Press release, 28 February 2013

ARION BANK'S FINANCIAL RESULTS FOR 2012

Arion Bank reported net earnings of ISK 17.1 billion in 2012, compared with ISK 11.1 billion in 2011. Return on equity was 13.8%, compared with 10.5% in 2011. Return on equity from regular operations was 10.6%, compared with 11.2% in 2011. Total assets amounted to ISK 900.7 billion, compared with ISK 892.1 billion at the end of 2011. The Consolidated Financial Statements of Arion Bank have been audited by the Bank's auditor, Ernst & Young ehf.

The Bank's capital ratio at the end of the period was 24.3%, compared with 21.2% at the end of 2011.

Highlights of the annual financial statements:

- Net earnings of ISK 17.1 billion, compared with ISK 11.1 billion in 2011.
- Earnings from regular operations of ISK 13.1 billion, compared with ISK 12.9 billion in 2011.
- Net operating income of ISK 44.8 billion in 2012, compared with ISK 33.3 billion in 2011. There are several factors behind this increase, the key ones being higher net interest income, lower impairment on loans and a rise in income from associate companies, and other income.
- Net interest income of ISK 27.1 billion, compared with ISK 23.4 billion in 2011. The increase is largely due to the growth of the loan portfolio following the Bank's acquisition of a mortgage portfolio from Kaupthing.
- Write-downs of currency-linked loans following judgments by the Supreme Court amounted to ISK 5.7 billion in 2012, compared with ISK 13.8 billion in 2011.
- Return on equity was 13.8%, compared with 10.5% in 2011. Return on equity based on regular operations was 10.6%, compared with 11.2% in 2011.
- The interest-rate differential as a percentage of the average interest-bearing assets was 3.4% in 2012, the same as for 2011.
- Cost-to-income ratio of 49.8% in 2012, compared with 52.5% in 2011. Cost-income-ratio from regular operations of 53.6% in 2012 compared with 53.9% in 2011.
- Salary expenses increased by 11% between years, a significant factor being the new 5.45% tax on the salaries of employees of financial companies.
- Calculated income tax of ISK 3.6 billion, compared with ISK 1.9 billion in 2011.
- Capital ratio of 24.3%, compared with 21.2% at the end of 2011.
- Liquidity ratio of 33%, which is well over the 20% statutory minimum.
- Cash ratio of 31%, above the statutory minimum of 5%.
- Loans to customers of ISK 566.6 billion at the end of the year, which is virtually the same as the previous year.
- Total assets of ISK 900.7 billion at the end of 2012, compared with ISK 892.1 billion at the end of 2011.
- Total equity at the end 2012 of ISK 130.9 billion, compared with ISK 114.6 billion at the end of 2011.

Höskuldur H. Ólafsson, CEO of Arion Bank:

“These annual results are satisfactory. Earnings from our core activities are pleasing and in line with our expectations. Operations continue to be stable and stability makes developments more predictable, which is crucial in our line of business. We sense increased confidence in the Bank which is a clear sign that our efforts to build our business during the last three years are paying off. Our bond issue in Iceland in 2012 and the recent international bond issue are clear signs of this growing faith. The bond issue in Norway represented an important step towards opening up the international markets to Icelandic companies. This is a step towards creating conditions in Iceland conducive to lifting the capital controls and to stimulating the economy.

In 2012 we focused on improving in several key areas. We began the year by thanking our customers for their patience and cooperation in recent years by repaying some of the previous year’s interest payments. Some 33,000 customers benefited from this. We also consolidated our range of goods and services by offering a wider range of non-indexed and indexed home loans, new options for buying cars, innovative savings options and expanding our financial advisory services. With a more diverse range of products and services we are better equipped to meet our customers’ demands and to make a difference. Our goal is to constantly improve ourselves and the services we offer and a concerted effort is under way at the Bank to achieve this.”

