

Arion Bank leads the way in home lending

By offering fixed interest for five years and then a range of subsequent options, the Bank is meeting borrowers' demands for greater financial security

In 2011 Arion Bank has taken the initiative and launched new products on the domestic mortgage market. Earlier in the year the Bank introduced a new loan option for home owners - a traditional inflation-indexed mortgage with the lowest interest rates on offer.

On 15 September Arion Bank again broke new ground by offering its customers fixed rate mortgages repayable over 25 or 40 years. Low, fixed 5-year rates represent an important innovation on the Icelandic loan market. Every five years the interest rates will be revised with respect to the current market rates. Customers then have a range of other options to choose from if they are not satisfied with the non-indexed terms on offer at the end of the five years. Anyone who passes a credit check at the Bank is eligible to take a loan.

By offering fixed interest for five years and then a range of subsequent options, the Bank is meeting borrowers' demands for greater financial security. Variable rates represent a risk for borrowers as repayments can increase sharply over a short period as interest rates rise. However, fixed interest rates for five years limit the risk to which the borrower is exposed.

The new loans have been very well received by the market and the Bank's customers.

Financial results for the first six months of 2011

The Bank's capital ratio increased to 21.4%

Arion Bank reported net earnings of ISK 10.2 billion for the first half of 2011, compared with ISK 7.9 billion during the same period in 2010. This figure exceeds the Bank's own projections, mainly as a result of the revaluation of the Bank's loan portfolio in Corporate Banking. Return on equity was 20.3% on an annualized basis.

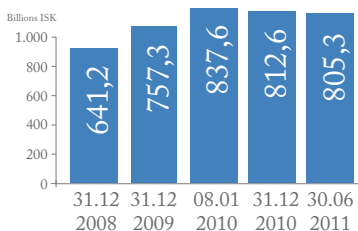
The Bank's capital ratio increased to 21.4% at the end of the period, well above the 16% minimum stipulated by the FME. The Bank's liquidity ratio was 35.0%, which is comfortably above the 20% minimum stipulated by the FME. The Bank's cash ratio was 16.0% (FME minimum of 5%).

The revaluation of the Bank's loan corporate loan portfolio resulted in a ISK 3.9 billion increase in the value of assets, taking into account Kaupthing's share, which is recognised in the income statement.

Net interest income was ISK 11.2 billion in H1 2011, compared with ISK 10.3 billion in H1 2010. The interest-rate differential as a percentage of average interest-bearing assets was 3.2% during the period, compared with 2.8% during the same period of 2010.

Net commission income of ISK 5.1 billion in H1 2011, compared with ISK 2.9 billion in H1 2010. This increase is largely attributable to the integration of new subsidiaries into the group in late 2010.

Total assets



During the second quarter Arion Bank completed the final settlement with the bankruptcy estate of Kaupthing Bank

Income statement - consolidated			
Million ISK	H1 2011	H1 2010	Diff%
Net interest income	11,160	10,297	8%
Net change in valuation on loans	3,944	339	1,063%
Net interest income less value on loans	15,104	10,636	42%
Net commission income	5,099	2,852	79%
Net financial income	1,939	1,407	38%
Other income	2,350	2,237	5%
Operating income	24,492	17,132	43%
Salaries and related cost	(5,516)	(4,452)	24%
Other operating expenses	(5,253)	(3,949)	33%
Net earnings before taxes	13,723	8,731	57%
Income taxes	(2,517)	(1,549)	62%
Bank levies	(446)	- 0	-
Net gain (loss) from discontinued oper. net of tax	(568)	755	(175%)
Net earnings	10,192	12,871	28%

During the second quarter Arion Bank completed the final settlement with the bankruptcy estate of Kaupthing Bank. The compensation instrument is therefore no longer a part of the banks's balance sheet.

Total assets amounted to ISK 805.3 billion at the end of the period, compared with ISK 812.6 billion at the end of 2010. Loans to customers totalled ISK 447.7 billion at the end of the period, compared with ISK 451.2 billion at the end of 2010.

