

Newsletter

Financial Institutions - Second edition - June 2010

Financial Results for 2009

Arion Bank builds on a strong asset base, and is profitable and fully funded. The Bank meets all liquidity and capital requirements set by the Financial Supervisory Authority (FME).

The year 2009 was the first full year of operations for Arion Bank. The financial foundations of the new bank were laid during the year. Arion Bank builds on a strong asset base, and is profitable and fully funded. The Bank meets all liquidity and capital requirements set by the Financial Supervisory Authority (FME).

Operating income

The Bank reported Net earnings of ISK 12.9 billion. Return on equity was 16.7%.

Operating income in 2009 amounted to ISK 49.6 billion, including Net interest income of ISK 12.1 billion and Net fee and commission income of ISK 5.9 billion. Net financial income and FX gain amounted to ISK 11.9 billion and is mainly due to the 7.6% weakening of the ISK.

The financial statements for 2009 are consolidated and include corporations taken over by the bank due to their inability to service their debt. Income from these subsidiaries which have been acquired with the sole purpose of resale was ISK 17.8 billion, but the net effect on earnings was close to zero after expenses have been accounted for. Arion Bank was established on 22 October 2008 which makes comparisons with previous years impossible.

A revaluation of the Bank's portfolio of loans and receivables resulted in a net ISK 10.3 billion increase. The total increase in value of loans and receivables was ISK 20.2 billion, offset by a decrease in value of ISK 9.9 billion.

Assets

Total assets on 31 December amounted to ISK 757.3 billion compared with ISK 641.2 billion at the end of 2008. The growth in assets during the year is largely due to the acquisitions of two savings banks, SPRON and SPM, in early 2009 and the weakening of the ISK.

Loans to credit institutions and customers totalled ISK 396.2 billion at the end of 2009 and deposits amounted to ISK 609.1 billion.

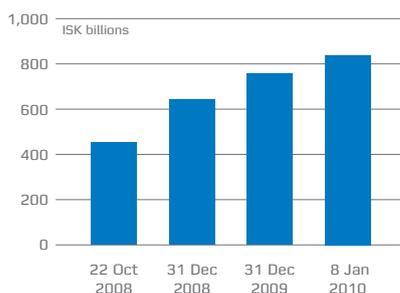
Total deposits as a ratio of loans to customers was 170.3%.

Operational highlights for 2009

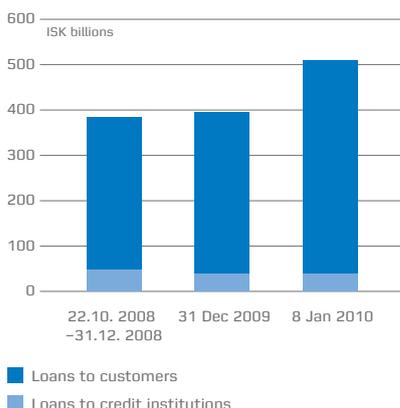
Restructuring of the loan portfolio

One of the most important tasks for Arion Bank since its establishment has been client debt restructuring. Many corporations and individuals found themselves with a severely diminished ability to service their debt in the wake of the crisis of 2008. The goal of the restructuring process is to return companies with a healthy capital structure and households with manageable leverage back to society to fuel economic recovery, and at the same time maximise the Bank's value in those assets.

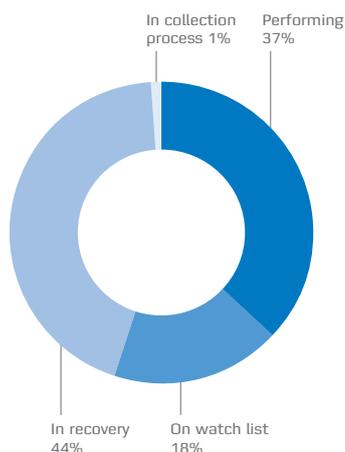
Assets



Loans



Performance of companies – Book value



Early in the process Arion Bank ratified, published and enacted transparent rules on debt workouts, both for individuals and corporates. The restructuring of Arion Bank's loan portfolio has progressed well since the Bank's establishment.

A division specialising in corporate restructuring was set up. The Bank has had to take over numerous companies and is working closely with other on their restructuring.

Several restructuring cases that Arion Bank has been working on are high profile such as the local retail giant Hagar which the Bank took over in 2009. The Board of Directors of Arion Bank decided early this year to float the company on NASDAQ OMX Iceland and thereby sell the Bank's holding in the company. Shares will be offered for sale to the general public and institutional investors. A stock market listing will put the company into an open and transparent sales process.

At the end of 2009 37% of the book value of the corporate loan book was performing but 44% was going through recovery. The Bank expects the loan portfolio to be normalised in 2011.

The Bank introduced a range of customised solutions designed to help households and individual borrowers tackle their debts. The Bank's solutions came in addition to solutions mandated by the government. As of 1 March 2010, around 14,000 of the Bank's customers had taken advantage of the available solutions.

