Condensed Consolidated Interim Financial Statements

1 January - 31 March 2011

Unaudited

Arion Bank
Borgartún 19
105 Reykjavík
Iceland

Reg. no. 581008 - 0150

Contents

Endorsement and Statement by the Board of Directors and the CEO

The Unaudited Condensed Consolidated Financial Statements of Arion Bank for the period ended 31 March 2011 include the Interim Financial Statements of Arion Bank and its subsidiaries, together referred to as "the Group".

Arion Bank is a group of financial undertakings which provide comprehensive services to companies, institutions and private customers. These services include corporate banking, retail banking, capital markets services, corporate financing, asset management and comprehensive wealth management for private banking clients.

Kaupskil ehf., a company owned by the creditors of Kaupthing Bank, holds 87% of the shares in Arion Bank. The remaining shareholding of 13% is held by the Icelandic State. The financial position of the Group is described in Note 5.

The number of full time equivalent positions was 1,273 at period end.

Operations during the period

Consolidated net earnings amounted to ISK 2,966 million for the period ended 31 March 2011. Consolidated total equity amounted to ISK 112,683 million at the end of the period, including share capital amounting to ISK 2,000 million. The capital adequacy ratio of the Group, calculated according to the Act on Financial Undertakings, was 19.7%. By law this ratio is required to be no lower than 8.0%, but the Icelandic Financial Supervisory Authority ("FME") requires it to be no less than 16%. The Bank's liquidity ratio and cash ratio were 36.0% and 16.0% respectively at the end of the period.

Due to the capital controls in Iceland, Arion Bank has a currency imbalance that results in net earnings being very sensitive to changes in the exchange rate. The Bank's objective is to close the imbalance in 2011.

Arion Bank generally preformed well during the period despite the challenging economic environment and its core banking performance was strong. The Bank continued to make good progress in the restructuring work on its loan book and other assets transferred from Kaupthing Bank. The Bank expects the recovery work to be largely completed by the end of 2011.

Uncertainties continue to prevail regarding the legality of foreign currency loans to corporations. In February 2011 the Supreme Court of Iceland issued two judgements on foreign currency loans of another financial institution to companies and ruled that the loans were illegal in the same way as it had in the 2010 judgement on loans to individuals. The new judgement creates certain uncertainties over foreign currency loans by Arion Bank to smaller companies if such loans were taken to court. The foreign currency loans issues are discussed in detail in Note 52.

Statement by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements for the period ended 31 March 2011 have been prepared in accordance with International Financial Reporting Standard (IAS 34 *Interim Financial Reporting*) as adopted by the EU.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the consolidated financial performance of the Group for the period ended 31 March 2011, its consolidated financial position as at 31 March 2011 and its consolidated cash flows for the period ended 31 March 2011.

The Board of Directors and the CEO of Arion Bank hereby confirm the Group's Unaudited Condensed Consolidated Interim Financial Statements for the period 1 January to 31 March 2011.

Reykjavik, 25 May 2011

Board of Directors

Chief Executive Officer

Consolidated Statement of Comprehensive Income
for the first quarter of 2011

	Notes	2011 1.1-31.3.	2010 1.1-31.3
Interest income		11,117	14,097
Interest expense		(5,231)	(8,462)
Net interest income	9	5,886	5,635
Increase in value of loans and receivables	10	2,057	403
Impairment on loans and receivables	11	440	(834)
Changes in compensation instrument	34	(2,910)	-
Net interest income less valuation changes on loans and receivables		5,473	5,204
Fee and commission income		4,124	1,893
Fee and commission expense		(1,632)	(430)
Net fee and commission income	12	2,492	1,463
Net financial income	13-16	729	185
Net foreign exchange (loss) gain	17	(312)	609
Share of profit or loss of associates	36	(17)	97
Other operating income	18	1,116	619
Operating income		9,481	8,177
Salaries and related expense	20	(2,658)	(2,172)
Administration expense		(1,909)	(1,290)
Depositors' and investors' guarantee fund	47	(180)	-
Depreciation and amortisation		(208)	(164)
Other operating expense	21	(166)	(132)
Earnings before tax		4,360	4,419
Income tax expense	23	(1,045)	(722)
Bank Levy	23	(67)	-
Net earnings from continuing operations		3,248	3,697
Net gain (loss) from discontinued operations net of tax	22	(282)	(287)
Net earnings		2,966	3,410
Attributable to:			
Shareholders of Arion bank		2,791	3,395
Non-controlling interest		175	15
Net earnings		2,966	3,410
Other comprehensive income			
Exchange difference on translating foreign operations	45	181	(2)
Total comprehensive income for the period		3,147	3,408
Earnings per share			
Basic and diluted earnings per share attributable to the shareholders of Arion bank (ISK)	24	1.40	1.20

The notes on pages 9 to 40 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK millions

Consolidated Interim Statement of Financial Position
as at 31 March 2011

Assets	Notes	31.03.2011	31.12.2010
Cash and balances with Central Bank	25	24,629	30,628
Loans and receivables to credit institutions	26-27	84,733	67,846
Loans and receivables to customers	28-30	432,505	451,219
Bonds and debt instruments	32-33	123,423	120,112
Shares and equity instruments with variable income	32	11,526	10,316
Derivatives	32,42	395	1,126
Securities used for hedging	32	2,145	3,213
Compensation instrument	34	22,507	24,188
Investment property	35	27,149	27,642
Investments in associates	36	2,968	2,713
Property and equipment		7,259	7,365
Intangible assets		4,357	4,352
Tax assets	41	306	295
Non-current assets and disposal groups held for sale	37	38,575	44,464
Other assets	38	20,210	17,136
Total Assets		802,687	812,615
Liabilities			
Due to credit institutions and Central Bank	32	68,322	95,646
Deposits	32	472,359	457,881
Borrowings	32,39	65,180	65,278
Subordinated liabilities	40	26,730	26,257
Financial liabilities at fair value	32	6,202	999
Tax liabilities	41	5,326	4,454
Non-current liabilities and disposal groups held for sale	37	10,181	13,514
Other liabilities	43	35,704	39,050
Total Liabilities		690,004	703,079
Equity			
Share capital	44	2,000	2,000
Share premium	44	73,861	73,861
Other reserves	45	1,706	1,525
Retained earnings		31,322	28,531
Total Shareholders' Equity		108,889	105,917
Non-controlling interest		3,794	3,619
Total Equity		112,683	109,536
Total Liabilities and Equity		802,687	812,615

The notes on pages 9 to 40 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity
for the Period from 1 January to 31 March 2011

	Share capital and share premium	Other reserves	Retained earnings	**Total Share-holders' equity**	Non-controlling interest	**Total equity**
Changes in equity from 1 January to 31 March 2011:						
Equity 1 January 2011	75,861	1,525	28,531	105,917	3,619	109,536
Total comprehensive income for the period attributable to the shareholders of Arion Bank		181	2,791	2,972		2,972
Total comprehensive income for the period attributable to the non-controlling interest					175	175
Equity 31 March 2011	75,861	1,706	31,322	108,889	3,794	112,683
Changes in equity from 1 January to 31 March 2010:						
Equity 1 January 2010	72,000	1,729	16,150	89,879	155	90,034
Redeemed share capital	(62,139)			(62,139)		(62,139)
Issued share capital	66,000			66,000		66,000
Total comprehensive income for the period attributable to the shareholders of Arion Bank		(2)	3,395	3,393		3,393
Total comprehensive income for the period attributable to the non-controlling interest					15	15
Non-controlling interests acquired during the period					(111)	(111)
Equity 31 March 2010	75,861	1,727	19,545	97,133	59	97,192

The notes on pages 9 to 40 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK millions

Condensed Consolidated Interim Statement of Cash Flows
for the Period from 1 January to 31 March 2011

	2011 1.1.-31.3.	2010 1.1.-31.3.
Net cash provided by operating activities	2,138	3,115
Net cash flow used in investing activities	(130)	(160)
Net increase in cash and cash equivalents	2,008	2,955
Cash and cash equivalents at beginning of the period	72,797	56,094
Effect of exchange rate changes on cash held	2,067	(662)
Cash and cash equivalents at end of the period	76,872	58,387

Cash and cash equivalents comprises		
Cash in hand and demand deposits	24,629	41,679
Due from credit institutions	60,169	25,105
Mandatory reserve with Central Bank	(7,926)	(8,397)
Total cash and cash equivalents	76,872	58,387

Non-cash investing and financing transactions:		
Loans and receivables received through changes in capitalization	-	112,824
Bonds and debt instruments delivered through changes in capitalization	-	(32,595)
Liabilities due to credit institutions and central bank transferred due to changes in capitalization	-	14,428
Borrowings transferred due to changes in capitalization	-	(61,252)
Subordinated loans transferred due to changes in capitalization	-	(29,543)
Net changes in equity due to changes in capitalization	-	(3,862)

The notes on pages 9 to 40 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK millions

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Notes to the Consolidated Financial Statements

General information

1. Reporting entity

Arion banki hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The address of Arion banki hf. registered office is Borgartún 19, Reykjavík. The Condensed Consolidated Interim Financial Statements for the period ended 31 March 2011 comprise the Parent company and its subsidiaries (together referred to as "the Group").

The Consolidated Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 25 May 2011.

