Press release, 26 February 2014

ARION BANK'S FINANCIAL RESULTS FOR 2013

Arion Bank reported net earnings of ISK 12.7 billion in 2013, 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. Total assets amounted to ISK 938.9 billion, compared with ISK 900.7 billion at the end of 2012. New loans increased by 60% between years to almost ISK 120 billion. Total loans to customers grew by 12%, particularly as a result of new loans related to the settlement of the Drómi bond, and totalled ISK 636 billion, compared with ISK 567 billion at the end of 2012. Arion Bank has now reduced operational risk by securing long term funding and by increasing the proportion of retail loans, which represented 49% of total loans to customers at the end of the year. The Consolidated Financial Statements of Arion Bank have been audited by the Bank's auditor, Ernst & Young ehf.

Earnings during the fourth quarter amounted to ISK 2.5 billion, the same as in the fourth quarter of 2012. Return on equity in the fourth quarter was 7.4%, compared with 8.2% in the same period of 2012. Return on equity based on core operations was 7.7%, compared with 7.9% in the same period of 2012.

The capital ratio at the end of 2013 was 23.6%, compared to 24.3% at the end of 2012.

Highlights of the annual financial statement:

- Net earnings of ISK 12.7 billion, compared with ISK 17.1 billion in 2012.
- Earnings in the fourth quarter of ISK 2.5 billion, the same as in the fourth quarter of 2012.
- Earnings from core activities of ISK 11.5 billion, compared with ISK 13.5 billion in 2012.
- Net operating income decreased to ISK 44.3 billion in 2013, compared with ISK 49.5 billion in 2012. The main reasons are a lower interest-rate differential and exchange rate losses owing to the appreciation of the Icelandic króna. Other income is lower on account of lower valuation changes on assets.
- Net interest income of ISK 23.8 billion, slightly lower than in 2012 due to the higher funding cost and lower inflation.
- Net valuation change negative by ISK 680 million. Net valuation change on loans positive by ISK 159 million. This is offset by an expense of ISK 839 million relating to intangible assets.
- Return on equity was 9.2%, compared with 13.8% in 2012. Return on equity from core operations was 10.5%, compared with 11.4% in 2012.
- The interest-rate differential as a percentage of the average interest-bearing assets was 2.9%, compared with 3.4% in 2012.
- The cost-to-income ratio was 57.3%, compared with 49.8% in 2012. The high ratio is primarily explained by a decrease in operating income, particularly net interest income. The cost-to-income ratio in core operations was 61.2%, compared with 55.5% in 2012.
- Income and bank taxes totalled ISK 6.0 billion, compared with ISK 4.7 billion in 2012. This represents an increase of ISK 1.3 billion despite the fact that the group's earnings were lower in 2013.
- Loans to customers of ISK 635.8 billion at the end of 2013, an increase of 12% from the end of 2012, particularly as a result of new loans taken over by the Bank in relation to an agreement between Arion Bank and ESÍ ehf. on the settlement of a bond issued by Drómi hf. in 2009 in connection with the transfer of deposits from SPRON to Arion Bank.
- Total assets of ISK 938.9 billion, compared with ISK 900.7 billion at the end of 2012.
- Total equity at the end of 2013 of ISK 144.9 billion, compared with ISK 130.9 billion at the end of 2012.

Höskuldur H. Ólafsson, CEO of Arion Bank:

Arion Bank's core operations were stable, solid and in line with our projections in 2013. Return on equity is 9.2% which is satisfactory given the huge increase in the bank tax, and the capital ratio is strong at 23.6%. We have seen 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.

We have now managed to structure the balance sheet as we intended. Systematic efforts to raise the proportion of loans to individuals have led to significant growth in this area. In 2010, loans to individuals represented 25% of total loans. This figure is now around 50%. Key steps in this process were the acquisition of Kaupthing's mortgage portfolio in 2011, and then at the end of 2013 the acquisition of the retail loan portfolio from ESÍ (the holding company of the Central Bank of Iceland), including the so-called Drómi portfolio. At the same time the Bank has significantly increased its share of new loans on the mortgage market, a market where the Bank has played a leading role. Our objective has been to have a balanced loan portfolio with a low level of risk - a good mix of retail and corporate loans. This change is reflected in the lower interest margin, which measured 2.9% in 2013.

Although they have decreased, one-off events and valuation changes on assets still have a considerable effect on the Bank's operations. Return on equity from core operations is slightly higher than return on equity after taking into account such factors, or around 10.5%. The underlying business is performing well but we aim to do even better.

The huge increase in public levies left its mark on the financial results. Arion Bank paid ISK 6.6 billion in tax in 2013, of which almost ISK 2.9 billion was a bank tax, a separate tax levied on financial companies. At the end of 2013 the government raised the tax rate sharply in order to fund a debt relief programme for indexed mortgages. The bank tax is calculated on the liabilities of financial institutions, which are mainly retail and corporate deposits. Actions which place such a heavy burden on financial institutions are bound to have an effect on their operations and services. It is largely a tax on deposits and as such will have a negative effect on the terms and services which financial institutions can offer their customers.

We will continue to seek opportunities to streamline the business and to strengthen the Bank's ability to compete for new customers. We are focusing on the interfaces between the Bank and our customers who require basic services: our branches, the online bank and the app. Changes will be made in response to the wishes and needs of our customers. We will increase the number of available options, improve efficiency, charge reasonable fees and develop long-term business relationships. The opening of a new service centre at Borgartún 18, Reykjavik in mid-2014 will be an integral part of this development.

