



# Arion Bank Mortgages Institutional Investor Fund

## Financial Statements 2016

ABMIF  
Borgatúni 19  
105 Reykjavík  
Kt. 570106-9610

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

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The Financial Statements of ABMIIF 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 1.537 millions according to the income statement and the profit is recognized as an increase in units in the fund's accounts. The net asset of the fund at the end of the period totalled ISK 24,607 millions according to the balance sheet.

The Board of Directors and CEO of Stefir hf. hereby confirm the fund's Financial Statements for the year 2016 with their signatures.

Reykjavik, 2 February 2017

Board of Directors:

*Haraldur Rindalpetóthi*  
*Jóhann & Vilfrann*  
*Kjetill Þorsteinsson*  
*Þorgerður Jónsdóttir*

CEO:

*Ólafur Hauðorn*

# Independent Auditor's Report

To the Board of Directors and unit holders of ABMIIF

## Opinion

We have audited the financial statements of ABMIIF for the year ended December 31, 2016 which comprise the statement of income, the statement of financial position, the statement of changes in net assets for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of ABMIIF as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with the Icelandic Financial Statement Act, Act on Financial Undertakings and Rules on the financial statements of UCITS.

## Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of ABMIIF in accordance with the Icelandic Institute of State Authorized Public Accountants (FLE), *Code of Ethics* and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How the matter was addressed in the audit
Existence and valuation of transferable securities	
Transferable securities are the largest single asset of the fund. As stated in note 7 accompanying the financial statement these assets consist of mortgage loans.	We have examined the internal controls present at the fund regarding calculation of the value of the securities
As the main assets on the balance sheet are securities we have considered them as a key audit matter. In our opinion the existence and management's valuation of the securities are of most significance.	We have tested on a sample basis tested that the underlying mortgages are stored in the funds archives. We have tested on a sample basis tested the collaterals backing the mortgages and management's valuation of them. Furthermore we have examined whether the loans are in default.

## Other information

Management is responsible for the other information. The other information comprises of the report of Board of Directors.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. Except from the confirmation regarding report of the board of directors as stated below.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the financial statements.

## Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Icelandic Financial Statement Act, Act on Financial Undertakings and Rules on the financial statements of UCITS, 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.

## Independent Auditor's Report, cont.

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In preparing the financial statements, management is responsible for assessing ABMIIF's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so

Those charged with governance are responsible for overseeing the ABMIIF's financial reporting process.

### Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 ABMIIF's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Reykjavík, 2 February 2017.

**Deloitte ehf.**

  
Páll Grétar Steingrímsson  
State Authorized Public Accountant

  
Pétur Hansson  
State Authorized Public Accountant

# Statement of Income 2016

	Note	2016	2015
<b>Income</b>			
Interests .....	2-5	1.672.968	1.639.549
Indexation .....		3.662.169	3.716.509
other income .....		601	312
<b>Total income</b>		<u>5.335.738</u>	<u>5.356.370</u>
<b>Expenses</b>			
Administration fee .....	6	124.619	136.486
Interest expenses and indexation .....		3.770.323	3.233.825
Other operating expenses .....		( 96.444)	( 101.661)
<b>Total expenses</b>		<u>3.798.498</u>	<u>3.268.650</u>
<b>Net income (expenses)</b> .....		1.537.240	2.087.720
<b>Profit transferred to units</b> .....		<u>1.537.240</u>	<u>2.087.720</u>
<b>Financing activities</b>			
Units sold .....		0	( 26.000.000)
<b>Total financing activities</b>		<u>0</u>	<u>( 26.000.000)</u>
<b>Changes in net assets</b> .....		1.537.240	( 23.912.280)
<b>Net assets at the beginning of the year</b> .....		23.069.557	46.981.837
<b>Net assets at the end of the year</b> .....		<u>24.606.797</u>	<u>23.069.557</u>

# Statement of Financial Positions at 31 December 2016

		31.12.2016	31.12.2015
	<b>Note</b>		
<b>Assets</b>			
Transferable securities .....		95.869.223	102.386.568
Total assets	7	<u>95.869.223</u>	<u>102.386.568</u>
Cash .....	8	29.628.707	21.716.041
Other assets .....	9	461.363	280.571
Total other assets		<u>30.090.070</u>	<u>21.996.612</u>
<b>Total assets</b>		<u>125.959.293</u>	<u>124.383.180</u>
<b>Liabilities</b>			
Loan from financial institutions .....		101.342.179	101.303.407
Liabilities with the management company .....		10.317	10.216
Other Liabilities .....		1	0
<b>Total liabilities</b>		<u>101.352.497</u>	<u>101.313.623</u>
<b>Net assets</b> .....		<b>24.606.797</b>	<b>23.069.557</b>
Number of units (in thousands) .....		<u>23.200</u>	<u>23.200</u>
Exchange rate of units at the end of the year .....		<u>1,06</u>	<u>0,99</u>