2. Basis of preparation

a) *Statement of compliance*

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting as endorsed by the European Union. The Condensed Consolidated Interim Financial Statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with Arion banks' annual Consolidated Financial Statements for the year 2010. The statements are available at Arion Banks' web site www.arionbanki.is.

b) *Basis of measurement*

The Consolidated Financial Statements are prepared on the historical cost basis except for the following:

- Financial assets/liabilities held for trading are measured at fair value
- Financial assets/liabilities designated at fair value through profit and loss are measured at fair value
- Investment properties are measured at fair value
- Compensation instrument is measured at fair value

Non-current assets (or disposal groups) classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell. Immediately before the initial classification, or where the assets and liabilities are not within the scope of IFRS 5, the carrying amounts are measured in accordance with applicable IFRSs.

c) *Functional and presentation currency*

The Consolidated Financial Statements are presented in Icelandic króna (ISK), which is the Parent Company's functional currency, rounded to the nearest million unless otherwise stated.

d) *Use of estimates and judgements*

The preparation of the Consolidated Financial Statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, contingent liabilities as well as income and expenses in the Consolidated Financial Statements presented. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the Consolidated Financial Statements.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Judgements made by management that have a significant effect on the Consolidated Financial Statements and estimates with a significant risk of material adjustment within the next financial year are discussed in Note 4 in these Financial Statements and Notes 73, 109, 110 and 111 in the annual Financial Statements 2010.

Significant accounting policies

The accounting policies adopted in the preparation of these Condensed Consolidated Interim Financial Statement are consistent with those followed in the preparation of the Group's annual Financial Statements for the year ended 31 December 2010.

3. Going concern assumption

The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. The Consolidated Statement of Financial Position of the Group presents uncertainty due to the asset-liability mismatches of significant risks as described in the Risk Management disclosures. A considerable portion of the purchased assets from Kaupthing Bank are denominated in low interest rate foreign currencies and are funded with deposits denominated in Icelandic króna, a high interest rate currency. Liquidity risk, as well as risks related to imbalances in currency, duration and interest rate base are outlined in the Risk Management disclosures. Whilst the Group's stress testing has resulted in the Group management assessing that it is sufficiently capitalised to deal with market shocks, significant market shocks during the realignment period of the Group's risk profile, poses some uncertainty.

The Group is making progress in adapting to the new economic reality in Iceland with a focus on strengthening the infrastructure and internal control. The main focus has been on safeguarding the value of the Group's assets through the recovery process and a team of specialists was put together to work with defaulting customers. A favourable outcome from this process is already strengthening the Group's business. Further information on risk factors in the Group's operation are provided in the Risk Management Disclosures.

4. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the risk management disclosures, provided elsewhere in these consolidated financial statements.

Key sources of estimation uncertainty

i) Impairment losses on loans and receivables
The Group reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Consolidated Statement of Comprehensive Income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

ii) Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

iii) Assets classified as held for sale
The Group classifies assets as held for sale if the assets are available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets and the sale is considered highly probable. For the sale to be highly probable management must be committed to sell the assets and be actively looking for a buyer, the assets must be actively marketed at a price that is reasonable in relation to their fair value and the sale is expected to be completed within one year. An extension of the period required to complete a sale does not preclude an asset or disposal group from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and there is sufficient evidence that the Group remains committed to its plan to sell the assets or disposal groups.

When classifying assets as held for sale the Group has determined that the requirements of IFRS 5 have been met.

As set out in Note 21 in the annual Financial Statements 2010, disposal groups being legal entities acquired exclusively with view to resale are measured at the lower of carrying amount and fair values less costs to sell. For the most part, fair values at the date of classification of these legal entities were calculated using valuation models based on discounted future cash flows that incorporated significant non-market observable inputs and assumptions. The use of reasonably possible alternative inputs and assumptions to these models, in particular changes to the discount rate employed (representing the required rate of return on equity), would have a significant impact on the fair value of these disposal groups.

iv) Fair value of Investment Property
In Iceland, there is no third party that provides information on the market value of investment properties located in Iceland. As the market is relatively inactive and assets are often quite dissimilar it is difficult to obtain comparison. The international financial crises and the financial crisis in Iceland had significant influence on the real estate market in Iceland. The effects of that resulted in a relatively passive market and with disparate properties on the market it can be complicated to determine prices of recent market transactions of comparable properties. This being the case there is great uncertainty about the actual fair value of the properties.

v) Intangible assets
The value of intangible assets with indefinite useful lives is not amortised, but the assets are tested for impairment at least once a year.

Notes to the Consolidated Financial Statements

Changes within the Group

5. Changes in ownership and capitalization of Arion Bank.

   On 3 September 2009, the Resolution Committee of Kaupthing Bank, on behalf of Kaupskil ehf., signed an agreement with the Icelandic Ministry of Finance regarding capitalization and future ownership of Arion Bank. Based on the agreement Kaupskil ehf. acquired a majority shareholding of 87% in Arion Bank. The remaining shareholding of 13% is held by the Icelandic State.

   Following an approval from FME, the annual shareholders' meeting of Arion Bank held 8 January 2010 approved the transfer of 87% of the Icelandic state shareholding to Kaupskil ehf.

   The Consolidated Financial Statements for 2010 reflect changes in capitalization following the changes in ownership of Arion Bank 8 January 2010.

   According to the agreement Arion Bank shall pay to the Icelandic State a special dividend amounting to ISK 6,500 million which shall be deducted from the retained earnings, by a way of single one time payment if certain conditions are met. As the conditions have been met the Group is discussing with the Icelandic State an arrangement for this payment.

6. Disposal of legal entities acquired exclusively with view to resale.

   On 18 February 2011 the Group sold its 100% shareholdings in Hekla ehf. and Hekla fasteignir ehf., subsidiaries of Hafrahlíd ehf. These legal entities were classified as non current assets and disposal groups classified as held for sale at year end 2010.

   The results from the disposal of these legal entities is included in net earnings from discontinued operations net of tax.

   An agreement to sell 34% share of Hagar hf., a retail chain, was signed in February 2011. The agreement includes a plan to list the company at Nasdaq OMX in Iceland. Condition for the sale is the approval by Competition authorities.

Operating Segment Reporting

7. Segment information is presented in respect of the Group's operating segments based on the Group´s management and internal reporting structure. Segment performance is evaluated based on earnings before tax.

   Inter segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

   Segment capital expenditure is the total cost incurred during the period to acquire property and equipment and intangible assets.

   Business segments

   The Group comprises two main business segments:

   Corporate Banking and Capital Markets serve large enterprises, investors and institutional investors. The role of the division is to provide universal financial services and tailored services to meet the needs of each customer. Corporate Banking and Capital Markets is organized into seven divisions: Corporate Trading, FX and Fixed Income Trading, Equities Trading, Research, Legal and Archives, and Credit Management.

   Retail Banking provides a comprehensive range of services, including advice on deposits and loans, savings, payment cards, pension savings, insurance, securities, funds and more. To maximize operational efficiency the branch network is divided into seven clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Customers of Retail Banking's 24 branches all around Iceland are over 100,000.

   Other business segments are: Asset Management, Corporate Finance, Overhead, Risk Management, Finance, Legal, Operations, Corporate Development and and activities of other non-core entities.

8. Summary of the Group's business segments:

1.1.-31.3.2011	Corporate Banking	Retail Banking	Other Divisions and Elimination	Total
Net interest income	3,926	2,501	(541)	5,886
Increase in value of loans and receivables	(449)	11	2,495	2,057
Impairment on loans and receivables	701	(203)	(58)	440
Changes in compensation instrument	-	-	(2,910)	(2,910)
Net fee and commission income	236	1,516	739	2,492
Net financial and FX income (expense)	(76)	396	98	417
Other income	6	417	676	1,099
Operating income	4,344	4,638	499	9,481
Operating expense	(677)	(3,098)	(1,346)	(5,121)
Earnings before tax	3,667	1,540	(847)	4,360
Net segment revenue from external customers	6,103	4,007	(629)	9,481
Net segment revenue from other segments	(1,759)	631	1,128	-
Operating income	4,344	4,638	499	9,481
Depreciation and amortisation	-	86	122	208
Total assets	248,787	227,093	326,807	802,687
Allocated equity	39,805	36,713	36,165	112,683

1.1.-31.3.2010				
Net interest income	3,691	3,118	(1,174)	5,635
Increase in value of loans and receivables	403	-	-	403
Impairment on loans and receivables	563	(1,735)	338	(834)
Net fee and commission income	134	476	852	1,463
Net financial and FX income (expense)	(1,395)	272	1,917	794
Other income	3	3	386	716
Operating income	3,399	2,459	2,319	8,177
Operating expense	(452)	(2,059)	(1,247)	(3,758)
Earnings before tax	2,947	400	1,072	4,419
Net segment revenue from external customers	5,941	(366)	2,602	8,177
Net segment revenue from other segments	(2,542)	2,825	(283)	-
Operating income	3,399	2,459	2,319	8,177
Depreciation and amortisation	-	53	251	305
Total assets	273,502	233,288	305,825	812,615
Allocated equity	43,760	35,233	30,543	109,536

The vast majority of the revenues from external customers was attributable to customers in Iceland.

