

Arion Bank Mortgages
Institutional Investor Fund
Financial Statements 2012

ABMIIF
Borgartun 19
105 Reykjavik

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

The Financial Statements for the year 2012 of ABMIF are included in part B of the financial statements of Stefnir hf. which contains the financial statements of UCITS, investment funds and professional investor funds of the management company. They have been prepared in accordance with the Finance Statemetns Act and rules on the financial statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority.

The fund reported profit of ISK 1,661 million according to the income statement and the profit is recognized as an increase in units in the fund's accounts. The net assets of the fund at the end of the period totalled ISK 41,274 million according to the balance sheet. In December 2011 it was proposed that the arrangement for Kaupthing covered bonds, which the fund is party to, be restructured. It was proposed that Arion Bank take over the obligations and liabilities of Kaupthing. The proposal was approved on 20 January 2012. The fund will continue to act as a guarantor for the issue but for Arion Bank instead of Kaupthing.

In response to the conditions created by the collapse of the financial sector in Iceland in the autumn of 2008, banks and financial companies have resorted to a range of measures to tackle clients' debt. In late 2009, Arion Bank gave its customers the option of adjusting the principal on the loans to 110% of the market value of the property. This option was available to customers until 30 June 2011. Provisions for losses have been made previously to meet the costs of these measures. Now provisions are done by a general provision and a special provision. By a special provision the expected loss is evaluated from the loans with the highest risk of loss is calculated. By 31 of December 2012 this special provision as part of the depreciation account was ISK 664 million.

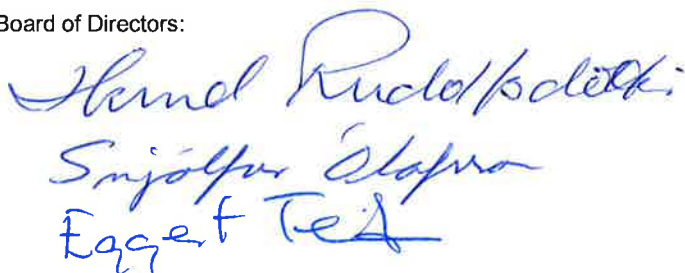
Additionally a general provision is part of the depreciation account. In the calculations of the general provision the default possibility is obtained from the credit rating system of Arion Bank hf. The recovery rate of 65% is estimated based on the Basel standards for accounting procedures of financial undertakings. The calculations assumes that six months will elapse from default which the general provision refers to and that it will be examined by credit control and a special provision will be made should this be required. By 31 December 2012 the general provision as part of the depreciation account was ISK 918 million.

During the year claims totaling ISK 179 million were written off.

The Board of Directors and CEO of Stefnir hf. hereby confirm the fund's Financial Statements for the year 2012 with their signatures.

Reykjavik, 12 March 2013

Board of Directors:



CEO:



Independent Auditor's Report

To the unit holder of ABMIIF.

We have audited the accompanying financial statements of ABMIIF, which comprise the endorsement and statement by the board of directors and the managing director, income statements, balance sheet, changes in net assets, statement of investments and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Icelandic Annual Financial Statements Act, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

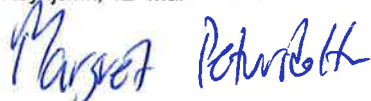
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of ABMIIF as at 31 December 2012, and of its financial performance and changes in net assets for the year then ended in accordance with the Icelandic Financial Statements Act and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 12 March 2013



Margrét Pétursdóttir

State Authorized Public Accountant

Ernst & Young ehf.

