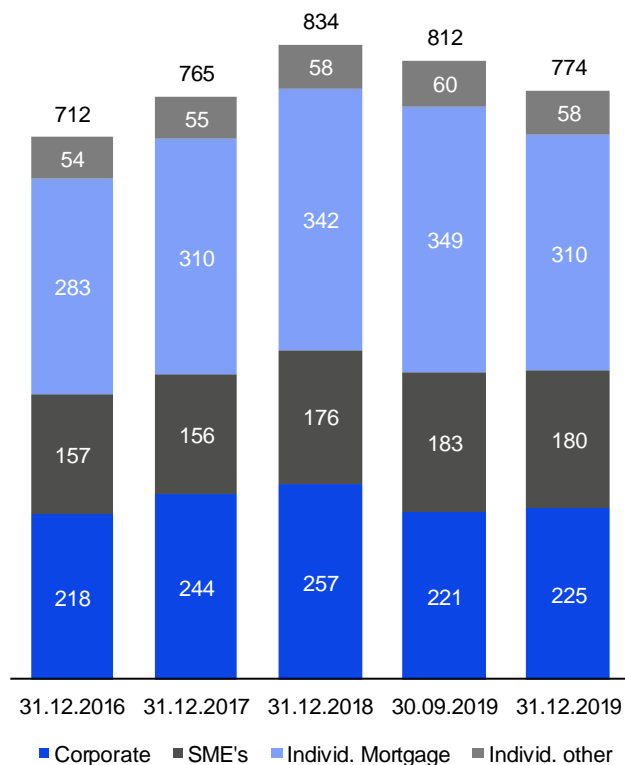


Loans to customers

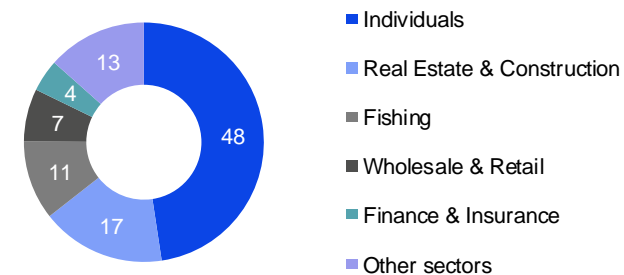
Focus on profitability results in the loan book trending lower thus releasing RWA's

- Loans to customers decrease by 7.2% during 2019
- The loan book continues to be well balanced between individuals and corporates
- Loans to individuals decrease 8.0% during the year due to sale of ISK 48 billion mortgage portfolio
 - Loans to individuals increase slightly from YE 2018 taking into account sale of mortgage portfolio
- The corporate loan book reduction has released approx. ISK 45 billion of RWA's since YE 2018
 - Loans to corporates decrease by 6.5% from YE 2018 but stable from 30.09.2019
 - Good diversification between sectors in the corporate loan book
- Demand for new lending affected by temporary economic slowdown
 - Reflected in loan commitments, 32% decrease from YE 2018
- 87% of the loan book was classified as stage 1 at YE 2019 compared with 92% at YE 2018
- The loan book is collateralized 89.8%, compared with 90.6%, at YE 2018

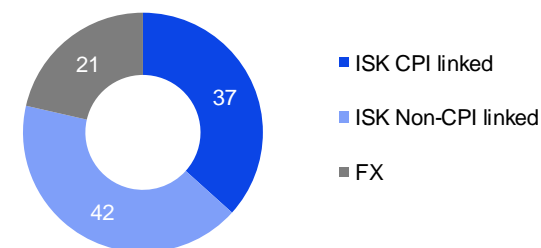
Loans to customers



Loans to customers by sector (%)



Loans to customers by currency (%)



