



Standard & Poor's upgrades Arion Bank's credit rating

In October Standard & Poor's upgraded Arion Bank's credit rating from BBB-/A-3 to BBB/A-2 with a positive outlook.

The upgrade reflects improving conditions in the Icelandic economy, the deleveraging of Icelandic households and corporations and the positive impact of the continued liberalization of capital controls. It also underlines Arion Bank's enhanced access to the international funding markets and improved capital following the sale of legacy equity positions.

Höskuldur H. Ólafsson, CEO of Arion Bank, said: "The upgrading of Arion Bank's credit rating is testament to the achievements we have made in recent years. This refers both to Arion Bank, which is steadily consolidating its financial position, and also to the Icelandic economy which is performing well at the moment. A higher credit rating is important as it raises our profile as potential clients among international investors and enables us to obtain better terms. The main cost item in our operation is funding and a higher credit rating enables us to reduce this cost and to offer our customers better terms."

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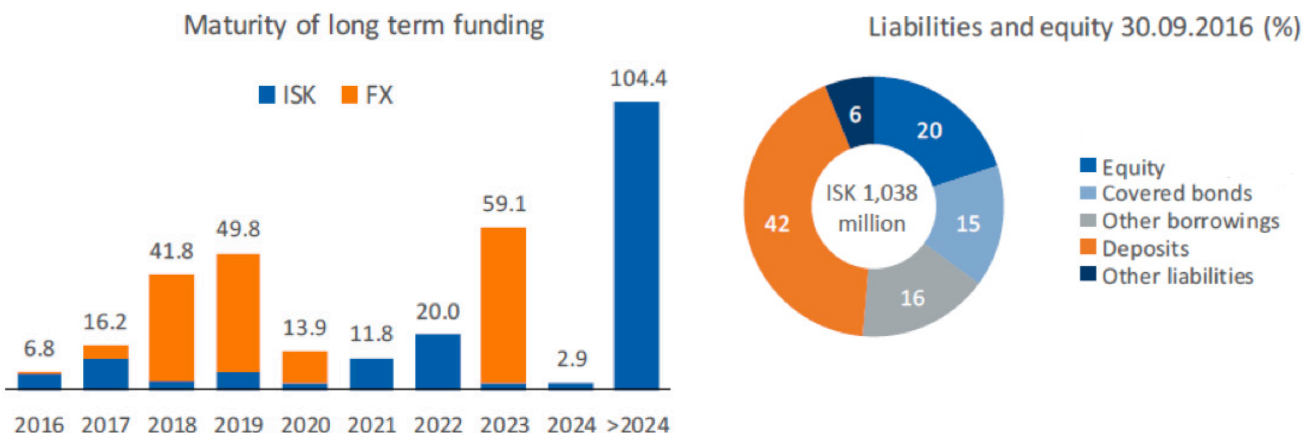
Arion Bank issues bonds in euros for second time this year

On 24 November, Arion Bank issued senior unsecured bonds for a total of €300 million. The bonds are 5-year instruments. Orders totaling over €400 million from more than 50 investors were received. The bonds have a fixed coupon of 1.625% and were sold at rates corresponding to a 1.65% margin over interbank rates. Arion Bank mandated Barclays, Citi, Deutsche Bank and Morgan Stanley for the transaction.

This represents the third euro benchmark issue by Arion Bank, and the second one in 2016. This bond issuance is yet another step in a targeted effort to diversify funding in recent years and follows the recent upgrade in credit rating. The terms on the bonds represent a substantial improvement since Arion Bank's last issuance in April this year, down by 105 points. The spread on the Bank's international issues on the secondary market has also decreased over the last few months, clearly indicating that there is demand on the international credit markets for Arion Bank bonds.

Following the issuance Arion Bank prepaid \$237 million of notes in addition to accrued interest. The notes are held by Kaupthing and were issued at the beginning of 2016 as part of the arrangements for the liberalization of capital controls in Iceland. The notes amounted to \$747 million when they were issued. This prepayment was in addition to the payment made in May 2016 of \$252 million. Following these payments \$257 million remain outstanding on these notes.

The Bank's funding profile continues to improve with new issuances both internationally and domestically, mainly covered bonds.



Arion Bank acquires insurance company Vördur

At the end of September Arion Bank completed the acquisition of the insurance company Vördur, adding non-life insurance to the product range, which already included life insurance. As a subsidiary of Arion Bank, Vördur will form a close partnership with the Bank, bringing benefits to the customers of both companies.

Arion Bank and BankNordik reached an agreement on Arion Bank's acquisition of the insurance company from BankNordik in October 2015. The agreement was subject to certain conditions, including the approval of the regulatory authorities. All conditions stipulated in the agreement have now been met.

Following the acquisition Höskuldur H. Ólafsson, CEO of Arion Bank, said: "Being able to offer our customers a full range of financial services is an integral part of our strategy, and the acquisition of Vördur adds non-life insurance to our diverse palette of products and services. Vördur is a dynamic company with a strong brand name on the Icelandic insurance market and we look forward to seeing the company continue to develop."



Arion Bank's strategic subsidiaries now include Valitor, a leading payment solutions company with operations in Iceland, Denmark and the UK; Stefmir, Iceland's leading fund management company; the life insurance company Okkar líftryggingar, and Vördur.