# Breakdown of Assets

## 1. Breakdown of Assets.

	Assets 31.12.2016	Rate %	Assets 31.12.2015	Rate %	Issuer
<b>Other transferable securities:</b>					
Mortgages, unindexed	7.049.446	5,6	6.012.059	4,8	Individuals
Mortgages, indexed .....	88.819.777	70,5	96.374.510	77,5	Individuals
Other transferable securities, total .....	95.869.223	76,1	102.386.568	82,3	
Investments, total .....	95.869.223	76,1	102.386.568	82,3	
Cash .....	29.628.707	23,5	21.716.041	17,5	
Other assets .....	461.363	0,4	281	0,2	
Total assets .....	125.959.293	100,0	124.383.180	100,0	

## 2 .Comparison with Investment Policy.

	Book value 31.12.2016	Rate of invest- ment %	Book value 31.12.2015	Rate of investment %	Investment policy %	
					Minimum	Maximum
Mortgages .....	95.869.223	100,0	102.386.568	100,0	0	100
Total investments .....	95.869.223	100,0	102.386.568	100,0		

## 3. Cumulative Purchases and Sales.

	Cumulative purchases 2016	Cumulative sales 2016	Cumulative purchases 2015	Cumulative sales 2015
Units sold .....	0	0	0	( 2.678)
	0	0	0	( 2.678)

## 4. Segmentation of investments by Countries and Currency.

		Book value 31.12.2016	Rate of investment %	Book value 31.12.2015	Rate of investment %
Iceland .....	ISK	95.869.223	100,0	102.386.568	100,0
		95.869.223	100,0	102.386.568	100,0



# Breakdown of Assets, cont.

## 5. Statement of Main Assets

	<b>Assets</b>	<b>Assets</b>	<b>Changes of</b>	
	<b>31.12.2016</b>	<b>31.12.2015</b>	<b>book value</b>	<b>%</b>
Mortgages, unindexed .....	7.049.446	6.012.059	1.037.388	0,8%
Mortgages, indexed .....	88.819.777	96.374.510	( 7554733 )	( 6,0%)
Mortgages .....	95.869.223	102.386.568	( 6517345 )	( 5,2%)
Other assets .....	30.090.070	21.996.612	8.093.458	6,4%
Total assets .....	<u>125.959.293</u>	<u>124.383.180</u>	<u>1.576.113</u>	<u>1,3%</u>

## 6. Net Assets and return of the Fund

	<b>31.12.2016</b>	<b>31.12.2015</b>	<b>31.12.2014</b>	<b>31.12.2013</b>
Net assets .....	24.606.797	23.069.558	46.981.837	43.449.993
Exchange rate .....	1,06	0,99	2,03	1,87

## 7. Return of the Fund

	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Return of the fund .....	6,66%	( 50,90%)	8,13%	5,27%
Real return of the fund .....	4,47%	( 51,86%)	7,02%	1,56%

## 8. Loan from Financial Institutions

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

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

	<b>Virði</b>
Repayments 2017 .....	2.987.035
Repayments 2018 .....	2.228.029
Repayments 2019 .....	2.313.074
Repayments 2020 .....	2.401.367
Repayments 2021 .....	2.493.030
Repayments later .....	88.919.644
	<u>101.342.179</u>

# Notes to the Financial Statements

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## Accounting methods

### 1. General information

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

### 3. Assessment and decisions

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

### 4. Indexed assets and liabilities

Indexed assets and liabilities are calculated on basis of indexes valid 1 of January 2017. Accrued indexation on principal of assets and liabilities is recognised in the income statement.

### 5. Interest income and expenses

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

### 6. Administration fee

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

The fund also pays fee for official supervisory.

### 7. Securities with fixed income

- a. Mortgages are recognised with accrued interest and indexation at the end of the year 2016. At the end of June 14,14% 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 141 millions, which of specific provision amounts to ISK 110 millions and collective provision amounts to ISK 31 millions. The provision account has been deducted from Securities with fixed income in the Balance sheet.

## Notes, cont.:

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### 7. Securities with fixed income, cont.

c. Mortgages are specified as:	31.12.2016	31.12.2015
Mortgages before impairment .....	96.010.305	102.635.144
Provision at the beginning of the year .....	( 248.576)	( 364.236)
Write-offs during the period .....	4.801	7.933
Reversal during the period .....	102.693	107.727
Mortgages at the end of the period .....	<u>95.869.223</u>	<u>102.386.568</u>
Provision for losses as a ratio of total loans .....	0,15%	0,24%

### 8. Cash

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

### 9. Other assets.

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

### 10. Taxation

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

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