Amounts are in ISK millions

Notes to the Consolidated Statement of Comprehensive Income

Net interest income

9. Interest income and expense is specified as follows:

1.1.-31.3.2011	Interest income	Interest expense	Net interest income
Cash and balances with Central Bank	104	-	104
Loans, receivables and deposits	8,896	4,291	4,605
Borrowings	-	602	(602)
Subordinated liabilities	-	329	(329)
Securities	1,919	-	1,919
Compensation instrument	173	-	173
Other	25	9	16
Interest income and expense	11,117	5,231	5,886
Interest income and expense from assets and liabilities at fair value	1,919	-	1,919
Interest income and expense from assets and liabilities not at fair value through profit or loss	9,198	5,231	3,967
Interest income and expense	11,117	5,231	5,886

1.1.-31.3.2010			
Cash and balances with Central Bank	188	-	188
Loans, receivables and deposits	10,517	7,320	3,197
Borrowings	-	830	(830)
Subordinated loans	-	302	(302)
Securities	2,862	-	2,862
Compensation instrument	349	-	349
Other	181	10	171
Interest income and expense	14,097	8,462	5,635
Interest income and expense from assets and liabilities at fair value	3,211	-	3,211
Interest income and expense from assets and liabilities not at fair value through profit or loss	10,886	8,462	2,424
Interest income and expense	14,097	8,462	5,635

Increase in value of loans and receivables

10. The increase in value of loans and receivables is determined in accordance with the accounting policy presented in the annual Financial Statements 2010. Increase in book value of loans and receivables consists of adjustment to reflect actual and estimated cash flows.

Amounts are in ISK millions

Impairment on loans and receivables

11. Impairment on loans and receivables is specified as follows:

	2011 1.1.-31.3.	2010 1.1.-31.3.
Impairment on loans and receivables to credit institutions	321	44
Impairment on loans and receivables to customers (reversed)	(761)	790
Impairment (reversed)	(440)	834

Further information on the unrealisable FX gains from FX denominated loans to borrowers with ISK income are in Note 52 c).

Net fee and commission income

12. Fee and commission income and expense is specified as follows:

1.1.-31.3.2011

Fee and commission income	2011 1.1.-31.3.	2010 1.1.-31.3.
Securities trading	48	33
Derivatives	42	46
Lending and guarantees	106	95
Asset management fees	559	475
Other fee and commission income - banking activities	3,161	926
Other fee and commission income	208	318
Fee and commission income	4,124	1,893
Fee and commission expense		
Securities trading	49	53
Asset management fees	31	2
Other fee and commission income - banking activities	1,514	299
Other fee and commission expense	38	76
Fee and commission expense	1,632	430
Net fee and commission income	2,492	1,463

Asset management fees are earned by the Group on trust and fiduciary activities where the Group holds or invests assets on behalf of the customers.

Amounts are in ISK millions

Net financial income

13. Net financial income is specified as follows:	2011 1.1.-31.3.	2010 1.1.-31.3.
Dividend income	3	3
Net gain (loss) on financial assets and liabilities classified as held for trading	(188)	155
Net gain (loss) on financial assets and liabilities designated at fair value through profit or loss	914	27
Net financial income	729	185

14. Dividend income is specified as follows:

Dividend income on trading assets	1	3
Dividend income on assets designated at fair value through profit or loss	2	0
Dividend income	3	3

15. Net gain (loss) on trading portfolio are specified as follows:

Net gain (loss) on equity instruments and related derivatives	6	420
Net gain (loss) on interest rate instruments and related derivatives	(157)	(223)
Net gain (loss) on other derivatives	(37)	(42)
Net gain (loss) on trading portfolio	(188)	155

16. Net gain (loss) on assets/liabilities designated at fair value through profit or loss are specified as follows:

Net gain (loss) on interest rate instruments designated at fair value	90	59
Net gain (loss) on equity instruments designated at fair value	824	(32)
Net gain (loss) on assets/liabilities designated at fair value through profit and loss	914	27

Net foreign exchange gain (loss)

17. Net foreign exchange gain (loss) is specified as follows:

FX gain (loss) on loans and receivables	2,388	(2,648)
FX gain (loss) on bank accounts	2,067	(662)
FX gain (loss) from deposits and borrowings	(3,728)	2,679
FX gain (loss) from subordinated liabilities	(1,337)	1,392
FX gain (loss) on bonds, equity and derivatives	37	222
FX gain (loss) from compensation instrument	106	(945)
FX gain (loss) on other assets and liabilities	155	571
Net foreign exchange gain (loss)	(312)	609

Other operating income

18. Other operating income is specified as follows:

Rental income from investment properties	542	355
Fair value changes on investment property	-	-
Earned premiums, net of reinsurance	202	193
Net gain on disposals of assets other than held for sale	4	-
Other income	368	71
Other operating income	1,116	619

Amounts are in ISK millions

Personnel

19. The Group's total number of employees is as follows:

	31.03.2011	31.03.2010
Average number of full time equivalent positions during the period	1,267	1,132
Full time equivalent positions at the end of the period	1,273	1,145

The Parent company's total number of employees is as follow:

Average number of full time equivalent positions during the period	961	985
Full time equivalent positions at the end of the period	965	981

20. Salaries and related expense are specified as follows:

	2011 1.1.-31.3.	2010 1.1.-31.3.
Salaries	2,143	1,770
Defined contribution pension plans	289	225
Salary related expense	226	177
Salaries and related expense	2,658	2,172

Salaries and related expense for the Parent company are specified as follows:

Salaries	1,563	1,500
Defined contribution pension plans	211	203
Salary related expense	168	146
Salaries and related expense	1,942	1,849

Other operating expense

21. Other operating expenses:

Direct operating expenses (including repairs and maintenance) arising on rental-earning investment properties	95	82
Claims incurred, net of reinsurance	71	50
Other operating expenses	166	132

Net gain (loss) from discontinued operations net of tax

22. Net gain (loss) from discontinued operations net of tax are specified as follows:

Net earnings (loss) from legal entities	125	(199)
Impairment loss on remeasurement to fair value of legal entities	(1,222)	-
Impairment loss on real estates	(13)	(35)
Other assets	(122)	(53)
Effect of compensation instrument	950	-
Net gain (loss) on non-current and disposal groups assets classified as held for sale	(282)	(287)

Net earnings (loss) from legal entities comprises the revenues, expenses and income tax expense from operations of legal entities that were classified as held for sale at period end.

Amounts are in ISK millions

Tax expense

23. Income tax recognised in the Consolidated Statement of Comprehensive Income are specified as follows:

	2011 1.1.-31.3.	2010 1.1.-31.3.
a) *Current tax expense*		
Current year	1,030	1,151
Deferred tax expense		
Changes in temporary differences	15	(429)
Total income tax expense	1,045	722

Reconciliation of effective tax rate:	1.1.-31.3.2011		1.1.-31.3.2010	
Earnings before income tax		4,360		4,419
Income tax using the Icelandic corporation tax rate	20.0%	872	18.0%	795
Non-deductible expense	7.0%	303	0.1%	3
Tax exempt revenues	(3.0%)	(130)	(1.8%)	(76)
Effective tax rate	24.0%	1,045	16.3%	722

b) Bank Levy

Bank levy is calculated according to law. The levy is 0,041% on total debt at end of period. Non-financial subsidiaries are exempt from this tax.

Earnings per share

24. Earnings per share are specified as follows:

	2011 1.1.-31.3.	2010 1.1.-31.3.
Net earnings attributable to the shareholders of Arion Bank	2,791	3,395
Weighted average share capital:		
Weighted average number of outstanding shares for the period, million	2,000	2,828
Basic earnings per share	1.40	1.20
Diluted earnings per share	1.40	1.20
Number of outstanding shares at the end of the period, million	2,000	2,000
Number of total shares at the end of the period, million, diluted	2,000	2,000

There were no instruments at period end that could potentially dilute basic earnings per share that were not included in the calculation of diluted earnings per share.

Amounts are in ISK millions

Notes to the Consolidated Statement of Financial Position

Cash and balances with Central Bank

25. Cash and balances with Central Bank are specified as follows:

	31.03.2011	31.12.2010
Cash on hand	9,318	9,609
Cash with Central Bank	7,385	13,250
Mandatory reserve deposits with Central Bank	7,926	7,769
Cash and balances with Central Bank	24,629	30,628

The mandatory reserve deposit with Central Bank is not available for the Bank to use in its daily operations.

Loans and receivables to credit institutions

26. Loans and receivables to credit institutions specified by types of loans:

Bank accounts	60,169	57,707
Money market loans	16,548	1,294
Overdrafts	90	29
Other loans	9,607	10,175
Provision on loans and receivables	(1,681)	(1,359)
Loans and receivables to credit institutions	84,733	67,846

27. Changes in the provision for losses on loans and receivables to credit institutions are specified as follows:

Balance at the beginning of the period	1,359	727
Provision for losses during the period	321	632
Balance at the end of the period	1,680	1,359

Loans and receivables to customers

28. Loans and receivables to customers specified by types of loans:

Overdrafts	38,295	37,390
Subordinated loans	525	499
Other loans and receivables	431,087	455,173
Provision on loans and receivables	(37,402)	(41,843)
Loans and receivables to customers	432,505	451,219

Amounts are in ISK millions

29. Loans and receivables to customers specified by sectors:

	31.03.2011	31.12.2010
Individuals	26.0%	24.7%
Financial and insurance activities	14.3%	14.1%
Manufacturing, mining and other industry	9.5%	13.3%
Real estate activities	13.5%	13.0%
Agriculture, forestry and fishing	11.3%	11.1%
Wholesale and retail trades, transport, accomodation and food service activities	10.3%	9.9%
Business services	9.5%	8.3%
Construction	2.5%	2.4%
Public administration, defence, education, human health and social work activities	1.7%	1.8%
Other services	1.4%	1.4%
Loans and receivables to customers	100.0%	100.0%

30. Changes in the provision for losses on loans and receivables to customers are specified as follows:

Balance at the beginning of the period	41,843	28,736
Provision for losses and write-offs during the period	(4,358)	13,277
Payment of loans previously written off	(83)	(170)
Balance at the end of the period	37,402	41,843
Specific	34,642	39,083
Collective	2,760	2,760
	37,402	41,843

Further information about the unrealisable FX gains from FX denominated loans to borrowers with ISK income are in Note 52 c).