Borgartúni 30

105 Reykjavík

Income Statement 2012

| | Notes | 2012 | 2011 |
|---|-------|--------------|------------|
| Financial income and (expenses) | 2-6 | | |
| Interests, indexation, dividends and currency exchange rate difference | | 11.103 | 11.840 |
| Interest expense | | (10.639) | (11.157) |
| Impairment on loans | 13 | 1.377 | (246) |
| Net financial income | | <u>1.841</u> | <u>437</u> |
| Operating expenses | | | |
| Administration fee | 7 | 169 | 142 |
| Other operating expenses | | 11 | 6 |
| | | <u>180</u> | <u>148</u> |
| Profit transferred to units | | <u>1.661</u> | <u>289</u> |

Balance Sheet at 31st December 2012

| | Notes | 2012 | 2011 |
|---|-------|-----------------------|-----------------------|
| Assets | | | |
| Securities with fixed income | 8,15 | 119.945 | 121.096 |
| Total securities | | <u>119.945</u> | <u>121.096</u> |
| Foreclosed assets | 9 | 501 | 445 |
| Cash | 10 | 52.661 | 23.514 |
| Total other assets | | <u>53.162</u> | <u>23.959</u> |
| Total assets | | <u><u>173.107</u></u> | <u><u>145.054</u></u> |
| Liabilities | | | |
| Units | 12 | 41.274 | 16.613 |
| Liabilities with management- og custody companies | | 29 | 19 |
| Issued bonds | 14 | 131.804 | 128.422 |
| Total other liabilities | | <u>131.833</u> | <u>128.441</u> |
| Total liabilities | | <u><u>173.107</u></u> | <u><u>145.054</u></u> |
| Net assets | | 41.274 | 16.613 |
| Number of units | | 23.200 | 9.637 |
| Exchange rate of units at the end of the year | 12 | 1,78 | 1,72 |

Statement of Changes in Net Assets 2012

| | Notes | 2012 | 2011 |
|--|-------|--------|--------|
| Operating activities | | | |
| Profit transferred to units | | 1.661 | 289 |
| Financing activities | | | |
| Units sold | | 23.000 | 0 |
| | | 23.000 | 0 |
| Changes in net assets | | 24.661 | 289 |
| Net assets at the beginning of the year | | 16.613 | 16.325 |
| Net assets at the end of the year..... | 12 | 41.274 | 16.614 |

Investment Statement 31 December 2012

| | Note | Market value | Asset 2012 % | Asset 2011 % | Asset Change % | Investment policy | |
|--------------------------------------|------|-----------------|--------------------|--------------------|----------------------|-------------------|--------------|
| | | | | | | Minimum % | Maximum % |
| Arion bank hf., property loans | 13 | 119.945 | 100 | 100 | 0 | 0 | 100 |
| Total assets | | 119.945 | 100 | 100 | 0 | | |

Notes to the Financial Statements

Accounting methods

1. Basis of preparation

The purpose of the ABMIF Fund is to invest in residential real estate loans from Arion Bank and its subsidiaries, in accordance with the terms of the issuance of Covered Bonds. And to guarantee the payment of all amounts due under any Covered Bonds issued by the Issuer under the Programme, subject to the term of the Covered Bond Guarantee.

2. Basis of preparation

The Financial Statement of Arion Bank Mortgages Institutional Investor Fund has been prepared in accordance with the Financial Statements Act and rules on the financial statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority. They are prepared on the historical cost basis and according to the same accounting methods as last year. The Financial Statements have been prepared in Icelandic krónur (ISK) rounded to the nearest million. The fund is a part of Stefnir hf. which is a subsidiary of Arion Bank hf. The Financial Statements form part of the consolidated financial statements of Arion Bank hf.

3. Assessment and decisions

When preparing the financial statement, the management is required by the Annual Accounts Act to assess and make decisions on important components of the financial statement which are subjective by their nature. The assessment is based on experience and other relevant factors which are otherwise unavailable. Any changes according to this assessment are recognized during the period in which they occur.

4. Foreign currencies

Assets and liabilities in foreign currencies are translated into ISK at the exchange rate at the end of the year, according to Reuter. Operating income and operating expenses in foreign currencies are translated at the exchange rate on the date of transaction. Foreign exchange difference related to translation of foreign assets is recognised in the income statement.

5. Indexed assets and liabilities

Indexed assets and liabilities are calculated on basis of indexes valid in January 2013. Accrued indexation on principal of assets and liabilities is recognised in the income statement.

6. Interest income and expenses

Interest income and expense are recognised in the income statement as they are incurred.