Arion Bank's 9M 2016 financial results

The financial results for the first nine months of 2016 were satisfactory. The Bank's core operations performed slightly below expectations as external conditions have been challenging in many respects, despite the strong economy. The Bank's core operations remain solid and the Bank continues to consolidate its capital.

Arion Bank reported net earnings of ISK 17.3 billion, compared with ISK 25.4 billion for the same period of 2015. Return on equity was 11.2%, compared with 19.8% for the first nine months of 2015. Adjusted earnings amounted to ISK 5.7 billion, and return on equity from adjusted operations was 3.7%.

The Bank enjoys a strong financial position and has focused on maintaining good liquidity in the period leading up to the lifting of the capital controls. The Bank's capital ratio at the end of the period was 26.1%, compared with 24.2% at the end of 2015. Tier 1 Capital increased during the period to 25.5%, compared with 23.4% at the end of 2015.

Highlights of the income statement and key performance indicators:

In ISK million	9M 2016	9M 2015	Q3 2016	Q3 2015
Net interest income	22,058	20,287	7,432	7,112
Net commission income	10,213	10,726	3,466	3,292
Net financial income	4,339	10,176	844	453
Share of profit of associates	710	6,956	16	2,739
Other operating income	2,642	2,232	781	709
Operating income	39,962	50,377	12,539	14,305
Salaries and related expense	(12,252)	(10,320)	(3,826)	(3,153)
Other operating expenses	(10,393)	(9,016)	(3,425)	(3,012)
Bank levy	(2,190)	(2,168)	(705)	(779)
Net impairment	6,827	(114)	5,882	(33)
Net earnings before taxes	21,954	28,759	10,467	7,328
Income tax	(5,261)	(3,639)	(3,170)	(1,272)
Net gain from disc. operations	569	277	206	15
Net earnings	17,262	25,397	7,503	6,071

KPI's:				
Return on equity (ROE)	11.2%	19.8%	14.4%	14.2%
Net interest margin (int. bearing assets)	3.1%	3.0%	3.1%	3.1%
Cost-to-income ratio	56.7%	38.4%	57.8%	43.1%
Tier 1 ratio	25.5%	22.2%	25.5%	22.2%

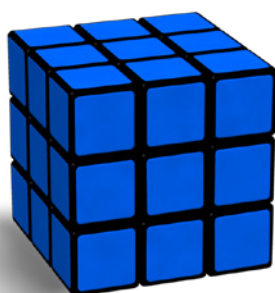
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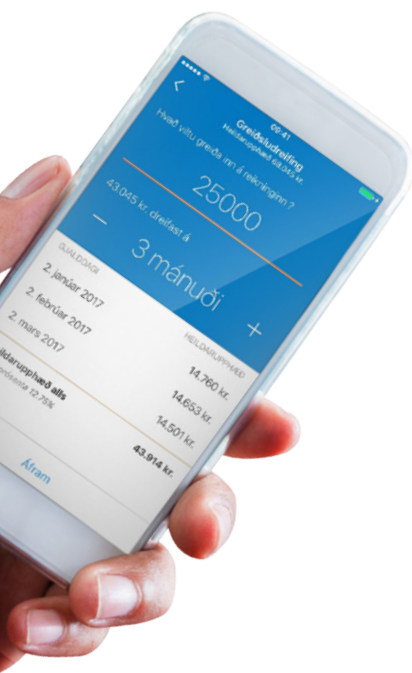
Digital future – a whole range of digital solutions

At Arion Bank a dedicated team of experts from across the Bank has been focusing on developing digital solutions. A special team is created for each project and it has 16 weeks to develop and produce a new digital solution. All solutions are developed with the aim of making it more convenient for our customers to manage their finances. Four solutions have been launched this year.

New customers

People can become customers of Arion Bank whenever and wherever it suits them without even visiting a branch by completing the process online. The only thing the customer needs is an eID to sign the necessary electronic documents. New customers can choose online the type of deposit account and credit card they want. Arion Bank employees then complete the switch from the customer's previous retail bank.





Simple payment plan

Customers can choose a payment plan for their credit card bills via their online bank account or the Arion app when a new bill is issued. They can then decide how much they want to pay at the end of the next month and over how many months the balance is spread.

Self-service channels for getting payment cards and opening bank accounts

Customers can browse the complete range of credit cards, debit cards, savings accounts and foreign currency accounts via Arion Online Bank and then order the products they want. The aim is to simplify the choice and to make it easier to decide on what product best suits each and every customer.

Credit appraisal for mortgages

Customers who are planning to take a mortgage can now apply for credit appraisal online and it only takes a few minutes as all relevant documents are gathered electronically by the Bank.

Frjálsi pension fund nominated for best pension fund in Europe award

Frjálsi, a pension fund managed by Arion Bank, has been named for the third time the best pension fund in the category for European nations with a population of less than one million people by Investment Pension Europe (IPE). This time it shared the award with another Icelandic pension fund. Frjálsi was also nominated for the award of best pension fund in Europe, the first time it has been nominated in this category.

Since 2005 Frjálsi has been the recipient of 10 awards from IPE, the most received by any Icelandic pension fund.



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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