Renegotiated loans

31. Since 2009 Arion bank has engaged in financial restructuring of customers that are experiencing financial difficulties. For a detailed discussion of the Group's recovery processes, see Note 108 b) in the annual Financial Statements 2010.

Starting in December 2009, the Group has run a comprehensive program of standard solutions to assist individuals who have run into financial difficulties. These programs are now closed. Through the programs, the Group reduced the debt level of 2.346 individuals by an average of 27%.

As per an agreement between the government and lending institutions, the Group participates in a coordinated effort to assist SMEs that are experiencing financial difficulties. The Group engages companies on a case-by-case basis using a transparent set of standard procedures. To date, the debt restructuring of 419 companies has been finalized. The total nominal value post restructuring is 101 bn ISK, some of which is subordinated debt on which the Group has taken a 23,3 bn ISK provision. In some instances the Group has taken an equity stake in a company.

The Group predicts that it will complete its restructuring activities in 2011.

Amounts are in ISK millions

Financial assets and liabilities

32. Financial assets and liabilities are specified as follows:

31.03.2011	Loans and receivables	Trading	Designated at fair value	Financial assets/ liabilities at amort. cost	Total
Loans and receivables					
Cash and balances with Central Bank	24,629	-	-	-	24,629
Loans to credit institutions	84,733	-	-	-	84,733
Loans to customers	432,505	-	-	-	432,505
Loans and receivables	541,867	-	-	-	541,867
Bonds and debt instruments					
Listed	-	8,634	41,771	-	50,405
Unlisted	-	20	72,998	-	73,018
Bonds and debt instruments	-	8,654	114,769	-	123,423
Shares and equity instruments with variable income					
Listed	-	8	2,143	-	2,151
Unlisted	-	870	6,283	-	7,153
Bond funds with variable income	-	315	1,907	-	2,222
Shares and equity instruments	-	1,193	10,333	-	11,526
Derivatives					
OTC derivatives	-	395	-	-	395
Derivatives	-	395	-	-	395
Securities used for hedging					
Bonds and debt instruments	-	2,145	-	-	2,145
Securities used for hedging	-	2,145	-	-	2,145
Compensation instrument	-	-	22,507	-	22,507
Other financial assets	-	-	-	19,449	19,449
Financial assets	541,867	12,387	147,609	19,449	721,312
Liabilities at amortised cost					
Due to credit institutions and Central Bank	-	-	-	68,322	68,322
Deposits	-	-	-	472,359	472,359
Borrowings	-	-	-	65,180	65,180
Subordinated liabilities	-	-	-	26,730	26,730
Liabilities at amortised cost	-	-	-	632,591	632,591
Financial liabilities at fair value					
Short position in bonds held for trading	-	6,129	-	-	6,129
Derivatives held for trading	-	73	-	-	73
Financial liabilities at fair value	-	6,202	-	-	6,202
Other financial liabilities	-	-	-	30,347	30,347
Financial liabilities	-	6,202	-	662,938	669,140

Amounts are in ISK millions

32. cont.

31.12.2010	Loans and receivables	Trading	Designated at fair value	Financial assets/ liabilities at amort. cost	Total
Loans and receivables					
Cash and balances with Central Bank	30,628	-	-	-	30,628
Loans to credit institutions	67,846	-	-	-	67,846
Loans to customers	451,219	-	-	-	451,219
Loans and receivables	549,693	-	-	-	549,693
Bonds and debt instruments					
Listed	-	4,731	41,833	-	46,564
Unlisted	-	20	73,528	-	73,548
Bonds and debt instruments	-	4,751	115,361	-	120,112
Shares and equity instruments with variable income					
Listed	-	12	2,062	-	2,074
Unlisted	-	612	5,451	-	6,063
Bond funds with variable income	-	360	1,819	-	2,179
Shares and equity instruments	-	984	9,332	-	10,316
Derivatives					
OTC derivatives	-	1,126	-	-	1,126
Derivatives	-	1,126	-	-	1,126
Securities used for hedging					
Bonds and debt instruments	-	3,213	-	-	3,213
Securities used for hedging	-	3,213	-	-	3,213
Compensation instrument	-	-	24,188	-	24,188
Other financial assets	-	-	-	16,688	16,688
Financial assets	549,693	10,074	148,881	16,688	725,336
Liabilities at amortised cost					
Due to credit institutions and Central Bank	-	-	-	95,646	95,646
Deposits	-	-	-	457,881	457,881
Borrowings	-	-	-	65,278	65,278
Subordinated liabilities	-	-	-	26,257	26,257
Liabilities at amortised cost	-	-	-	645,062	645,062
Financial liabilities at fair value					
Short position in equity held for trading	-	923	-	-	923
Derivatives held for trading	-	76	-	-	76
Financial liabilities at fair value	-	999	-	-	999
Other financial liabilities	-	-	-	34,048	34,048
Financial liabilities	-	999	-	679,110	680,109

Included in unlisted Bonds and debt instruments designated at fair value is Drómi bond, which the Group received when acquiring deposits from Spron in March 2009.

Amounts are in ISK millions

33. Bonds and debt instruments designated at fair value specified by issuer:

	31.03.2011	31.12.2010
Financial institutions	73,894	74,626
Public	40,523	40,393
Corporates	352	342
Bonds and debt instruments designated at fair value	114,769	115,361

No pledged bonds were held at period end (31.12.2010: ISK 20,005 million). Pledged bonds at year-end comprised Icelandic Government Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank.

Compensation instrument

34. The compensation instrument is originated due to the difference in the fair value of the transferred assets, liabilities and contingent liabilities from Kaupthing Bank to Arion Bank in accordance with the FME decision in 2008. The compensation instrument amounted to ISK 38,300 million and was originally denominated 50% in ISK and 50% in EUR and subject to floating rates of interest. Due to lowering of the balance of the instrument the denomination has changed to 100% ISK. The maturity of this instrument is 30 June 2012 and is a priority claim against Kaupthing Bank.

Compensation instrument is specified as follows:	31.03.2011	31.12.2010
Balance at the beginning of the period	24,188	34,371
Changes due to the Escrow and Contingent Value Rights Agreement		
Continuing operations	(2,910)	(11,604)
Discontinued operations	950	2,017
Accrued interest	173	1,256
Foreign exchange rate differences	106	(1,852)
Balance at the end of the period	22,507	24,188

Related to the compensation instrument is the Escrow and Contingent Value Rights Agreement where Kaupthing Bank receives 80% of the appreciation of defined Arion Bank loans (the "ring-fenced assets"). The increase in value of the defined loans will decrease the value of the compensation instrument. If the compensation instrument is finally settled due to an increase in the aggregate value of the ring-fenced assets (such increase being 125% of the compensation instrument) then 50% of the increase in value of ring-fenced assets above the amount needed for closing the compensation instrument will be passed onto Kaupthing Bank up to a cap of ISK 5 billion.

During the period changes in those defined assets amounted to ISK 3,638 million, 80% of this increased value belonging to Kaupthing Bank, ISK 2,910 million as presented in the Consolidated Interim Statement of Comprehensive Income, 20% belonging to Arion bank as a part of the Consolidated Interim Statement of Comprehensive Income. The total face value of the defined loans was approximately ISK 850,000 million and the book value was approximately ISK 225,000 million the end of the period.

The Group holds a guarantee in specific assets of Kaupthing Bank against the total balance of the compensation instrument. This guarantee is a priority claim against Kaupthing Bank.

