

ARION BANK'S FINANCIAL RESULTS FOR 2013

"Arion Bank's core operations were stable, solid and in line with our projections in 2013. Return on equity was 9.2%, which is satisfactory given the substantial increase in the bank tax, and the tier 1 ratio is strong at 19.2%. We saw a surge in demand for the Bank's basic services. New loans increased by 60% in 2013 from the previous year and totalled ISK 120 billion", said Höskuldur H. Ólafsson, CEO of Arion Bank, in a press statement following the release of Arion Bank's financial statements for the year 2013.

The 2013 financial results were satisfactory, despite a decrease in net earnings. The Bank reported net earnings of ISK 12.7 billion, compared with ISK 17.1 billion in 2012. Return on equity was 9.2%, compared with 13.8% in 2012. Return on equity from core operations was 10.5% in 2013, compared with 11.4% in 2012.

| Million ISK | Q4 2013 | Q3 2013 | Q2 2013 | Q1 2013 |
|---|---------------|---------------|---------------|--------------|
| Net interest income | 5,487 | 5,646 | 6,379 | 6,288 |
| Net commission income | 2,939 | 2,986 | 2,849 | 2,449 |
| Net financial income | 721 | 658 | 1,123 | (827) |
| Other income | 3,615 | 1,610 | 1,249 | 1,176 |
| Operating income | 12,762 | 10,900 | 11,600 | 9,086 |
| Salaries and related expenses | (4,098) | (2,760) | (3,357) | (3,322) |
| Other operating expenses | (3,114) | (2,516) | (2,951) | (3,277) |
| Net change in valuation | (561) | (253) | 456 | (322) |
| Net earnings before taxes | 4,989 | 5,371 | 5,748 | 2,165 |
| Income tax | (292) | (1,102) | (1,163) | (586) |
| Bank levy | (2,572) | (112) | (97) | (91) |
| Net gain from discontinued operations, net of tax | 402 | 62 | 14 | (79) |
| Net earnings | 2,527 | 4,219 | 4,502 | 1,409 |
| Shareholders of Arion Bank | 2,789 | 4,093 | 4,440 | 1,697 |
| Minority interest | (262) | 126 | 62 | (288) |

Net operating income amounted to ISK 44.3 billion in 2013, compared with ISK 49.5 billion in 2012. The main reasons for the decrease are a lower net interest margin, which was 2.9%, and exchange rate losses owing to the appreciation of the Icelandic króna. Net interest income amounted to ISK 23.8 billion, somewhat lower than in 2012 as a result of higher funding costs and lower inflation. Commission income was higher than in 2012 but other income decreased on account of lower valuation changes on assets. The impact of valuation changes on the bottom line is minimal in 2013.

NEWSLETTER

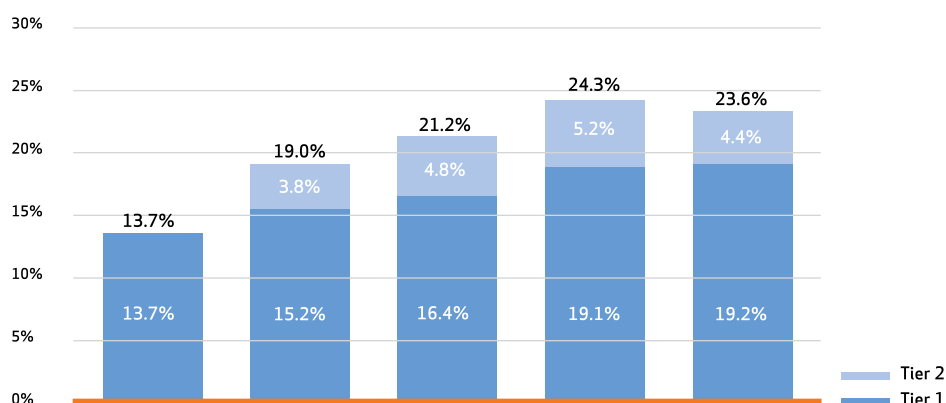


Here you can find Arion Bank's Annual Report for 2013, Investor presentations and Press releases.