Balance sheet – Liabilities and equity

Deposits are increasing in the funding mix

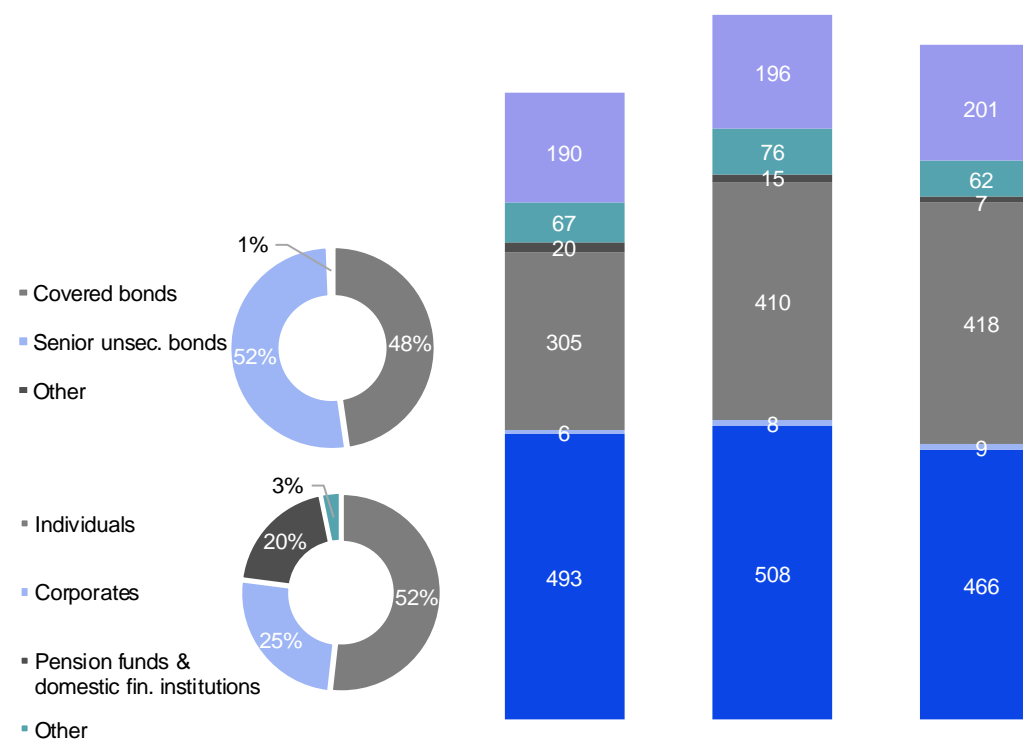
- Strong equity position and a very high leverage ratio despite capital release
 - Dividend payments of ISK 9.1 billion in Q1 2019
 - Share-buy back up to ISK 8.0 billion from 31 October
 - Proposed dividend payment of ISK 10.0 billion in March 2020, ISK 5.5 per share
- The Bank is a frequent issuer of covered bonds in the domestic market and a regular issuer of senior unsecured in the international market
 - Bank levy is calculated on year end position of liabilities and the Bank strategically seeks to limit large MM deposits at year end
- Deposits increased by 5.8% from YE 2018 but decrease 3.0% during the fourth quarter – continued focus on deposits going forward
- The Bank has issued a number of Tier 2 subordinated bonds in line with its capital strategy
- The funding mix is well balanced between deposits, covered bonds and senior unsecured bonds

Equity
 CET1 ratio 21.2% Capital adequacy ratio 24.0%
 Leverage ratio 14.1%

Borrowings (in ISK)
 ISK 147 billion
 EUR 117 billion
 Other currencies 41 billion

Deposits
 On demand 71%
 Up to 3M 16%
 More than 3M 13%
 8.3% increase from YE 2018

31.12.2019 ISK 1,082 billion 30.09.2019 ISK 1,213 billion 31.12.2018 ISK 1,164 billion



█ Deposits █ Due to credit institutions and Central Bank █ Borrowings █ Subordinated liabilities █ Other liabilities █ Equity