Investment property

35. Investment property is specified as follows:

	Investment properties	Investment properties in progress	Total 31.03.2011	31.12.2010
Balance at the beginning of the period	21,550	6,092	27,642	22,947
Acquisition through business combination	-	-	-	3,000
Additions during the period	365	36	401	3,519
Disposals during the period	-	(894)	(894)	(1,561)
Fair value adjustments	-	-	-	(263)
Investment property	21,915	5,234	27,149	27,642

Amounts are in ISK millions

Investments in associates

36. The Group´s interest in its principal associates are as follows:

	31.03.2011	31.12.2010
Audkenni hf. Engjateigur 3, 105 Reykjavík, Iceland	20.0%	20.0%
Borgarland ehf., Egilsholt 1, 310 Borgarnes, Iceland	42.0%	42.0%
Farice ehf.,Smáratorg 3, 201 Kópavogur, Iceland	43.5%	43.5%
Hótel Borgarnes hf., Egilsgata 16, 310 Borgarnes, Iceland	20.6%	20.6%
KB rádgjöf ehf. Hlídarsmári 17, 201 Kópavogur, Iceland	43.1%	43.1%
Kríuvarp ehf., Borgartún 35, 105 Reykjavík, Iceland	25.0%	25.0%
Reiknistofa bankanna hf. Kalkofnsvegur 1, 150 Reykjavík, Iceland	21.7%	21.7%
Reitir fasteignafélag hf., Kringlan 4-12, 103 Reykjavík, Iceland	42.7%	42.7%
Ölgerðin Egill Skallagrímsson ehf., Grjótháls 7-11, 110 Reykjavík, Iceland	20.0%	20.0%

Investments in associates are specified as follows:

Carrying amount at the beginning of the period	2,713	5,985
Acquisition through business combination	-	108
Additions during the period	272	7
Sold during the period	-	(54)
Transferred from associates due to step acquisition	-	(3,889)
Share of profit (loss)	(17)	556
Carrying amount at the end of the period	2,968	2,713

Non-current assets and disposal groups held for sale

37. Non-current assets and disposal groups held for sale are specified as follows:

	31.03.2011	31.12.2010
Legal entities	36,097	41,927
Real estates	2,407	2,456
Other assets	71	81
Non-current assets and disposal groups held for sale	38,575	44,464

The legal entities were acquired exclusively with view to resale and are classified as disposal groups held for sale in accordance with IFRS 5. At period end the largest entities were BM Vallá ehf., Fram Foods hf., Hagar hf., Penninn á Íslandi ehf. and Rekstrarfélag tíu-ellefu ehf.

Real estates and other assets classified as non-current assets are generally the result of foreclosures on companies and individuals.

Liabilities associated with the legal entities held for sale are as follows:

	31.03.2011	31.12.2010
Legal entities, total liabilities	10,181	13,514

Amounts are in ISK millions

Other assets

38. Other assets are specified as follows:	31.03.2011	31.12.2010
Unsettled securities trading	415	366
Accounts receivable	16,905	14,312
Accrued income	506	802
Prepaid expenses	729	448
Sundry assets	1,655	1,208
Other assets	20,210	17,136

Unsettled securities trading was settled in less than three days from the reporting date.

Borrowings

39. Borrowings are specified as follows:	31.03.2011	31.12.2010
Bonds issued	7,353	7,156
Other loans	57,827	58,122
Borrowings	65,180	65,278

The Group has not repurchased any of its own debt during the period (2010: Nil).

Interest of other loans is 3 month Libor +300 bps to the year 2015 and thereafter 3 month Libor +400 bps until 2019 when the loan expires.

The total book value of pledged loans at 31 March 2011 was ISK 75 billion (31 December 2010: 74). Pledged loans at period end comprised mortgage loans to individuals, loans to municipals and loans to state related entities (see Note 28) that were pledged against amounts borrowed.

Subordinated liabilities

40. Subordinated liabilities are specified as follows:	31.03.2011	31.12.2010
Tier II capital	26,730	26,257
Subordinated liabilities	26,730	26,257

The interest on the loan is 3 month Euribor +400 bps to the year 2015 and thereafter 3 month Euribor +500 bps.

Amounts are in ISK millions

Tax assets and tax liabilities

41. Tax assets and liabilities are specified as follows:

	31.03.2011		31.12.2010	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	4,529	-	3,821
Deferred tax	306	797	295	633
Tax assets and liabilities	306	5,326	295	4,454

Derivatives

42. Derivatives fair value are specified as follows:

	Fair value	
31.03.2011	Assets	Liabilities
Currency and interest rate derivatives, agreements unlisted:		
Forward exchange rate agreements	13	-
Interest rate and exchange rate agreements	362	-
	375	-
Bond derivatives:		
Bond swaps, agreements unlisted	20	73
Derivatives	395	73
31.12.2010		
Currency and interest rate derivatives, agreements unlisted:		
Forward exchange rate agreements	2	-
Interest rate and exchange rate agreements	1,100	-
	1,102	-
Bond derivatives:		
Bond swaps, agreements unlisted	24	75
Derivatives	1,126	75

Other liabilities

43. Other liabilities are specified as follows:

	31.03.2011	31.12.2010
Accounts payable	18,662	24,704
Withholding tax	480	2,600
Deposit and investor guarantee fund	2,850	2,669
Insurance claim	2,048	1,992
Unsettled securities trading	1,006	110
Sundry liabilities	10,658	6,975
Other liabilities	35,704	39,050

Unsettled securities trading was settled in less than three days from the reporting date.

Amounts are in ISK millions

Equity

Share capital and share premium

44. According to the Parent Company's Articles of Association, total share capital amounts to ISK 2,000 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at Shareholders' meetings of the Group.

Issued share capital	Number (million)	31.03.2011	Number (million)	31.12.2010
At 1 January	2,000	75,861	12,646	72,000
Redeemed on 8 January			(12,386)	(62,139)
Issued on 8 January			1,740	66,000
	2,000	75,861	2,000	75,861

Share premium represents excess of payment above nominal value that Shareholders have paid for shares sold by the Group.

Other reserves

45. Other reserves are specified as follows:

	31.03.2011	31.12.2010
Statutory reserve	1,637	1,637
Foreign currency translation reserve	69	(112)
Other reserves	1,706	1,525

Off Balance Sheet information

Obligations

46. The Group has granted its customers guarantees, unused overdraft and loan commitments. These items are specified as follows:

	31.03.2011	31.12.2010
Guarantees	9,887	11,675
Unused overdrafts	34,138	40,896
Loan commitments	14,004	13,946

The Group estimates possible loss of ISK 1,269 million in relation to guarantees transferred from Kaupthing Bank. Should any of the guarantees default, Kaupthing bank will pay compensation up to ISK 3,000 million to Arion bank agreement thereon was signed in September 2009.

47. Depositors' and Investors' Guarantee fund

According to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme the total assets of the Depositors' and Investors' Guarantee Fund shall amount to a minimum of 1% of the average amount of guaranteed deposits in the commercial bank concerned during the preceding year. In the event that total assets do not amount to the 1% minimum, all commercial banks shall contribute to the Fund an amount equivalent to 0.15% of the average of guaranteed deposits in the Group during the preceding year. The Group expensed ISK 180 million in the first quarter of 2011 and the liability to the Fund had a period end balance of ISK 2,850 million, representing the net present value of the estimated future payments to the Fund over a five year period. The Group has granted the Fund a guarantee for the total obligation amounting to ISK 3,364 million.

The Icelandic parliament is to discuss a bill on the Depositors’ and Investors’ Guarantee Fund which, if passed, would entail a substantial increase in the size of the fund and the Groups’ liabilities. There is still considerable uncertainty over what shape the proposed legislation will finally take and therefore a liability is not being recognised in the balance sheet. However, based on the current draft bill, Arion Bank's additional liability will eventually amount to be more than ISK 10 billion.

Assets under management and under custody

48. Assets under management and assets under custody are specified as follows:

	31.03.2011	31.12.2010
Assets under management	629,177	618,062
Assets under custody	1,779,021	1,745,384

Amounts are in ISK millions

Contingent liabilities

49. Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. Due to the current economic climate in Iceland the prospects of possible litigation against the Group has become more likely. The Group has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Group makes adjustments to account for any adverse effects which the claims may have on its financial standing. At period end, the Group had several unresolved legal claims.

There are two significant legal claims against the Group and one upcoming significant court case where the Bank is the plaintiff;

First, a major client of Kaupthing Bank has, in the course of the company's restructuring process, filed three rescission actions against Arion Bank in the district court of Reykjavik relating to substantial transactions between the company and Kaupthing Bank. The claims are based on the argument that the company had in fact been bankrupt at the time of the payments and that Kaupthing Bank was a related party at the time. Arion Bank has opposed the claims in court. Should there be a ruling in favor of the company, the Group intends to reclaim from Kaupthing Bank any amount it would be required to pay to the company on the basis of the said claims. Should there be a ruling in favor of the company, the Group were to be deemed not to have a priority claim on the assets of Kaupthing Bank, then the losses for the Group could be substantial.

Second, a number of clients alleged that assets under management were improperly managed resulting in the clients suffering financial loss. Five of these claims were taken to court of law. On May 13 2011 all of these claims were dismissed by the court. It is still uncertain whether the clients will challenge that result in the an appellate court, i.e. the Supreme Court of Iceland.

By means of a decision issued by the Icelandic Financial Supervisory Authority (FME) on 21 March 2009, the Bank acquired the deposits of SPRON. According to the decision the resolution committee of SPRON should establish a specific limited liability company owned by SPRON, later Drómi, designed to receive all the assets of the savings banks and all security interests, including all liens, guarantees and other comparable interests linked to SPRON's claims. The subsidiary was then supposed to take over all SPRON's obligations to Arion Bank relating to the acquisition of SPRON's deposits obligations and was supposed to issue a bond to Arion Bank as compensation for the deposit obligations. Such obligation to the Bank was documented with an agreement on repaying the debt. The agreement states that the interest rate on the debt principal shall be determined by the FME at any given time. The FME decided that the debt should bear a given annual interest rate plus an interest premium from that time until the debt has been paid in full. It was also specified that the FME was permitted to review the decision upon request by the parties every six months. In a letter dated 2 December 2009 Drómi insisted that the FME review its former interest rate decision. On 4 February 2011 the FME decided that the debt should bear annual interest rate which should be the original given interest rate plus the original given interest premium from the takeover date until 30 June 2010, but without an interest premium from that time until the debt has been paid in full. The Bank has brought legal action against the FME and Drómi in an attempt to annul the FME's decision of 4 February 2011. On 4 May 2011 Drómi brought legal action against the FME and the Bank. Drómi principally demands the annulment of all decisions by the FME on interest rates and secondly demanding a different interest rate from the outset.