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Income statement – highlights

Income Statement				
In ISK million	**2012**	**2011**	**Diff.**	**Diff. %**
Net interest income	27,142	23,388	3,754	16%
Net change in valuation on loans	-4,690	-8,649	3,959	-46%
Net interest income less val. on loans	22,452	14,739	7,713	52%
Net commission income	10,748	10,685	63	1%
Net financial income	583	511	72	14%
Net gain (loss) on foreign exchange	1,434	1,836	-402	-22%
Other income	9,595	5,505	4,090	74%
Operating income	**44,812**	**33,276**	**11,536**	**35%**
Salaries and related expense	-12,459	-11,254	-1,205	11%
Other operating expense	-12,209	-10,762	-1,447	13%
Net earnings before taxes	**20,144**	**11,260**	**8,884**	**79%**
Income tax	-3,633	-1,912	-1,721	90%
Bank Levy	-1,062	-1,046	-16	2%
Net earnings from continuing operation	**15,449**	**8,302**	**7,147**	**86%**
Net gain from discont. oparation net of tax	1,607	2,792	-1,185	-
Net earnings	**17,056**	**11,094**	**5,962**	**54%**

Operating income

Operating income increased by ISK 11,536 million between years to ISK 44,812 million in 2012. The increase is due to positive changes in most areas of operations.

Net interest income amounted to ISK 27,142 million, compared with ISK 23,388 million in 2011. The increase is explained by the substantial growth of the loan portfolio following the Bank's acquisition of a mortgage portfolio from Kaupthing at the end of 2011. In addition, there has been a relative increase in indexed loans which generate higher interest due to inflation during the year. The interest-rate differential as a percentage of the average interest-bearing assets was 3.4% in 2012 and 2011.

Net valuation changes on loans amounted to an expense of ISK 4,689 million, compared with an expense of ISK 8,649 million in 2011. Write-downs of illegal currency-linked loans account for much of this. In 2011 the group expensed ISK 13,823 million in respect of such loans, and in 2012 an additional ISK 5,744 million was expensed. Loans to larger companies have, however, increased the book value of loans.

Net commission income amounted to ISK 10,748 million, compared with ISK 10,685 million during 2011. There has been little change in the commission income base but the Bank is working on increasing it.

Net financial income amounted to ISK 583 million in 2012, compared with ISK 511 million in 2011. The Bank’s securities portfolio was valued at ISK 137.8 billion at the end of 2012, and the above valuation changes were thus insignificant.

Net foreign exchange gain amounted to ISK 1,434 million, compared with ISK 1,836 million in 2011. The Bank has worked to reduce its foreign exchange balance in recent years and it is now well below 15% of its capital base, which is in compliance with the rules of the Central Bank of Iceland.

Other operating income amounted to ISK 9,595 million in 2012, compared with ISK 5,505 million in 2011. The main factors of income included in other operating income are lease income from investment properties owned by Landfestar and Landey and income from insurance premiums at OKKAR Life Insurance, all of which are subsidiaries of the Bank. Also included are valuation changes relating to investment properties owned by the Bank's real estate companies, which explains the majority of the increase between years. Moreover, the increase over last year is partly explained by valuation changes of associated companies owned by the Bank.

Operating expenses

Operating expenses increased by ISK 2,622 million between years to ISK 24,668 million, a rise of 11.9%. The cost-to-income ratio was 49.8%, compared with 52.5% in 2011. The cost-to-assets ratio was 2.8%, compared with 2.7% in 2011. Note that off balance sheet assets under management have increased sharply this year.

Salaries and related expenses amounted to ISK 12,459 million, compared with ISK 11,254 million in 2011. In 2012 there were on average 1,166 full-time equivalent positions at Arion Bank Group, compared with 1,217 in 2011. Salaries and related expenses have increased from last year following the introduction of a 5.45% financial sector tax, and an increase in salaries of approximately 2% more than the average increase in the wage index which was 7.8% between years.