¹ Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities

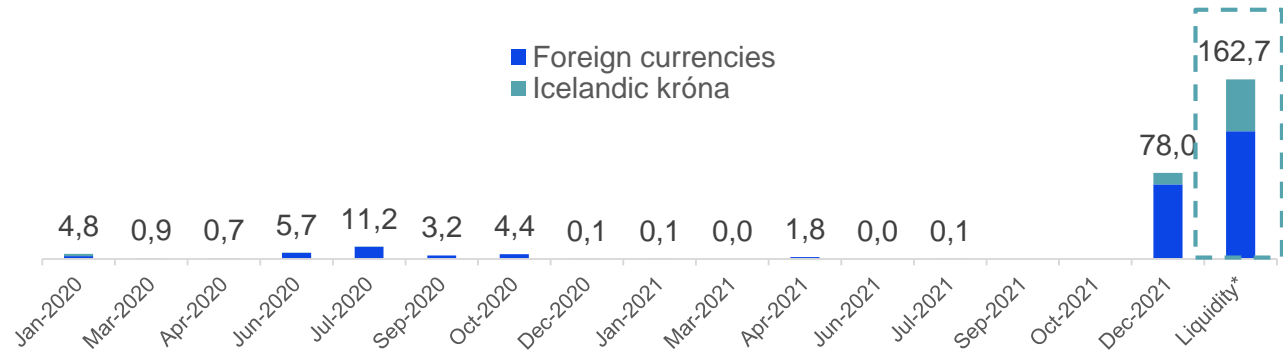


Funding and liquidity

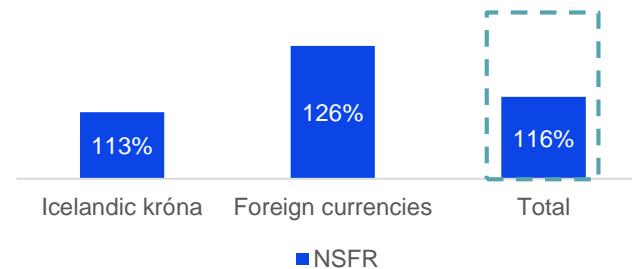
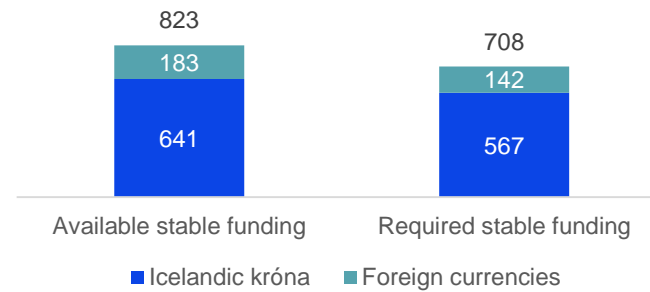
No need for international funding in 2020

- Liquid assets cover all maturities in 2020 and 2021
- No need** for international funding in 2020
 - The aim is to start refinancing EUR 2021 maturity in H2 2020
 - Arion has tendered EUR benchmark issues 6-12 months ahead of maturity
- Arion will continue to be regular issuer of covered bonds in the domestic market with the aim to sue ISK 15-20 bn in the domestic market
- LCR 188% and NSFR 116% well above regulatory requirements
- In addition to ISK **162.7 bn.** liquidity reserve Arion has **ISK 73 bn. (50/50 inflation linked/fixed rate)** of residential mortgages that could be used for covered bond funding

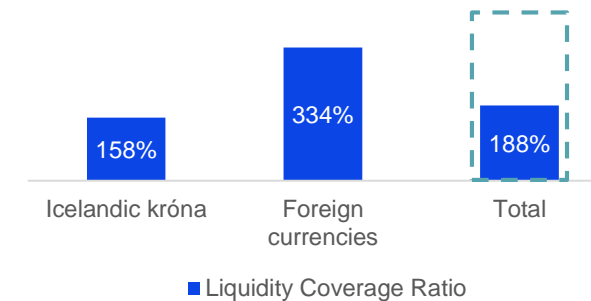
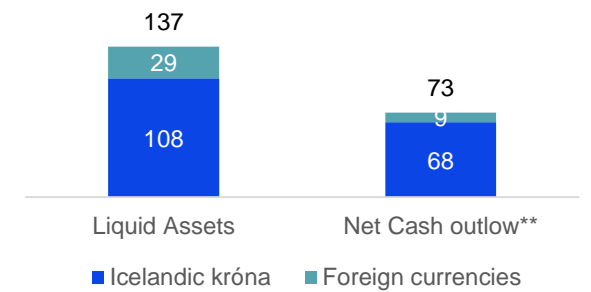
Maturity profile of Borrowing monthly to year end 2021 vs Liquid assets at YE2019