Deposits totalled ISK 448.7 billion, compared with ISK 457.9 billion at the end of 2010. For further information on the accounts please visit our website. ([link](#))

Continued leadership in Asset Management

Arion Bank's Asset Management Division is a clear leader in the Icelandic asset management sector with ISK 633 billion in assets under management. The division consists of Private Banking, Institutional Asset Management, and Investment Services.

The subsidiary Stefnir Asset Management Company operates the fund management business. Stefnir manages a wide range of UCITS-funds, non-UCITS funds and institutional investor funds.

A dynamic force within the domestic economy

In late 2010 Stefnir raised a new private equity fund, named SIA, which has subsequently been a key investor in some of the largest private equity deals in Iceland, including Sjóvá, a large insurance company, Hagar, Iceland's largest retailer, and Sjoklæðagerðin, a leading brand in outdoor clothing.

Stefnir also provides a wide range of fixed income funds, ranging from short-term liquidity funds to long-term government bond funds. The company manages two Icelandic equity funds, which combined have a market share of over 60% in its fund category. Stefnir has been at the forefront of launching specialized fund products, meeting the different needs of its broad client base.

ISK 633 billion in assets under management

The final steps in rationalizing the Bank

Ever since it was established Arion Bank has placed great importance on the cost effectiveness of its operations. It has long been evident that the Icelandic financial system is too costly to run.

The Bank has taken many important steps to improve its efficiency. During the last three years the Bank has closed more than a third of its branches, making its branch network the most cost effective in Iceland.

Arion Bank has cut 10% of the Bank's full-time employee in 2011 as a part of its streamlining measures. This reflects the fact that Arion Bank has reached an important juncture in its operations; debt recovery activities are coming to a conclusion, while work relating to corporate restructuring and the aftermath of the financial crisis in Iceland is slowing down.

Furthermore, demand for new loans and investments is currently at a low. Although the Bank's financial results have been satisfactory, a large proportion of these profits originates from the revaluation of the corporate banking division's loan portfolio. Arion Bank has consolidated its position on the market but these latest measures are necessary in order to strengthen the Bank and to improve its ability to compete in the future.

Arion Bank has placed great importance on the cost effectiveness of its operations

Changes in management and organization

Arion Bank recently introduced certain changes to its organization. As the Bank moves closer to completing the tasks which stemmed from Iceland's economic crisis in late 2008, the focus of our work is shifting more towards the future and how we can best serve our customers going forward. As a consequence of this new focus a number of changes were made to the Bank's organizational structure and key management.

The recovery team, which has been a key function within the Bank for the last three years, is now a part of Corporate Banking. As the Bank has made good progress in recent years in corporate recovery following the financial crisis the team now is a much smaller entity within the Bank. At the same time Capital Markets will become an important function within a new division, Investment Banking, previously Corporate Finance.

Sigurjón Pálsson has been appointed managing director of Arion Bank's Operations division. Sigurjón is taking over as managing director of Operations from Helgi Bjarnason who has been appointed managing director of Retail Banking.

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Geothermal cluster founded at a seminar held at Arion Bank

Arion Bank, in association with Gekon, held a well-attended seminar on geothermal energy at the Bank's headquarters. Dr Michael Porter, professor at the Harvard Business School and one of the world's leading authorities on competitive strategy and the competitiveness of nations, was the guest of honour and addressed the seminar.

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The seminar was held to coincide with the publication of the report Added Value in Geothermal Energy which explores collaboration in the Icelandic geothermal cluster and also to celebrate the founding of a formal geothermal cluster. Arion Bank is the project's main sponsor.

At the seminar several companies and stakeholders formally entered into collaboration within the geothermal cluster. This will involve 10 collaborative projects aimed at the further growth and development of the Icelandic geothermal cluster. A total of 60 different stakeholders are involved in fostering collaboration within the Icelandic geothermal cluster, with the ultimate objective of making the cluster more competitive. There are approximately 20 founding members, including Arion Bank, Landsvirkjun, HS Orka, GEORG, Manvit, Íslandsbanki, Samtök iðnaðarins and KPMG.

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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>

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