Other operating expenses amounted to ISK 12,209 million, compared with ISK 10,792 million in 2011. There has been a 13% increase in expenses between years. The most significant increase was linked to higher write-offs and write-downs relating to software licences and intangible assets, the increase in computer expenses, partly as a result of the depreciation of the ISK, and the increase in other expenses relating to write-downs associated with on-going litigation and for which provisions have been made. The change relating to the three items above is approximately ISK 1,500 million.

Taxes

Income tax amounted to ISK 3,633 million, compared with ISK 1,912 million in 2011. The effective income tax rate was 18.0% in 2012, compared with 17.0% in 2011. The increase is partly due to the additional 6% interest rate levied on earnings of financial companies above ISK 1 billion.

Special tax on financial companies amounted to ISK 1,062 million, compared with ISK 1,046 million in 2011. This increase is particularly attributable to the growth of the Bank's balance sheet, as the tax base in calculated on the Bank's liabilities.

In addition Arion Bank and its subsidiaries have paid more than ISK 545 million in the form of a 5.45% financial sector tax which is levied on the salaries of employees in the financial services sector.

Total tax payments made by Arion Bank in 2012 amounted to ISK 5,240 million. In addition payments of ISK 275 million were made to the FME and ISK 142 million to the Debtors' Ombudsman.

Discontinued operations

Net income from discontinued operations amounted to ISK 1,607 million, compared with ISK 2,792 million in 2011. The Bank realized a profit of ISK 875 million from the sale of its holding in Hagar during the first half of the year. The Bank also generated a profit of ISK 1,376 million from the sale of its 39% stake in N1 hf. The sale was formally completed at the beginning of June after having been approved by the regulatory authorities. The loss on other discontinued operations and foreclosure assets owned by the Bank amounted to ISK 644 million.

Fourth quarter results

Net earnings in the fourth quarter 2012 amounted to ISK 2.5 billion, compared with a loss of ISK 2.5 billion during the same period of 2011. The main difference between years relates to the write-down of currency-linked loans following judgments by the Supreme Court. The total write-down in the fourth quarter of 2011 was ISK 13.8 billion and ISK 5.7 billion in the fourth quarter of 2012. Other factors include the exchange rate which was more favourable in the fourth quarter of 2012 than the same period of 2011, and capital gains and valuation changes on investment assets were higher in the final quarter of 2012 than in 2011. However, capital gains were realized on the sale of Hagar in the fourth quarter of 2011. Expenses were considerably higher in the fourth quarter of 2012 than 2011 as a result of higher irregular items.

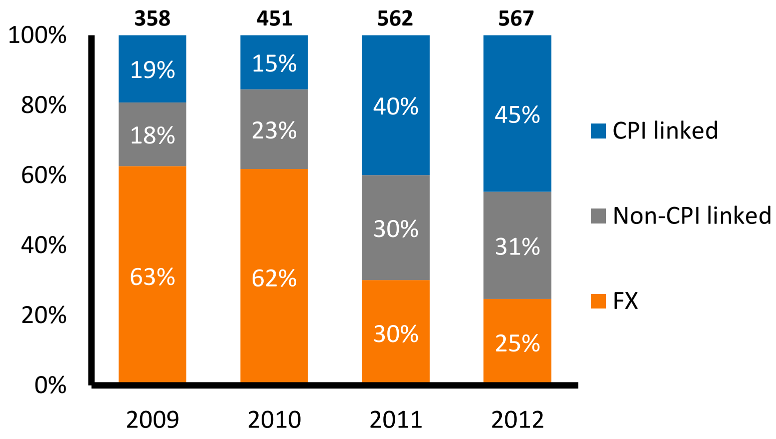
Balance sheet – highlights

Assets					
In ISK millions	**31.12.2012**	**31.12.2011**	**Diff.%**	**31.12.2010**	**Diff.%**
Cash & balances with CB	29,746	29,200	2%	30,628	-3%
Loans to credit institutions	101,011	69,103	46%	67,846	49%
Loans to customers	566,610	561,550	1%	451,219	26%
Financial assets	137,800	157,659	-13%	134,767	2%
Investment properties	28,919	27,100	7%	27,642	5%
Non-current assets & disp.groups HFS	11,923	23,886	-50%	44,464	-73%
Other assets	24,666	23,623	4%	56,049	-56%
Total assets	**900,675**	**892,121**	**1%**	**812,615**	**11%**