Risk Management Disclosures

50. Credit Risk

a) Credit quality by class of financial assets

The table below shows the credit quality of financial assets:

31.03.2011	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
Loans and receivables to credit institutions	84,732	-	1	84,733
Loans and receivables to customers				
Loans to corporates	115,196	33,294	171,449	319,939
Loans to individuals	78,168	6,508	27,890	112,566
Total	278,096	39,802	199,340	517,238

Past due but not impaired loans by class of financial assets:

31.03.2011	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans to corporates	2,025	671	4,113	26,529	33,339
Loans to individuals	1,329	648	436	4,050	6,463
Total	3,355	1,319	4,549	30,580	39,802

The majority of the loans have been acquired at discount and are in process of being restructured or in a recovery process.

At period end the value of collateral that the Group holds relating to loans individually determined to be impaired amounts to 120,143 million ISK. The collateral consists of cash, securities and residential and commercial real estate.

b) Large Exposure Disclosures

A large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10% of the Group's capital base net of eligible collateral according to FME rules No 216/2007.

The legal maximum for individual large exposures is 25% of risk capital and the sum of all large exposures cannot exceed 800% of risk capital.

The maximum exposure to a group of connected clients at period end was 40 billion ISK (31.12.2010: 36 billion) before taking account of eligible collateral, excluding claim on Drómi and Kaupthing Bank. The Group has four large exposures at period end (31.12.2010: seven exposures) net of eligible collateral.

No large exposure exceeds the legal limit of 25% at period end. The Ministry of Finance has pledged that Arion bank will be held harmless from the exposure due to the bond claim on Drómi see Note 32. The FME has ruled that the Group can use the hold harmless statement as a credit enhancement towards the claim on Drómi ehf. Consequently, the Group finds that the net exposure on Drómi is zero, or 2% when taking into consideration financial related parties.

The Group reports large exposures among all assets. Thus the Kaupthing Bank compensation instrument (see Note 34) is also listed as a large exposure. The compensation instrument fell below the 25% legal limit mid year 2010 and the net exposure at 31 March 2011 is zero, due to a cash pledge provided by Kaupthing Bank.

The sum of all large exposures is 68% before collateral mitigation or 59% net of eligible collateral, which is well below the 800% legal maximum and the Group's internal 150% limit net of collateral.

Amounts are in ISK millions

51. Liquidity risk

The Group's primary source of funding is deposits from individuals, corporations and financial institutions. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, the majority of which is on demand.

Secured Liquidity

The Group calculates its secured liquidity ratio from cash on hand and cash balances with the Central Bank of Iceland, Treasury notes and Housing Fund bonds which are held specifically as liquidity reserves and other eligible assets for repo transactions with the Central Bank and compare it with the total interest bearing liabilities.

The FME has set a guideline for minimum secured liquidity ratio and a minimum cash ratio. These guidelines stipulates that the Group should have adequate liquidity reserves to withstand an instantaneous deposit outflow of 20% (Secured Liquidity Ratio), and that cash and cash equivalents shall amount to at least 5% (Cash Ratio) of on-demand deposits. The high liquidity reserve required by the FME reflects the uncertainty of the deposit's stickiness of the Icelandic banks and the fact that a large part of the Group's liabilities are primarily short term or on-demand deposits while the contractual maturity of the assets is much higher. The Group actively monitors its liquidity reserves and has made excellent progress in understanding and modelling the behaviour of its deposit base. The ratios during the period were as follows:

	Liquidity ratio	Cash ratio
Period-end	36%	16%
Maximum	36%	16%
Minimum	29%	12%
Average	32%	14%

Deposit Stickiness

The Group's deposit base has been split into seven different categories depending on its stickiness. The term stickiness of deposit defines the past stability of deposit and the projected behaviour over time. A deposit is described as being sticky if it has shown to be a stable funding for the Group in the past and is expected to remain stable in the future. Every depositor within a specific group shares common characteristics that can be used as a measure of stickiness. The criteria for different levels or categories of stickiness include, but not limited to, behaviour of depositor over time, behaviour of depositor in stressed condition, the depositors business relationship with the Group and the maturity of the deposit. These criterias are based both on qualitative and quantitative methods.

- Capital controls: Deposits from customers believed to be waiting for the lifting of capital controls
- Resolution process: Deposits from customers in a resolution process
- Investors: Deposits from investors who may withdraw when other investment opportunities appear or competitor offers higher deposits rate
- Deposits - legal entities: Deposits from legal entities with no other business relationship with the Group and not quantified as an active investor
- Deposits - retail individual: Deposits from retail individual with no other business relationship with the Group and not quantified as an active investor
- Deposits - legal entities with business realtionship: Deposits from legal entities with business relationship with the Group
- Deposits - retail individual: Deposits from retail individual with business relationship with the Group

The table below shows the split between different levels of the Group's deposit stickiness at period end, according to the Group's classification. The rating 7 means the stickiest deposits and the rating 1 the least sticky. The Group adopted new classification for the deposit stickiness in the year 2010.

% of deposit base:

Stickiness rating	31.03.2011 %	31.03.2011 Amount	31.12.2010 %	31.12.2010 Amount
1 Capital controls	8%	41,707	7%	39,932
2 Resolution process	9%	47,628	9%	48,718
3 Investors	30%	160,273	29%	160,437
4 Deposits - legal entities	9%	47,602	9%	49,817
5 Deposits - retail individuals	12%	64,679	12%	66,423
6 Deposits - legal entities with business relationship	17%	92,651	17%	94,100
7 Deposits - retail individuals with business relationship	16%	86,141	17%	94,100
Total	100%	540,681	100%	553,527

Amounts are in ISK millions

52. Market risk

a) Interest rate Risk

The following table shows the sensitivity of net present value of interest bearing assets and liabilities to changes in interest rate by currency and maturity in millions of ISK in the Group. Risk is quantified by assuming a 200 bps simultaneous upward shift in all yield curves in the relevant duration band. The sensitivity does not relate to variation of annual net interest income.

		0-1Y	1-5Y	5-10Y	10-20Y	>20Y
31.03.2011						
CPI Indexed linked	ISK	535	(193)	(673)	(10,656)	234
Non Indexed linked	ISK	(239)	(683)	(230)	(324)	(51)
	EUR	9	6	-	-	-
	Other	(271)	(31)	-	-	-
31.12.2010						
CPI Indexed linked	ISK	486	(160)	(673)	(10,833)	(78)
Non Indexed linked	ISK	(73)	(577)	(376)	(364)	(67)
	EUR	(65)	(26)	-	-	-
	Other	(584)	(40)	-	-	-

52. cont.

The table below analyses the Group's assets and liabilities at carrying amount by residual maturity.

31.03.2011 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	24,629	16,704	-	7,925	-	-	-
Due from banks	84,733	52,277	26,767	1,476	3,406	807	-
Loans and receivables to customers	432,505	-	7,706	41,447	226,483	156,869	-
Bonds and debt instruments	123,423	10,247	99	452	72,845	39,780	-
Shares and equity instruments	11,526	-	-	-	-	-	11,526
Derivatives	395	-	25	8	362	-	-
Assets leg	7,065	-	4,731	161	2,173	-	-
Liabilities leg	(6,670)	-	(4,706)	(153)	(1,811)	-	-
Securities used for hedging	2,145	2,145	-	-	-	-	-
Compensation instrument	22,507	-	-	-	22,507	-	-
Investment property	27,149	-	-	-	-	-	27,149
Investments in associates	2,968	-	-	-	-	-	2,968
Property and equipment	7,259	-	-	-	-	-	7,259
Intangible assets	4,357	-	-	-	-	-	4,357
Tax assets	306	-	-	-	-	-	306
Non-current assets held for sale	38,575	-	-	-	-	-	38,575
Other assets	20,210	415	5,201	13,613	171	-	810
Total assets 31.03.2011	802,687	81,788	39,798	64,921	325,774	197,456	92,950
Liabilities							
Due to credit inst. and Central Bank	68,322	37,305	4,125	3,621	23,271	-	-
Deposits	472,359	362,080	12,853	73,466	18,644	5,316	-
Borrowings	65,180	-	706	98	4,643	59,733	-
Subordinated liabilities	26,730	-	-	-	-	26,730	-
Financial liabilities at fair value	6,202	6,129	73	-	-	-	-
Assets leg	(4,403)	-	(4,403)	-	-	-	-
Liabilities leg	10,605	6,129	4,476	-	-	-	-
Tax liabilities	5,326	-	-	-	-	-	5,326
Non-current liabilities held for sale	10,181	-	-	-	-	-	10,181
Other liabilities	35,704	1,006	26,673	-	2,669	-	5,356
Total liabilities 31.03.2011	690,004	406,520	44,430	77,185	49,227	91,779	20,863
Off balance sheet items							
Guarantees	9,887	181	1,347	1,107	5,810	1,442	-
Unused overdraft	34,138	34,138	-	-	-	-	-
Loan commitments	14,004	14,004	-	-	-	-	-
Total off balance sheet items	58,029	48,323	1,347	1,107	5,810	1,442	-
Net interest sensitivity gap	54,654	(373,055)	(5,979)	(13,371)	270,737	104,235	72,087

Amounts are in ISK millions

52. cont.