Net Stable Funding Ratio



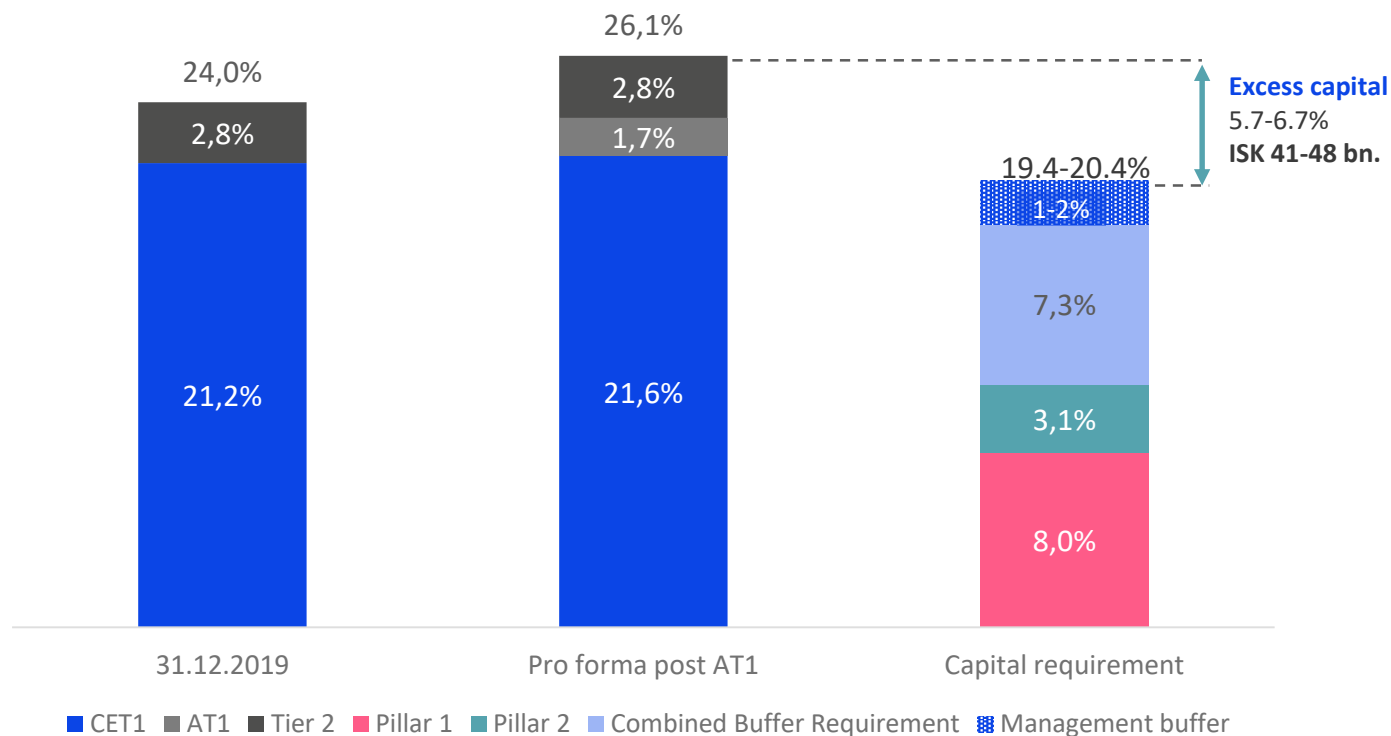
Liquidity Coverage Ratio



Strong capital position further strengthened with recent AT1

Arion is well above any capital requirements – excess capital ISK 41-48 bn.

- Arion finalized its inaugural AT1 in February, increasing capital by 1.7%
- SME supporting factor reduces RWA by ISK 12bn (~0.4% CET increase)
- Takes into account a scenario where the countercyclical buffer is reduced to 0%
- This scenario also assumes dividend payment of ISK 10bn



Proforma 2019 capital position includes the application of the SME supporting factor to RWA
Capital requirement assumes Countercyclical buffer to be reduced to 0%



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