Arion Bank had *total assets* of ISK 900,675 million at the end of 2012, compared with ISK 892,121 million at the end of 2011. Changes in individual balance sheet items can be attributed to changes in liquidity management which have resulted in a decrease in securities holdings and the sale of acquired assets in connection with debt settlement agreements. Non-current assets and disposal groups held for sale decreased significantly following the sale of holdings in acquired companies.

Loans to customers

Loans to customers totalled ISK 566,610 million at the end of 2012, compared with ISK 561,550 million at the end of 2011. Loans to customers have changed considerably in recent years. The figure below shows the breakdown of the loan portfolio according to currency in the last four years. It shows the substantial change brought by the restructuring of corporate and private debt and the recalculation of loans to individuals and smaller companies following recent court judgments. The proportion of indexed loans has grown sharply, particularly following the acquisition of the mortgage portfolio from Kaupthing at the end of 2011. In addition large companies have taken new indexed loans as their income is index-linked. The structure of the loan portfolio has therefore changed from being largely in foreign currencies to being largely indexed loans in Icelandic krona.



Securities

Securities holdings amounted to ISK 137,800 million at the end of 2012, compared with ISK 157,659 million at the end of 2011.

Securities					
In ISK millions	**31.12.2012**	**31.12.2011**	**Diff.%**	**31.12.2010**	**Diff.%**
Bonds	117,730	140,568	-16%	120,112	-2%
Shares and instruments w. variable income	16,844	14,045	20%	10,316	63%
Derivatives	788	674	17%	1,126	-30%
Securities used for hedging	2,438	2,372	3%	3,213	-24%
Securities total	**137,800**	**157,659**	**-13%**	**134,767**	**2%**

Arion Bank uses cash to invest in liquid bonds, which explains the fluctuations in bondholdings between years. Changes in equities holdings are largely connected to the acquisition of shares in debt settlement agreements, both in listed and private equity in Icelandic and international companies

Non-current assets and disposal groups held for sale

Non-current assets and disposal groups held for sale amounted to ISK 11,923 million at the end of 2012, compared with ISK 23,886 million at the end of 2011. The decrease is mainly due to the exit of the subsidiaries BM Vallá ehf. and Penninn á Íslandi ehf. from the asset portfolio and the fact that major holdings in Hagar hf. and N1 hf. were divested. The Bank's main assets in this category are the subsidiary Fram Foods ehf, the stake in HB Grandi hf, and residential and commercial property. The majority of these assets are expected to be sold in 2013.

Liabilities and equity

Total liabilities amounted to ISK 769,797 million at the end of 2012, compared with ISK 777,563 million at the end of 2011. The reason for the decrease is a reduction in deposits at the Bank, particularly of deposits owned by investors who have funds tied up by the capital controls. Other borrowing has increased with a new covered bond issue amounting to ISK 5,000 million during the first half of 2012. Index-linked and currency-linked liabilities have also increased.

Liabilities and equity

In ISK million	**31.12.2012**	**31.12.2011**	**Diff.%**	**31.12.2010**	**Diff.%**
Due to credit institutions & CB	32,990	16,160	104%	95,646	-66%
Deposits from customers	448,683	489,995	-8%	457,881	-2%
Non current liab. & disp.groups HFS	1,769	4,950	-64%	13,514	-87%
Financial liabilities at fair value	13,465	4,907	174%	999	1248%
Other liabilities	43,585	42,243	3%	43,504	0%
Borrowings	195,085	187,203	4%	65,278	199%
Subordinated loans	34,220	32,105	7%	26,257	30%
Equity	130,878	114,558	14%	109,536	19%
Total liabilities and equity	**900,675**	**892,121**	**1%**	**812,615**	**11%**