31.12.2010 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	30,628	22,859	-	7,769	-	-	-
Due from banks	67,846	49,572	15,372	691	1,803	408	-
Loans and receivables to customers	451,219	-	8,155	43,902	236,701	162,461	-
Bonds and debt instruments	120,112	6,467	-	32	73,984	39,629	-
Shares and equity instruments	10,316	-	-	-	-	-	10,316
Derivatives	1,126	-	44	262	820	-	-
Assets leg	5,687	-	2,447	538	2,702	-	-
Liabilities leg	(4,561)	-	(2,403)	(276)	(1,882)	-	-
Securities used for hedging	3,213	3,213	-	-	-	-	-
Compensation instrument	24,188	-	-	-	24,188	-	-
Investment property	27,642	-	-	-	-	-	27,642
Investments in associates	2,713	-	-	-	-	-	2,713
Property and equipment	7,365	-	-	-	-	-	7,365
Intangible assets	4,352	-	-	-	-	-	4,352
Tax assets	295	-	-	-	-	-	295
Non-current assets held for sale	44,464	-	-	-	-	-	44,464
Other assets	17,136	368	2,915	13,220	186	-	447
Total assets 31.12.2010	812,615	82,479	26,486	65,876	337,682	202,498	97,594
Liabilities							
Due to credit inst. and Central Bank	95,646	58,985	3,508	5,153	28,000	-	-
Deposits	457,881	327,824	27,974	78,307	18,823	4,953	-
Borrowings	65,280	600	501	32	4,349	59,796	-
Subordinated liabilities	26,257	-	-	-	-	26,257	-
Financial liabilities at fair value	999	923	76	-	-	-	-
Assets leg	(4,283)	-	(4,283)	-	-	-	-
Liabilities leg	5,282	923	4,359	-	-	-	-
Tax liabilities	4,454	-	-	-	-	-	4,454
Non-current liabilities held for sale	13,514	-	-	-	-	-	13,514
Other liabilities	39,050	110	31,644	-	1,970	-	5,326
Total liabilities 31.12.2010	703,079	388,442	63,703	83,492	53,142	91,006	23,294
Off balance sheet items							
Guarantees	11,675	67	1,029	2,173	7,347	1,059	-
Unused overdraft	40,896	40,896	-	-	-	-	-
Loan commitments	13,946	13,946	-	-	-	-	-
Total off balance sheet items	66,517	54,909	1,029	2,173	7,347	1,059	-
Net interest sensitivity gap	43,018	(360,872)	(38,246)	(19,789)	277,193	110,433	74,298

Amounts are in ISK millions

52. cont.

b) Inflation risk

The Group is exposed to inflation risk when there is a mismatch between inflation linked assts and liabilities. The total amount of indexed assets amount to ISK 111.7 billions (31.12.2010: 106 billions) and the total amount of indexed liabilities amount to ISK 93.8 billions (31.12.2010: 87.8 billions).

31.03.2011	Up to 1 year	1 to 5 years	Over 5 years
Assets - CPI indexed linked			
Loans and receivables to customers	2,423	33,118	67,376
Bonds and debt instruments	120	2,766	3,778
Total	2,543	35,884	71,154
Liabilities - CPI indexed linked			
Deposits	40,091	42,475	2,851
Borrowings	-	5,911	2,507
Total	40,091	48,386	5,358
Net on balance sheet position	(37,548)	(12,502)	65,796
Net off balance sheet position	-	2,172	-
Total CPI Balance	(37,548)	(10,330)	65,796

c) Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Group is primarily exposed to currency risk through a currency mismatch between assets and liabilities. The liabilities of the Group are predominantly ISK denominated deposits whereas the Group's assets consist largely of foreign currency denominated loans to customers.

Amounts are in ISK millions

52. cont.

The following table shows the breakdown of assets and liabilities by currency at period end:

Assets	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Cash with Central Bank	14,003	3,095	3,870	228	1,365	856	1,212	24,629
Loans to credit institutions	22,332	10,125	23,502	1,259	6,956	725	19,834	84,733
Loans and receivables to customers	181,950	71,313	28,886	61,822	13,416	48,596	26,522	432,505
Bonds and debt instruments	122,308	1,085	30	-	-	-	-	123,423
Shares and equity instruments	7,296	2,490	967	-	162	-	611	11,526
Derivatives	389	-	-	6	-	-	-	395
Securities used for hedging	2,145	-	-	-	-	-	-	2,145
Compensation instruments	22,507	-	-	-	-	-	-	22,507
Investment property	27,149	-	-	-	-	-	-	27,149
Investments in associates	2,822	146	-	-	-	-	-	2,968
Property and equipment	7,259	-	-	-	-	-	-	7,259
Intangible assets	4,357	-	-	-	-	-	-	4,357
Tax assets	306	-	-	-	-	-	-	306
Non-current assets held for sale	34,621	3,954	-	-	-	-	-	38,575
Other assets	19,127	461	343	-	25	-	254	20,210
Total assets 31.03.2011	468,571	92,669	57,598	63,315	21,924	50,177	48,433	802,687
Liabilities								
Due to credit inst. and Central Bank	29,144	9,956	2,541	2,142	2,379	461	21,699	68,322
Deposits	425,546	24,627	6,526	677	3,786	235	10,962	472,359
Borrowings	8,189	3,139	18,542	19,328	6,470	9,512	-	65,180
Subordinated liabilities	-	26,730	-	-	-	-	-	26,730
Financial liabilities at fair value	6,163	-	4	-	-	35	-	6,202
Tax liabilities	5,326	-	-	-	-	-	-	5,326
Non-current liabilities held for sale	8,298	1,883	-	-	-	-	-	10,181
Other liabilities	31,312	2,529	1,385	17	108	2	351	35,704
Equity	112,683	-	-	-	-	-	-	112,683
Total liabilities 31.03.2011	626,661	68,864	28,998	22,164	12,743	10,245	33,012	802,687
Net on balance sheet position	(158,089)	23,805	28,600	41,151	9,181	39,932	15,421	
Net off balance sheet position	284	13	-	(297)	-	-	-	
Net position 31.03.2011	(157,804)	23,818	28,600	40,854	9,181	39,932	15,421	
Net position 31.12.2010	(170,263)	24,097	23,018	55,109	7,896	46,627	13,516	
Loans to customers with ISK income	121,754	(32,385)	(11,601)	(35,883)	(4,959)	(28,300)	(8,626)	
Net real position 31.03.2011	(36,050)	(8,567)	16,999	4,971	4,222	11,632	6,794	
Net real position 31.12.2010	(48,556)	(8,817)	11,247	17,999	4,109	15,969	8,050	

Amounts are in ISK millions

52. cont.

A natural hedge for currency risk

The currency risk is mitigated by the specific nature of foreign currency loans to customers with ISK income. The Group refers to this as a natural hedge because the loans do not generate profit and loss for small to moderate fluctuations in the exchange rate. These loans were purchased from Kaupthing Bank at a fair value which is based on the customer's ability to repay the loan, which is largely unaffected by changes in the exchange rate. IFRS accounting rules stipulate that the depreciation of the ISK against the loan currency be classified as an impairment event rather than a gain in the loan value if the borrower's ability to repay the loan remains unchanged. Conversely, an appreciation of the ISK is an impairment reversal and that this reversal may be made in certain situations up to the gross value of the loan, which may be significantly higher than the fair value at which the loan was transferred to Arion bank. The Group has modelled the effect of this mitigating effect and has presented the relevant authorities with its measure of the effective currency risk which is attributed to this portfolio of loans. The 31 March 2011 values of the foreign currency imbalance are shown in the following table with year end 2010 values by comparison. The book value refers to the value of the imbalance without accounting for the natural hedge whereas the effective value takes into consideration the mitigating effect of the natural hedge, as modelled by the group. This strength of the natural hedge is different at different times. Previously, the natural hedge effect was applied on a portfolio level, but is now applied on a loan-by-loan basis.

	31.03.2011		31.12.2010	
	Book value	Effective value	Book value	Effective value
FX imbalance due to customers with FX income	36,050	36,050	48,556	48,556
FX imbalance due to customers with ISK income	121,754	53,572	121,707	48,683
Total	157,804	89,622	170,263	97,239

The effective FX imbalance due to customers with ISK income during the period was 44% and 2010 40% respectively, whereas the effective FX imbalance due to customers with FX income is always 100%.

The relevant authorities have granted temporary dispensation from rules regarding the currency imbalance.

Amounts are in ISK millions

53. Capital Adequacy Disclosures

Capital base at 31 March 2011 amounts to ISK 134.749 million. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 19.7%, exceeding the minimum legal requirement of 8%.

The Group, Parent company and subsidiaries that are subjected to capital requirements rules comply in full with imposed capital requirements (2010: the same).

A remark about capital requirements for currency imbalance is in order. As indicated in the discussion about currency risk, there exists a risk mitigation in the form of a natural hedge when the imbalance is due to an FX loan to a borrower with ISK income. The effect of this natural hedge is reflected in the RWA for market risk where the 44% effective contribution of the corresponding portion of the FX imbalance has been accounted for at period end (31.12.2010: 40%).

