

Ladies and Gentlemen

The year 2011 was a good year for Arion Bank. We took important steps in many areas. Recovery work with our customers, both corporations and households, progressed well. We strengthened our balance sheet and increased our long-term funding. The final steps in reorganizing the Bank were taken. At times they were difficult steps, but they were necessary. The Bank's development is an ongoing task - but we now have a solid base to build upon.

The Icelandic economy showed good signs of recovery during the year. Economic growth was above 3% - amongst the highest in the OECD. The country has made good progress, built up strong financial institutions and in many ways serves as an example to others, especially given the economic instability in many European countries.

The challenges presented in the autumn of 2008 were considerable; not just for the authorities but also for the corporate sector and the general public. From the outset it was clear that the financial companies would play a key role in the rebuilding of the Icelandic economy. It would often prove to be a difficult and thankless task, given the part played by the financial sector in the Icelandic crisis. However, everyone involved in the reconstruction of the Icelandic economy has performed their duties effectively.

The government has made great strides in stabilizing the budget deficit, indeed to such an extent that Iceland has completed the International Monetary Fund (IMF) programme. This has, however, not been a painless process. Taxes on individuals and corporations have been raised, not least on financial companies, and the public sector has had to endure cut-backs.

The Icelandic banks have put great effort into financially restructuring thousands of companies. Arion Bank has completed the reorganization of close to 900 corporate clients. The Bank has also channelled its energy into resolving household debt and has now reorganized the debts of more than 14,000 individuals.

As a result the quality of Arion Bank's loan book increased substantially during 2011. This has been done through hard work shared between our employees and our customers. This progress, along with the acquisition of a mortgage fund from the bankruptcy estate of Kaupthing, has been key in improving the quality of Arion Bank's loan book. Non-performing loans are now down to 13% from more than 50% in 2009. We have not yet reached a stage where we can say that things are fully back to normal, but clearly very good progress is being made.

When almost one thousand companies are being financially restructured in this manner, it is simply inevitable that there will be a few cases where the Bank has to take over a company in order to best protect its interests. It is important to stress that acquisitions like these are only done as a last resort. This has proven to be the case here in Iceland, just as it was the case in the financial crisis that hit Sweden in the nineties. It can take years before the banks have divested all acquired companies. Fortunately, Arion Bank made good progress in 2011 in divesting acquired companies and the Bank was responsible for the first listing on the Icelandic stock exchange since 2008 – an important step, not only for Arion Bank but for the regeneration of the Icelandic financial market as a whole. Hagar's IPO attracted huge interest from the general public and investors and was heavily oversubscribed, which indicates that there is a current lack of available investment options.

The current economic growth in Iceland is to a large extent fuelled by private consumption. For economic growth to be sustainable investment is crucial, but the fact is that investment in Iceland is at an all-time low. It is not an overstatement to say that the most pressing task today is to increase investments in Iceland.

The main reason for the low level of investment is the continued uncertainty in the Icelandic economy and, of course, the capital controls. The sooner the uncertainty is reduced the better, for everyone: the financial sector, the corporate world and subsequently families and individuals. The sooner Iceland attracts foreign investment, the quicker the rebuilding process can proceed.

The banks have done what is in their power to limit the uncertainty by establishing themselves as financially strong institutions with strong capital ratios well above the current requirements of the Icelandic Financial Supervisory Authority. We now need the government's help to reduce the uncertainty with all necessary means, only in doing so will investors regain the needed confidence.

It is right to note that, even though it is fitting that the financial institutions shoulder their responsibilities in the rebuilding process, it is also important that taxes on the financial sector do not inhibit the sector's competitiveness and its ability to meet the demands of its customers.

The authorities must recognize the importance for the economy of having strong financial institutions operating in a stable, predictable and transparent environment. Taxes imposed on financial companies may not be out of step with what is common practice elsewhere in the business sector and the general environment.

The same goes for other aspects of the regulatory environment. In this context I would like to mention that I have followed the news in Iceland on the possible separation of retail and investment banking activities with some amazement. No such discussion is taking place in Sweden - or elsewhere in Scandinavia as far as I am aware. Following the financial crisis there has of course been a discussion in all countries on how to make the financial system safer, but the main emphasis has been on reducing risk and increasing capital requirements through the BASEL framework.

It is, of course, necessary to examine what went wrong and how we can improve the financial system, but at the same time we need to recognize that a lot of changes have already been made. We are already working with very strict capital and liquidity requirements. Numerous new laws regarding the financial sector and its regulators have been put in place. It is my view that we must be careful and not rush into new rules and regulations that can have negative effects on financial markets and lead to less banking services being provided to the corporate sector and increase the price of financial services.

Any Iceland specific solutions that will cause the operating environment of Icelandic banks to differ from those in other countries will of course weaken our competitive position, which will have negative effects on the economy and reduce the likelihood of foreign investment in the sector.

A resilient financial system is a mainstay of every modern nation. For us at Arion Bank it has been an absolute priority in recent years to develop a financially robust bank. These endeavours have paid off. The Bank's capital ratio is 21.2%, which we consider to be vitally

important given the prevailing uncertainties. Recent rulings of the Supreme Court in regards to recalculations of currency-linked loans are a stark reminder of this importance.

During the year we streamlined the business by reducing the number of employees and rationalizing the branch network. These were not easy decisions to make but they were vital. The Bank's employees deserve praise for their tireless work under difficult circumstances. The workload has seemed at times overwhelming, but our employees have approached their work steadfastly.

In closing, I would like to emphasize that the year 2011 was a good year for Arion Bank. The focus has shifted from debt recovery cases linked to the past, to projects driven by the future. During the year Arion Bank offered its customers a range of new products and services, becoming the market leader in personal mortgages and offering products which had previously not been available.

The Bank will continue in this direction in 2012. The customers and their future needs and prosperity will be the focus of our efforts.

The outlook for 2012 is in many ways positive. We do, however, need to exercise caution in all our actions since the environment we operate in remains volatile, in spite of the immense progress made. I look to the year ahead with confidence and believe it will present us with good opportunities

It is imperative for Iceland, that now when good progress is being made, when the most important tasks related to settling past business have either been completed or are in process, that the focus is shifted even more firmly on to the future, to the growth of the economy and the opportunities that lie ahead.

I would like to thank my fellow board members, the Bank's Management team and its dedicated employees for the rewarding cooperation during the last 12 months. I look forward to our continued cooperation and I have high expectations for the coming year.

Thank you very much!