Deposits

Total deposits amounted to ISK 481,673 million, an increase of ISK 24,482 million in 2012. During the first quarter of 2012 one of the Bank's largest depositors withdrew its entire deposits in connection with a settlement with a foreign creditor involving the Central Bank of Iceland and other parties. The Bank believes that this change improves the quality of the deposit base and the liquidity and cash ratios. Despite the decrease in deposits in recent quarters, the Bank has maintained its share on the deposit market in most categories; deposits are decreasing in general with greater investment opportunities opening up elsewhere.

The Bank has been making efforts to lengthen the minimum deposit term in order to make the Bank’s funding more secure. Approximately 40% of deposits were restricted at the end of 2012, compared with 23% at the end of 2011.

The group closely monitors its deposits and categorizes them according to their stickiness. The table below shows changes in deposit categories between years. Categories 1-4, which are the stickiest, have decreased in comparison with the less sticky categories 5-7.

Deposit stickiness

	2012	**2011**	**Diff. %**
1. Capital controls	2%	9%	-7%
2. Resolution process	18%	11%	7%
3. Investors	21%	25%	-4%
4. Deposits - legal entities	14%	16%	-2%
5. Deposits - retail individuals	11%	11%	0%
6. Deposits - legal entities with business relationship	16%	11%	5%
7. Deposits - retail individuals with business relationship	18%	17%	1%
	100%	**100%**	**0%**

Borrowings

Borrowings amounted to ISK 195,085 million at the end of 2012, compared with ISK 187,203 million at the end of 2011. The increase is largely due to covered bond issues, both indexed and non-indexed, amounting to ISK 5 billion during the first half of 2012. The issue is part of a €1 billion bond series and is listed on NASDAQ OMX Iceland. The increase in the CPI has some effect as a significant proportion of the Bank's liabilities are inflation-linked.

Subordinated liabilities

Subordinated liabilities amounted to ISK 34,220 million at the end of 2012, compared with ISK 32,105 million at the end of 2011. The change is insignificant and is only connected to changes in the exchange rate of foreign currencies linked to the loans.

Equity

Total equity amounted to ISK 130,878 million at the end of 2012, compared with ISK 114,558 million at the end of 2011. The change primarily relates to earnings generated during the year.

Key performance indicators

	Year 2012	Year 2011	Year 2010	Year 2009
Return on equity (ROE)	13.8%	10.5%	13.4%	16.7%
Return on total assets (ROA)	1.9%	1.4%	1.5%	1.8%
Net interest margin (int.bearing assets)	3.4%	3.4%	2.7%	1.9%
Net interest margin (total assets)	3.1%	2.9%	2.4%	1.7%
Cost-to-income ratio	49.8%	52.5%	54.2%	47.7%
Cost-to-Total assets ratio	2.8%	2.7%	2.2%	2.2%
CAD-ratio	24.3%	21.2%	19.0%	13.7%
Tier 1 ratio	19.1%	16.4%	15.2%	13.7%
Loans to deposit ratio	126.3%	114.6%	98.5%	72.2%
Secured liquidity ratio	33.0%	34.7%	24.8%	23.9%
Cash ratio	31.0%	15.3%	11.2%	8.1%
The Group's average number of employees	1,166	1,217	1,159	1,141
The Group's employees at the end of year	1,190	1,158	1,241	1,124
The parent's empl. at the end of the period 1)	949	858	936	923

1) Former employees of Verdis and Sparisjodur Ólafsfjardar are included in parent company numbers for 2012.

Financial calendar for 2013

The Annual General Meeting of Arion Bank will be held on 21 March 2013.

The Bank's interim financial statements are scheduled for publication in the weeks stated below.

First quarter 2013	Week 21
Second quarter 2013	Week 35
Third quarter 2013	Week 48

This calendar may be subject to change.