Total assets amounted to ISK 938.9 billion, compared with ISK 900.7 billion at the end of 2012. Total loans to customers grew by 12%, particularly as a result of new loans related to the settlement of the Drómi bond (see below), and totalled ISK 636 billion, compared with ISK 567 billion at the end of 2012. With the settlement of the Drómi bond the Bank acquired mortgage loan portfolios valued at ISK 50 billion that had belonged to the failed savings bank SPRON and its subsidiaries. Arion Bank has now reduced risk by securing long-term funding and by increasing the proportion of loans to individuals, which represented 49% of total loans to customers at the end of the year.

Total equity at the end of 2013 was ISK 144.9 billion, compared with ISK 130.9 billion at the end of 2012.

CAD ratio



IMPORTANT MILESTONES IN 2013 – BANK OF THE YEAR 2013



The Bank has achieved a great deal in recent years in its efforts to build up a strong bank, achievements we are proud of and which have not gone unnoticed.

As we discussed in the last edition of the Newsletter, Arion Bank became the first Icelandic bank since 2007 to raise funding on the international markets. Around 60 investors from several countries invested NOK 500 million in bonds issued by the Bank in Norwegian kroner.

Another highlight this year was when The Banker magazine, which is published by The Financial Times, named Arion Bank as the bank of the year in Iceland for 2013. This was the first time since 2007 that the magazine had given an award to an Icelandic bank.

The Banker magazine based its choice on several factors, recognizing that the Bank has been a leader in the Icelandic market in several key areas. In addition to entering the international funding markets, the Bank led the way in the Icelandic housing

market by offering new and innovative products, such as mortgages with fixed rates for five years. Additionally the Bank has had great success in restructuring customers' debt, with problem loans in our loan portfolio down from 56% to 6.3%. Finally, Arion Bank has been a pioneer in terms of new technology which makes banking easier and faster for our customers. The Bank has a first-rate online banking solution and a banking app, the Arion app, that is top-of-the-line and has proven very popular amongst our customers.



Höskuldur H. Ólafsson, CEO of Arion Bank, receives the Bank of the Year awards from The Banker Magazine

[The S&P press release on Arion Bank's ratings](#)

BB+ RATINGS FROM STANDARD & POOR'S

Recently Arion Bank became the first bank in Iceland for more than five years to be rated by an international ratings agency. Standard & Poor's rated the Bank BB+, which is only one level below the rating assigned to the Republic of Iceland.

The ratings assigned by S&P reflect Arion Bank's sound position on the Icelandic market. The Bank has increased its market share in the household segment in recent years and its operations are now divided equally between corporate and retail business. S&P's ratings also reflect the Bank's strong capital and earnings.

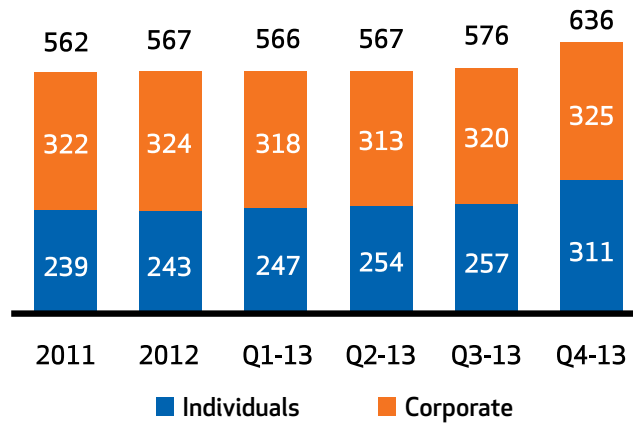
The Bank's risk position is regarded by S&P as adequate. The restructuring of the loan book has largely been completed and S&P believes that further impairments will most likely be limited. The Bank's liquidity position is strong according to S&P, with high coverage of maturing debt. In addition, liquid securities and cash fully cover all potential outflows of foreign deposits.

The ratings from S&P represent yet another step for Arion Bank in opening up access to international funding markets. Even though the Bank has no immediate funding needs we feel that it is important to have access to international funding markets for us to be better able to service our customers and provide them with competitive funding in foreign exchange as well as in Icelandic krónur.