The table shows the Group's RWA calculations:

Capital Base	31.03.2011	31.12.2010
Share capital	2,000	2,000
Share premium	73,861	73,861
Statutory reserve	1,706	1,525
Retained earnings *	31,322	28,531
Non-controlling interests	3,794	3,619
Total Equity	112,683	109,536
Deduction from Tier 1 capital	4,664	4,647
Total Tier 1 capital	108,019	104,889
Tier 2 capital	26,730	26,257
Total Capital base	134,749	131,146
Risk weighted assets		
Credit risk	515,458	513,328
Market risk FX	90,322	97,657
Market Risk Other	22,163	20,397
Operational risk	57,267	57,267
Total Risk weighted assets	685,210	688,649
Tier 1 ratio	15.8%	15.2%
Capital adequacy ratio	19.7%	19.0%

*Retained earnings and reserves based on unaudited figures.

Amounts are in ISK millions

Other information

The uncertainty regarding the book value of Foreign currency lending

54. By two very similar judgments on 16 June 2010, the Supreme Court of Iceland stated that two car loans were in fact loans in Icelandic krona indexed to a foreign currency exchange rate (rather than loan agreements denominated in foreign currency) and that Act No. 38/2001 on Interest and Price Indexation made such indexation illegal. These judgments were mainly based on the wording of the respective loan documents.

By a judgment on 16 September 2010, the Supreme Court of Iceland stated that a loan agreement, which was ruled to be in Icelandic krona indexed to a foreign currency exchange rate, should bear the non-indexed Icelandic krona interest rate posted by the Central Bank of Iceland.

On 18 December 2010, the Icelandic Parliament passed an act (Act No. 151/2010) removing legal uncertainty on how to recalculate interest on loans in Icelandic krona indexed to a foreign currency exchange rate. According to the law, the principal of such loans shall be recalculated from the start date bearing the non-indexed interest rate for the Icelandic krona posted by the Central Bank. Furthermore, the law requires that banks recalculate foreign-currency mortgage loans for personal residents before 28 March 2011. As applicable, the loan principal shall be adjusted to the outcome of the recalculation or if the borrower has overpaid, the amount shall be reimbursed.

In accordance with the act, the Bank is now in the process of recalculating all mortgage loans for personal residents in foreign currency to individuals. Over 60% of the number of foreign currency loans to individuals is affected and the book value of the loans at end of March 2011 reflects the result of the calculations.

The Supreme Court has not yet ruled on the legitimacy of any of the Group's own loan agreements in foreign currency. Therefore, the legitimacy of loans to corporates and individuals not addressed by Act No. 151/2010 is still not clear. However, based on an opinion of legal counsel to the FME, provided last summer, an important category of the Bank's corporate loan documents has been classified as having no risk from court rulings.

As a worst case scenario, if all the Bank's vulnerable foreign currency loans are ruled illegitimate, they will be recalculated according to Act No. 151/2010 with a considerable loss to the Group. After taking into account provisions and a mitigation of credit risk and currency imbalance, the Group estimates that its capital ratio will remain above the 16% limit which is currently stipulated by the FME.

By two very similar judgments on 14 February 2011, the Supreme Court stated that two foreign currency loans from Frjálsi Fjárfestingabankinn to small SMEs were in fact loans in Icelandic krona and indexed to a foreign currency exchange rate. Therefore, these loans were in breach of Act No. 38/2001 on Interest and Price Indexation. The court passed another two similar judgements on 8 March 2011 dealing with foreign currency loans from NBI hf. The judgments mean that the legitimacy of loans to corporates and individuals not addressed by Act No. 151/2010 is not entirely clear. However, the Supreme Court upheld the interest calculation scheme specified in the judgment of 16 September 2010 and subsequently in Act No. 151/2010

Related parties

55. The Group has a related party relationship with Kaupskil ehf., Kaupthing Bank, the Group's associates, the Board of Directors of Arion bank, the key management personnel of the Group and close family members of individuals referred to above. Loans to related parties are reported in the Consolidated Interim Statement of Financial Position.

No unusual transactions took place with related parties during the period. Transactions with related parties have been conducted on an arm's length basis. There have been no further guarantees provided or received for related party receivables or payables than the one related to the compensation instrument as disclosed in Note 34.

The following table shows outstanding balances with related parties:

31.03.2011	Assets	Liabilities	Net balance
Shareholders with significant influence over the Group	42,718	66,597	(23,879)
Board of Directors and key Management personnel	286	336	(50)
Associates and other related parties	19,518	1,236	18,281
	62,522	68,169	(5,648)
31/12/2010			
Shareholders with significant influence over the Group	42,605	65,170	(22,565)
Board of Directors and key Management personnel	348	903	(555)
Associates and other related parties	20,603	2,416	18,187
	63,556	68,489	(4,933)

Offsetting agreement between Arion Bank and Kaupthing Bank

56. According to the FME decision of 22 October 2008, the customers of Kaupthing Bank are allowed to offset their debt against assets transferred to Arion Bank. The claim registration period for customers of Kaupthing Bank ended on 30 December 2009. The amount of possible set off is still unknown but the effect on the Consolidated Statement of Financial Position will principally be a reclassification of assets from Loans and receivables to Accounts receivable within Other assets. Although the claim registration period is due the customers of Kaupthing Bank still have the right to request set off, thus the amounts are unknown.

An agreement signed on 3 September 2009 relating to certain aspects of the financial settlement between the banks sets out the way guarantees, shared collateral and claims subject to set off are treated. There is uncertainty regarding compensation for interest recognised on the transferred asset from Kaupthing Bank from the time the transaction took place until the set off process is finalized. The amount for interest recognised in 2011 and 2010 is considered immaterial in these Financial Statements.

Events after Balance Sheet date

57. Events after Balance Sheet date

a) Sale of subsidiary

In March Arion Bank and Landsbankinn hf. signed a letter of intent whereby Landsbankinn hf. purchases new equity issued by Arion verdbréfavarsla hf., currently a wholly owned subsidiary of Arion Bank. After the issuance of new equity Arion Bank will hold 75,5% share in Arion verdbréfavarsla hf. Following this agreement the attention is to increase the number of shareholders and within three years the total shareholding of Arion Bank and Landsbankinn hf. should be less than 50%. The letter of intent is signed with the notice of a due diligence and an approval by Competition authorities.

b) Acquisition of legal entity

In April 2011 the Group's shareholding in it´s associate KB rádgjöf ehf. increased from 43,1% to 100,0% resulting in a change in classification as subsidiary and accounted for accordingly.

c) Foreign currency lending

In February and March 2011 the Supreme Court of Iceland pronounced four judgments on foreign currency loans to companies, with three judgements dealing with loans to companies. The court decided that the loans were illegal in the same way as it had in the 2010 judgments which led to new legislation on mortgage loans to individuals. The new judgments create certain doubt over foreign currency loans to smaller companies if such loans were taken to the courts. The Group has already allowed for exchange rate adjustment in its accounts in relation to an agreement with the other banks and the authorities. However, if the corporate loans are largely deemed illegal the Group will suffer substantial losses but this will not jeopardize the 16% capital ratio requirement.

Amounts are in ISK millions

Subsidiaries

58. Shares in subsidiaries are specified as follows:

Company:	Country	Currency	Activity1	Equity interest accum. %
AB-fjárfestingar ehf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0
AFL - sparisjódur, Adalgata 34, 580 Siglufjördur	Iceland	ISK	RB	94.5
Arion verdbréfavarsla hf., Ármúli 13, 108 Reykjavík	Iceland	ISK	OD	100.0
Drög ehf., Pósthólf 878, 121 Reykjavík	Iceland	ISK	OD	100.0
Eignabjarg ehf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0
Ekort ehf., Gardatorg 5, 210 Gardabær	Iceland	ISK	RB	100.0
ENK 1 ehf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0
Gen hf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0
GIR Fund Management Ltd., Walker House Mary Street, George Town.	Cayman Isl.	ISK	OD	100.0
Kaupthing Advisory Company S.A., 35a, avenue J.F. Kennedy	Luxemb.	EUR	OD	100.0
Kaupthing Management Comp S.A., 35a, avenue J.F. Kennedy	Luxemb.	EUR	OD	100.0
Landey ehf., Sudurlandsbraut 22, 105 Reykjavík	Iceland	ISK	OD	100.0
Landfestar ehf., Sudurlandsbraut 22, 105 Reykjavík	Iceland	ISK	OD	100.0
Menntaskóli Borgarfjarðar ehf., Borgarbraut 54, 310 Borgarnes	Iceland	ISK	OD	55.9
Nidurskógur ehf., Digranesgata 2, 310 Borgarnes	Iceland	ISK	OD	100.0
Okkar líftryggingar hf., Sóltún 26, 105 Reykjavík	Iceland	ISK	OD	100.0
Sparisjódur Ólafsfjardar, Adalgata 14, 625 Ólafsfjördur	Iceland	ISK	RB	100.0
SPM ehf., Digranesgata 2, 310 Borgarnes	Iceland	ISK	RB	100.0
Stefnir hf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0
Valitor Holding hf., Laugavegur 77, 101 Reykjavík	Iceland	ISK	RB	52.9
Vesturland hf., Borgartún 19, 105 Reykjavík	Iceland	ISK	OD	100.0

1. RB: Retail Banking, OD: Other Divisions.

Amounts are in ISK millions