

Arion Bank Mortgages Institutional Investor Fund

Interim Financial Statements 30 June 2016

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

The Interim Financial Statements of ABMIIF are included in part B of the Interim Financial Statements of Stefir hf. which contains the Interim 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 727 millions 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 23,797 millions according to the balance sheet.

The Board of Directors and CEO of Stefir hf. hereby confirm the fund's Interim Financial Statements for the period 1 January - 30 June 2016 with their signatures.

Reykjavik, 31 August 2016

Board of Directors:

CEO:

Review Report on Interim Financial Statements

To the Board of Directors the unit holder of ABMIIF.

We have reviewed the accompanying interim financial statement of ABMIIF for the period of 1 January to 30 June 2016, which comprise the endorsement and signatures of the board of directors and managing director, income statement, balance sheet, changes in net assets, statement of investment and a summary of significant accounting policies and other explanatory notes.

Management's and the Board of Directors Responsibility for the Financial Statements

Management and the board is responsible for the preparation and fair presentation of this interim financial information in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Auditor's Responsibility

Our responsibility is to express an conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standards on Review Engagements, ISRE 2410. A review of interim financial information 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 information does not give a true and fair view of the financial position of the entity as at 30 June 2016 and of its financial performance and its change in net assets in the period, in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 31 August 2016

Deloitte ehf.

Páll Grétar Steingrímsson
State Authorized Public Accountant

Petur Hansson
State Authorized Public Accountant

Interim Statement of Income 1 January - 30 June 2016

		01.01. - 30.06 2016	01.01. - 30.06 2015
	Skýr.		
Income:	2-5		
Interests		798	963
Indexation		2.251	2.622
Total income		<u>3.049</u>	<u>3.585</u>
Expenses:			
Administration fee	6	62	74
Interest expenses and indexation		2.308	2.290
Other operating expenses		(48)	(112)
Total expenses		<u>2.322</u>	<u>2.252</u>
Net income (expenses)		727	1.333
Profit transferred to units		<u>727</u>	<u>1.333</u>

Interim Statement of Changes in Net Assets

1 January - 30 June 2016

	01.01. - 30.06 2016	01.01. - 30.06 2015
	Skýr.	
Operating activities		
Profit transferred to units	727	1.333
Financing activities		
Units sold	0	(26.000)
Financing activities	0	(26.000)
Changes in net assets	727	(24.667)
Net assets at the beginning of the year	23.070	46.982
Net assets at the end of the period	23.797	22.315

Interim Statement of Financial Positions at 30 June 2016

	Skýr.	30.06.2016	31.12.2015
Assets:			
Transferable securities	7	95.705	102.387
Total assets		95.705	102.387
Other assets:			
Cash	8	28.407	21.735
Other assets	9	1.412	281
Total other assets		29.819	22.016
Total assets		125.524	124.403
Liabilities			
Units		23.797	23.070
Loan from financial institutions		101.716	101.303
Liabilities with the management company		11	10
Other liabilities		0	20
Total other liabilities		101.727	101.333
Total liabilities		125.524	124.403
Net assets		23.797	23.070
Number of units		23.200,070	23.200,070
Exchange rate of units at the end of the period		1,03	0,99

Statement of Assets 30 June 2016

	Book value		Book value		Issuer
	30.6.2016	%	31.12.2015	%	
Other transferable securities:					
Mortgages, unindexed	5.401	4	6.012	5	Individuals
Mortgages, indexed	90.304	72	96.375	77	Individuals
Other transferable securities, total	95.705	76	102.387	82	
Investments, total	95.705	76	102.387	82	
Cash	28.407	23	21.735	17	
Other assets	1.412	1	281	0	
Total assets	125.524	100	124.403	100	

Interim Statement of Investments 30 June 2016

Comparison with Investment policy:

	Book value 30.06.2016	%	Book value 31.12.2015	%	Investment policy	
					Minimum	Maximum
Mortgages	95.705	100	102.387	100	0	100
Total investments	95.705	100	102.387	100		

Segmentation by countries and currency:

	Book value 30.06.2016	%	Book value 31.12.2015	%
Ísland ISK	95.705	100	102.387	100
	95.705	100	102.387	100

Statement of Main Assets

	Book value 30.06.2016	Book value 31.12.2015	Changes of book value	%
Mortgages, unindexed	5.401	6.012	(611)	(0,5%)
Mortgages, indexed	90.304	96.375	(6.070)	(4,8%)
Mortgages	95.705	102.387	(6.682)	(5,3%)
Other assets	29.819	22.016	7.803	6,2%
Total assets	125.524	124.403	1.121	0,9%

Net assets, exchange rate and return of the fund

Net assets and return of the fund:

	30.06.2016	31.12.2015	31.12.2014	31.12.2013
Net assets	23.797	23.070	46.982	43.450
Exchange rate	1,0257	0,9944	2,0251	1,8728

Return of the fund:

	01.01.-30.06. 2016	2015	2014	2013
Return of the fund	3,15%	(50,90%)	8,13%	5,27%
Real return of the fund	1,71%	(51,86%)	7,02%	1,56%

Loan from Financial Institutions

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.

Repayments on loan agreements at the end of June 2016 are as follows:

	Book value
Repayments 2016	1.880
Repayments 2017	2.132
Repayments 2018	2.213
Repayments 2019	2.298
Repayments 2020	2.385
Repayments later	90.807
	<u>101.716</u>

Notes to the Interim Financial Statements

Accounting methods

1. General information

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 Interim 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. The Interim Financial Statements have been prepared in Icelandic krónur (ISK) rounded to the nearest million. The fund is a part of Stefmir hf. which is a subsidiary of Arion Bank hf. The Interim Financial Statements form part of the consolidated Interim Financial Statements of Arion Bank hf. The interim Financial Statements have been prepared in accordance with new rules from the Financial supervisory Authority regarding Financial Statements of UCITS and investment funds, effective 1 January 2016. The new rules do not involve changes in estimates and assumptions that affect the reported amounts of assets nor the net earnings of the fund.

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. Indexed assets and liabilities

Indexed assets and liabilities are calculated on basis of indexes valid 1 of July 2016. Accrued indexation on principal of assets and liabilities 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 Stefmir 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 fee for official supervisory.

7. Securities with fixed income

a. Mortgages are recognised with accrued interest and indexation at the end of June 2016. At the end of June 17,4% of the fund's mortgages were calculated according to the index for mortgage payment adjustment.

b. Provisions are done by a general provision and a special provision. Total provision for losses amounts to ISK 197 millions, which of specific provision amounts to ISK 137 millions and collective provision amounts to ISK 60 millions. The provision account has been deducted from Securities with fixed income in the Balance sheet.

c. Mortgages are specified as:	30.6.2016	31.12.2015
Mortgages before impairment	95.902	102.635
Provision at the beginning of the year	(248)	(364)
Write-offs during the period	0	8
Reversal during the period	51	108
Mortgages at the end of the period	95.705	102.387
Provision for losses as a ratio of total loans	0,21%	0,24%

Notes, cont.:

8. Cash

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

9. Other assets.

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

10. 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.