Updated Financial Institution website

The Financial Institutions section on Arion Bank's website has been updated. Information accessibility has been improved with new sections added. Please visit our website at: www.arion-banki.is/?PageID=5211

Restructuring of operations

To align the Bank's operations to a new economic reality, great effort has been put into scaling down various functions such as IT and the branch network.

When the banking regulator decided to transfer the deposits of the savings bank SPRON to Arion Bank, all SPRON branches were closed. Arion Bank also scaled down its own branch network. A total of seven branches or service points were closed or merged with existing branches. Arion Bank is therefore leading the needed consolidation within the Icelandic financial sector.

New Ownership: Equity injection

The Resolution Committee of Kaupthing decided on 1 December, on behalf of the creditors of Kaupthing, to exercise its option to acquire 87% in the Bank. This was in line with an agreement dated 20 July 2009 between the Resolution Committee and the Ministry of Finance. Under the agreement Kaupskil ehf, a subsidiary of Kaupthing Bank, controls 87% share in Arion Bank while the Icelandic State Banking Agency controls the government's 13% share.

For the 87% of the share capital in Arion Bank Kaupthing, through its subsidiary Kaupskil, on 8 January 2010 contributed assets valued at ISK 66,000 million as equity.

These assets represent 65% of the overall capitalisation of Arion Bank.

Kaupthing capitalised Arion Bank in the following manner:

ISK millions	8 Jan 2010
ISK mortgage loans	6,584
Due to credit institutions and CB	14,428
Corporate loans	28,770
Other loans	16,218
Capitalisation	66,000

After the capital injection the capital ratio of Arion Bank is 16.4%; 12.4% Tier 1 and 4% Tier 2

Economic update

Each month the Research department at Arion Bank sends out an economic update with the latest economic developments in Iceland. To subscribe to mailing list or to read the latest economic updates please visit <http://www.arionbanki.is/?PageID=5394>

With a new CEO and a new Board of Directors Arion Bank enters the second phase of the re-generation process. The foundations are in place and the construction continues with continued focus on the restructuring of client debt and increased attention on customer services.

With the capitalisation, and a related funding agreement with the CB, Arion Bank disposed of bonds in return for new assets. The assets that Arion Bank received bear higher interest than the bonds, which should have a positive effect on the Bank's Net interest income in 2010. After the capital injection the capital ratio of Arion Bank is 16.4%; 12.4% Tier 1 and 4% Tier 2. The Bank meets the capital requirements of the FME of 16% capital ratio.

New Board of Directors

On 18 March 2010 a new Board of Directors of Arion Bank was elected, one that reflects the new ownership structure. The Chairwoman of the Board is Monica Caneman. Other members of the Board appointed by Kaupskil are Gudrún Johnsen, who is Vice-Chairwoman, Steen Hemmingsen and Theodór S. Sigurbergsson. The Icelandic State Banking Agency appointed one member, Kristján Jóhannsson. On 20 May 2010, at the General Meeting of Arion Bank, Colin S. Smith joined the Board of Directors.

During the selection process a keen emphasis was placed on appointing directors with broad experience of the banking and corporate sectors. The appointments also took into account the particularly challenging conditions in the Icelandic economy and the task of reconstruction facing the Icelandic business sector. Bringing in non-Icelandic board members with far-reaching expertise was a further important consideration. Two of the new Board members are from Scandinavia and one from the UK; all have broad experience of international finance and are experts in their respective fields.

The Chairwoman, Monica Caneman, is the former deputy CEO of Skandinaviska Enskilda Banken (SEB), where she worked for 25 years. Since 2001 she has developed a career around corporate board assignments.

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New CEO

One of the first tasks of the newly appointed Board was to appoint a new CEO of Arion Bank. Finnur Sveinbjörnsson, who has been the CEO of Arion Bank since its establishment, decided at the end of 2009 to step down and make way for a new CEO to work alongside the new Board of Directors. Mr. Sveinbjörnsson joined the Bank at a time of great uncertainty. Now, when he steps down 18 months later, the Bank is on a secure footing with ownership issues resolved, the valuation of the transferred assets and liabilities finalised, funding in place and the Bank is in a leading position within the Icelandic retail banking market.

Höskuldur Ólafsson is Arion Bank's new CEO and it will be his task to lead the Bank in these challenging times. Mr. Ólafsson is the former CEO of Valitor - VISA Iceland and will start with Arion Bank on 1 June 2010.

With a new CEO and a new Board of Directors Arion Bank enters the second phase of the re-generation process. The foundations are in place and the construction continues with continued focus on the restructuring of client debt and increased attention on customer services.

Annual Report

Detailed information on Arion Bank's operations in 2009 can be found both in the Financial Statements for the year and the Annual Report which are on the Bank's website.

For detailed information please visit: <http://www.arionbanki.is/?PageID=5707>

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