THE LARGEST PRIVATE MORTGAGE LENDER IN ICELAND

At the end of 2013 Arion Bank reached an agreement with ESI, a holding company of the Central Bank of Iceland, on the acquisition by Arion Bank of mortgage portfolios belonging to the failed savings bank SPRON. The value of the loan portfolios is estimated at ISK 50 billion, and the transaction consolidated our position as the largest private mortgage lender in the Icelandic market.

A balanced loan book – 51% corporate and 49% individuals



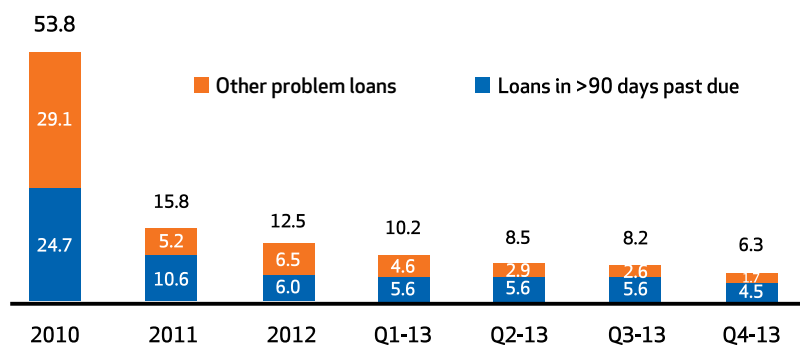
Loans to individuals now amount to 49% of Arion Bank’s loans to customers, which is a good position to be in and one we set out to reach in 2010 when the long-term strategy for the Bank was set. At the end of 2010 this ratio amounted to 25% of the loan portfolio but has increased with acquisitions of mortgage portfolios and an increased emphasis on mortgage lending.

The high proportion of retail loans resulted in a decrease in the net interest margin during 2013 to 2.9%. Other factors also affect the margin, mainly lower inflation during the year and a higher proportion of term deposits. At the same time these changes have a positive effect on the risk profile of the loan portfolio and the Bank in general.

A SUBSTANTIAL DECREASE IN PROBLEM LOANS

Excellent results were achieved during 2013 in reducing the proportion of problem loans. At the end of 2012 problem loans stood at 12.5% but with targeted efforts during the year the figure had been cut to 4.5%, before taking into the account the acquisition of mortgage portfolios valued at ISK 50 billion on 31 December 2013.

Development of problem loans (%)



With the inclusion of the new loan portfolios, problem loans accounted for 6.3% of the loan book. There remain some challenges associated with the new loans which the Bank endeavours to resolve as soon as possible. The Bank fully intends to reduce problem loans even further in 2014.

A NEW FLAGSHIP BRANCH TO OPEN IN THE SPRING

In the spring Arion Bank will open a new flagship branch just across the street from the Bank's headquarters in Borgartún 19, Reykjavík. The new branch will replace two of Arion Bank's branches in downtown Reykjavík, at Hlemmur and Austurstraeti.

Arion Bank has taken many important steps in consolidating the Bank's branch network in Iceland in recent years. Since 2009 the Bank has closed 15 branches and now operates 25 branches nationwide. After the new branch opens in the spring the Bank's branch network will consist of 24 branches nationwide.

The new branch will be one of the Bank's main service centers. The branch network is divided into six geographical areas, each with its own head branch with substantial autonomy when it comes to decision-making and lending. The new flagship branch in Borgartún will serve as such a head branch for the western part of Reykjavík.

The new branch will introduce a new look and feel for our branch network and will enable us to provide even better services to our customers. There will be greater emphasis on in-depth financial consultation. Arion Bank has in recent years placed great importance on the education of its employees, and now we have a number of certified financial consultants. More state-of-the-art ATMs will be installed to take over the more straightforward tasks that our employees have been carrying out for our customers. This will result in a more streamlined branch operation and enhanced services to our customers.

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ECONOMIC UPDATE

Each month the Arion Research 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 [our website](#).

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