7. Administration fee

The fund pays Stefnir hf. administration fee which includes the following operating costs for the fund: salaries of employees of the management company, marketing costs and administration; included in the administration fee is a custody fee to Arion banki hf. Administration fees are 0.1% of the fund's total assets.

8. Securities with fixed income

- a. Property loans are recognised with accrued interest and indexation at the end of the year. At the end of the year, 46,2% of the fund's property loans were calculated according to the index for mortgage payment adjustment.
- b. Because of circumstances following the fall of the Icelandic commercial banks in the fall 2008, banks and other financial institutions have taken actions to meet customer's debt conditions. Arion bank hf. offered late in the year 2009 ways for customers to adjust the principal of their debt to 110% of property market value. Customers were able to apply for this special resort until the 30th of June 2011. An amount to meet these special measures has already been charged to the income statement previously. Now provisions are done by a general provision and a special provision. On 31st december 2012 total provision for losses amounts to ISK 1,582 million. The provision account has been deducted from Securities with fixed income in the Balance sheet.

Notes, contd.:

9. Foreclosed assets

The fund has foreclosed real estate (residential property) following auctions of the relevant property to secure the fund's loans. These properties are valued by employees of Arion Bank. The valuation takes into account the condition and location of the property. The valuation is then reduced by 20% as a precautionary provision.

10. Cash

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

11. Taxation

The fund does not pay income tax; instead profit or loss from operations are taxed with the unit holders. Individuals pay capital gains tax on profits on their securities when redeemed. Profit and loss on unit shares owned by companies are treated as taxable income and expenses, regardless of redemption.

The fund is exempt from capital gains tax in Iceland but not in those countries where capital gains tax is imposed on income of foreign residents and when no double taxation agreement stating that such income should be taxed in Iceland exists between Iceland and the relevant country.

12. Units

a. Real return of the mutual fund ABMIF as of 31 December 2012.

| | Return |
|----------------------|----------|
| Last 3 months | (0,29%) |
| Last 6 months | 0,47% |
| Last 12 months | (1,27%) |

b. Statement of book value and exchange rate of units.

| | Book value | Exchange rate |
|------------------------|------------|---------------|
| 31 December 2012 | 41.274 | 1,78 |
| 31 December 2011 | 16.613 | 1,72 |
| 31 December 2010 | 16.325 | 1,69 |

13. Securities with fixed income are specified as follows:

| | 2012 | 2011 |
|--|----------------|----------------|
| Property loans before impairment | 121.527 | 124.234 |
| Provision at the beginning of the year | (3.138) | (3.920) |
| Write-offs during the year | 179 | 1.029 |
| Reversal (impairment) during the year | 1.377 | (247) |
| Property loans at year end | <u>119.945</u> | <u>121.096</u> |
| Provision for losses as a ratio of total loans | <u>1,30%</u> | <u>2,53%</u> |

Notes, contd.:

14. Issued bonds

The fund issued bonds to finance its acquisition of mortgages. The bonds are calculated taking into account accrued interest and the consumer price index. Interest on the bonds ranges from 3.75% - 4.00% p.a.

The fund's interest-bearing liabilities are:

| | |
|--------------------------|---------|
| Indexed bond issue | 131.804 |
|--------------------------|---------|

Repayments on issued bonds at the end of the year are broken down as follows:

| | |
|------------------------|----------------|
| Repayments 2013 | 2.486 |
| Repayments 2014 | 2.581 |
| Repayments 2015 | 2.681 |
| Repayments 2016 | 2.784 |
| Repayments 2017 | 2.892 |
| Repayments later | 118.380 |
| | <u>131.804</u> |

15. Segmentation of investments and proportional division:

| | Other ISK | % | Total ISK | % |
|-----------------------------------|----------------|------------|----------------|------------|
| Other financial instruments | 119.945 | 100 | 119.945 | 100 |
| | <u>119.945</u> | <u>100</u> | <u>119.945</u> | <u>100</u> |

In the case of any discrepancy between the English and the Icelandic texts, the Icelandic versions shall prevail and questions of interpretation will be addressed solely in the Icelandic language.

