

Arion Bank Mortgages
Institutional Investor Fund

Interim Financial Statements 30 June 2013

Contents

Endorsement and Signatures of the Board of Directors and the Managing Director	3
Report on review of interim financial statements	4
Income Statement	5
Balance Sheet	6
Statement of Changes in Net Assets	7
Investment Statement	8
Notes	9

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

The Interim Financial Statements for the period 1 January - 30 June 2013 of ABMIF are included in part B of the interim 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 1,028 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 42,302 million according to the balance sheet.

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 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 the end of June 2013 this special provision as part of the depreciation account was ISK 550 million.

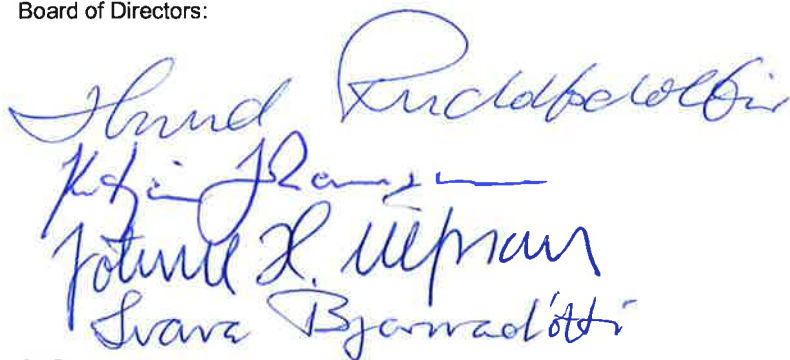
Additionally a general provision is part of the depreciation account. In the calculations of the general provision the default possibility is obtained from the credit rating system of Arion Bank hf. The recovery rate of 65% is estimated based on the Basel standards for accounting procedures of financial 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 the end of June 2013 the general provision as part of the depreciation account was ISK 916 million.

During the period January - June 2013 claims totaling ISK 56 million were written off.

The Board of Directors and CEO of Stefnir hf. hereby confirm the fund's Interim Financial Statements for the period of 1 January - 30 June 2013 with their signatures.

Reykjavik, 26 August 2013

Board of Directors:


Handwritten signatures of the Board of Directors: Hóndur Þrudþorðsson, Kjetil Þorsteinsson, Jónur L. Halldórsson, and Svava Bjarnadóttir.

CEO:


Handwritten signature of the CEO: Eddi Hauðinnar.

Report on review of interim financial statements

To the unit holder of ABMIF.

We have reviewed the accompanying interim financial statements of ABMIF, 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 explanatory notes. Management is responsible for the preparation and presentation of these interim financial statements in accordance with Icelandic Financial Statements Act. Our responsibility is to express a conclusion on these interim financial statements based on our review.

Scope of review

We conducted our review in accordance with the International Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the accompanying Interim Financial Statements are not prepared, in all material respects, in accordance with Icelandic Financial Statements Act and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 26 August 2013



Margrét Pétursdóttir
State Authorized Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Income Statement 1 January - 30 June 2013

	Notes	1.1. - 30.6. 2013	1.1. - 30.6. 2012
Financial income and (expenses)	2-6		
Interests, indexation, dividends and currency exchange rate difference		6.603	6.506
Interest expense		(5.542)	(6.919)
Reversal of impairment on loans	13	60	1.568
Net financial income		1.121	1.155
 Operating expenses			
Administration fee	7	87	83
Other operating expenses		6	1
		93	84
 Profit transferred to units		1.028	1.071

Balance Sheet at 30 June 2013

	Notes	30.6. 2013	31.12. 2012
Assets			
Securities with fixed income	8,13	119.783	119.945
Total investments		<u>119.783</u>	<u>119.945</u>
Foreclosed assets	9	202	501
Cash	10	55.932	52.661
Total other assets		<u>56.134</u>	<u>53.162</u>
Total assets		<u><u>175.917</u></u>	<u><u>173.107</u></u>
Liabilities			
Units	12	42.302	41.274
Issued bonds	14	133.600	131.804
Liabilities with management- og custody companies		15	29
Total other liabilities		<u>133.615</u>	<u>131.833</u>
Total liabilities		<u><u>175.917</u></u>	<u><u>173.107</u></u>
Net assets		42.302	41.274
Number of units		23.200	23.200
Exchange rate of units at the end of the period	12	<u>1,82</u>	<u>1,78</u>

Statement of Changes in Net Assets

1 January - 30 June 2013

	Notes	1.1. - 30.6. 2013	1.1. - 30.6. 2012
Operating activities			
Profit transferred to units		1.028	1.071
Financing activities			
Units sold		0	23.000
		0	23.000
Changes in net assets		1.028	24.071
Net assets at the beginning of the year		41.274	16.613
Net assets at the end of the period	12	42.302	40.684

Investment Statement 30 June 2013

	No	Market value	Asset	Asset	Asset	Investment policy	
			30.6.2013 %	31.12.2012 %	Change %	Minimum %	Maximum %
Arion bank hf., property loans		119.783	100	100	0	0	100
Total assets		119.783	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 Interim 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 Stefir 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 June 2013, 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 July 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 Stefir 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 period, 54.2% 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. Provisions are done by a general provision and a special provision. Total provision for losses amounts to ISK 1,466 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 ABMIIF as of 30 June 2013

	Return
Last 3 months	1,20%
Last 6 months	0,17%
Last 12 months	0,64%

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

	Book value	Exchange rate
30 June 2013	42.302	1,82
31 December 2012	41.274	1,78
31 December 2011	16.613	1,72

13. Securities with fixed income are specified as follows:

	30.6.2013	31.12.2012
Property loans before impairment	121.249	121.527
Provision at the beginning of the year	(1.582)	(3.138)
Write-offs during the period	56	179
Reversal (impairment) during the period	60	1.377
Property loans at period end	<u>119.783</u>	<u>119.945</u>
Provision for losses as a ratio of total loans	<u>1,21%</u>	<u>1,30%</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	133.600
Repayments on issued bonds at the end of the period are as follows:	
Repayments 2013	2.402
Repayments 2014	2.641
Repayments 2015	2.743
Repayments 2016	2.849
Repayments 2017	2.959
Repayments later	120.006
	<u>133.600</u>

15. Segmentation of investments and proportional division:

	Other ISK	%	Total ISK	%
Other financial instruments	119.783	100	119.783	100
	<u>119.783</u>	<u>100</u>	<u>119.783</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.