

**Arion Bank Mortgages
Institutional Investor Fund**
Financial Statements 2015

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

The Financial Statements of ABMIF are included in part B of the Financial Statements of Stefir hf. which contains the Financial Statements of UCITS, investment funds and institutional investors' funds under management. They have been prepared in accordance with law on Financial Statements and rules on the Financial Statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority.

The fund reported profit of ISK 2,088 million according to the income statement and the profit is recognized as an increase in units in the fund's accounts. The net asset of the fund at the end of the period totalled ISK 23,070 million according to the balance sheet.

The Board of Directors and CEO of Stefir hf. hereby confirm the fund's Financial Statements for the year 2015 with their signatures.

Reykjavik, 23 February 2016

Board of Directors:

Stenud Rudolfssóttir
Kjartan Þorsteinsson
Svava Bjarnadóttir

Guðlaugur Gunnarsson
Jónur E. Úlfsson

CEO:

Eli Hauðsson

Independent Auditor's Report

To the Board of Directors the unit holder of ABMIIF.

We have audited the accompanying financial statements of ABMIIF, which comprise the endorsement of Board of Directors and the managing director, statement of financial position as at December 31, 2015, and the income statement, statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

Management and the board of directors is responsible for the preparation and fair presentation of this financial statement in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS and for such internal control as management and the board of directors determine 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 the financial statement 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 about 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 judgment, 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 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 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 December 31, 2015, and its financial performance and its change in net assets for the year then ended in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 23 February 2016

Deloitte ehf.


Pálína Arnadóttir

State Authorized Public Accountant


Pétur Hansson

State Authorized Public Accountant

Income Statement 2015

		2015	2014
Financial income and (expenses)	4-6		
Interests, indexation, dividends and currency exchange rate difference		7.913	8.255
Interest expense		(5.791)	(5.625)
Reversal of impairment on loans	8	116	1.067
Net financial income		2.238	3.697
 Operating expenses			
Administration fee	7	136	160
Other operating expenses		14	5
		150	165
 Profit transferred to units		2.088	3.532

Balance Sheet at 31 December 2015

	Notes	2015	2014
Assets			
Securities with fixed income	8	102.387	115.233
Total investments		<u>102.387</u>	<u>115.233</u>
Foreclosed assets	9	0	3
Cash	10	21.735	33.008
Other assets	11	261	0
Total other assets		<u>21.996</u>	<u>33.011</u>
Total assets		<u><u>124.383</u></u>	<u><u>148.244</u></u>
Liabilities			
Units	13	23.070	46.982
Loan from financial institutions	14	101.303	101.250
Liabilities with management- and custody company		10	12
Total other liabilities		<u>101.313</u>	<u>101.262</u>
Total liabilities		<u><u>124.383</u></u>	<u><u>148.244</u></u>
Net assets		23.070	46.982
Number of units		23.200	23.200
Exchange rate of units at the end of the year	13	<u>0,99</u>	<u>2,03</u>

Statement of Changes in Net Assets 2015

	2015	2014
Operating activities		
Profit transferred to units	2.088	3.532
Financing activities		
Units sold	(26.000)	0
	(26.000)	0
Changes in net assets	(23.912)	3.532
Net assets at the beginning of the year	46.982	43.450
Net assets at the end of the year 13	23.070	46.982

Investment Statement 2015

	Market value	Asset 31.12.2015 %	Asset 31.12.2014 %	Asset Change %	Investment policy	
					Minimum %	Maximum %
Mortgages	102.387	100	100	0	0	100
Total assets	102.387	100	100	0		

Notes to the Financial Statements

Accounting methods

1. Basis of preparation

The purpose of the ABMIIF 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 Statements of Arion Bank Mortgages Institutional Investor Fund have been prepared in accordance with the Financial Statements Act and rules on the Financial Statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority. They are prepared on the historical cost basis 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 statements, the management is required by the Annual Accounts Act to assess and make decisions on important components of the financial statements which are subjective by their nature. The assessment is based on experience and other relevant factors which are otherwise unavailable. Any changes according to this assessment are recognized during the period in which they occur.

4. Foreign currencies

Assets and liabilities in foreign currencies are translated into ISK at the exchange rate at the end of the year 2015, 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 2016. 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.

The fund also pays fees for official supervisory.

8. Securities with fixed income

a. Mortgages are recognised with accrued interest and indexation at the end of 2015. At the end of the year 19,3% of the fund's mortgages were calculated according to the index for mortgage payment adjustment.

b. Provisions are done by a general provision and a special provision. Total provision for losses amounts to ISK 249 million, which of specific provision amounts to ISK 155 million and collective provision amounts to ISK 94 million. The provision account has been deducted from Securities with fixed income in the Balance sheet.

Notes, contd.:

8. Securities with fixed income, cont.

c. Mortgages are specified as:	31.12.2015	31.12.2014
Mortgages before impairment	102.635	115.598
Provision at the beginning of the year	(364)	(1.435)
Write-offs during the year	8	3
Reversal during the year	108	1.067
Mortgages at the end of the year	<u>102.387</u>	<u>115.233</u>
Provision for losses as a ratio of total loans	0,24%	0,32%

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. Other assets

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

12. 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.

13. Units

a. Real return of the mutual fund ABMIIF as of 31 December 2015

	Return
Last 3 months	2,35%
Last 6 months	3,09%
Last 12 months	(51,86%)

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

	Book value	Exchange rate
31 December 2015	23.070	0,99
31 December 2014	46.982	2,03
31 December 2013	43.450	1,87

Notes, contd.:

14. Loan agreement

The fund and Arion Banki hf. made Subordinated Intercompany Loan Agreements to finance the acquisition of the mortgages. The loan agreements are calculated taking into account accrued interest and the consumer price index. Interest on the loan agreements ranges from 3.75% - 4.00% p.a.

The fund's interest-bearing liabilities are:

Indexed loan agreements	101.303
Repayments on loan agreements at the end of the year are as follows:	
Repayments 2016	2.865
Repayments 2017	2.102
Repayments 2018	2.182
Repayments 2019	2.266
Repayments 2020	2.352
Repayments later	89.536
	<u>101.303</u>

15. Segmentation of investments and proportional division

	Other ISK	%	Total ISK	%
Other financial instruments, mortgages	102.387	100	102.387	100
	<u>102.387</u>	<u>100</u>	<u>102.387</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.