A great deal has been achieved in terms of building up the Bank in recent years, achievements we are proud of and which have not gone unnoticed. In 2013 Arion Bank became the first Icelandic bank since 2007 to raise funding on the international markets. Around 60 investors from several countries bought bonds issued by the Bank denominated in Norwegian kroner. Recently Arion Bank became the first bank in Iceland for more than five years to be rated by the international ratings agency Standard & Poor's. The Bank is rated BB+, which is only one level below the rating assigned to the Republic of Iceland. Another pleasing development during the 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. All of us who work at Arion Bank are proud of this recognition.

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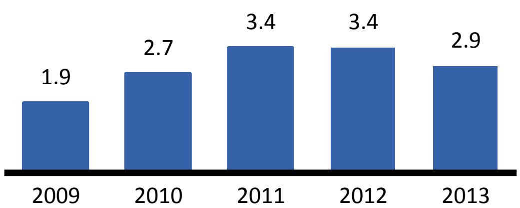
Income statement – highlights

Income Statement				
In ISK million	**2013**	**2012**	**Diff.**	**Diff. %**
Net interest income	23,800	27,142	-3,342	-12%
Net commission income	11,223	10,748	475	4%
Net financial income	3,441	583	2,858	490%
Net gain/ -loss on foreign exchange	-1,766	1,434	-3,200	-223%
Other operating income	7,650	9,595	-1,945	-20%
Operating income	**44,348**	**49,502**	**-5,154**	**-10%**
Salaries and related expense	-13,537	-12,459	-1,078	9%
Other operating expense	-11,858	-12,209	351	-3%
Net impairment	-680	-4,690	4,010	-86%
Net earnings before taxes	**18,273**	**20,144**	**-1,871**	**-9%**
Income tax	-3,143	-3,633	490	-13%
Bank levy	-2,872	-1,062	-1,810	170%
Net earnings from continuing operation	**12,258**	**15,449**	**-3,191**	**-21%**
Net gain/ -loss from discont. operation net of tax	399	1,607	-1,208	-75%
Net earnings	**12,657**	**17,056**	**-4,399**	**-26%**

Operating income

Operating income in 2013 amounted to ISK 44,348 million, which is ISK 5,154 million less than in 2012. This decrease is primarily a result of the lower interest-rate differential and the decrease in other operating income compared with 2012.

Net interest margin in % 2009-2013



Net interest income amounted to ISK 23,800 million in 2013, compared with ISK 27,142 million in 2012. This represents a decrease of more than ISK 3 billion between years and it is primarily a result of lower inflation and higher interest expenses on funding, both on term loans and new borrowing in Iceland and abroad. The interest-rate differential as a percentage of the average interest-bearing assets was 2.9%, compared with 3.4% in 2012. The interest-rate differential has developed more or less in line with inflation and the composition of interest-bearing assets and liabilities also has some effect. In the future the Bank expects the interest-rate differential of interest-bearing assets and liabilities to be around 3% under normal circumstances.

Net commission income increased slightly to ISK 11,223 million in 2013, compared with ISK 10,748 million in 2012. Commission income in Asset Management and Investment Banking has increased significantly, while income from card transactions and loans fell slightly between years.

Net financial income amounted to ISK 3,441 million in 2013, compared with ISK 583 million in 2012. This income is primarily generated by the group's equities holdings, while bond holdings also create some income. Positive conditions on the Icelandic securities market are the main reasons for the significant change between years.

Net exchange rate loss amounted to ISK 1,766 million in 2013, compared with a net gain of ISK 1,434 million in 2012. The Bank's net foreign exchange balance was ISK 31.6 billion at the end of the year which meant that volatility in the exchange rate had a significant impact on operating income. The foreign exchange balance of the parent company is within the 15% limit stipulated by the Central Bank of Iceland. It is the Bank's policy to have strong liquidity in foreign currency. However, the exchange rate in recent periods meant this policy generated an exchange rate loss during the period.

Other operating income amounted to ISK 7,650 million in 2013, compared with ISK 9,595 million in 2012. The main types of income included in other operating income are lease income, valuation changes and profit from sale of investment properties owned by Landfestar and Landey, valuation changes on associated company owned by Eignabjarg and income from insurance premiums at OKKAR Life Insurance, all of which are subsidiaries of the Bank. Valuation changes and profit from sale of investment properties and associate companies are lower in 2013 than in 2012 which is the main reason for the decrease between years in other operating income.

Operating expenses

Operating expenses totalled ISK 25,395 million in 2013, an increase of ISK 727 million or 2.9% from 2012. Operating expenses include a fine of ISK 500 million imposed on Valitor by the Competition Authority and confirmed by the Competition Authority Appeals Committee. Operating expenses include the writing down of real estate and software used by the Bank, a total of ISK 600 million. This is partly offset by a decrease in operating expenses owing to the reversal of a provision relating to litigation against Stefnir which was expensed in 2012. The cost-to-income ratio increased to 57.3%, compared with 49.8% in 2012. The cost-to-assets ratio was 2.8% in 2013, the same figure as in 2012. The cost-to-income ratio is affected by the decrease in operating income which partly results from lower net interest income and the aforementioned expenses relating to housing and software.

Salaries and related expenses amounted to ISK 13,537 million, compared with ISK 12,459 million in 2012. In 2013 there were on average 1,159 full-time equivalent positions at Arion Bank, compared with 1,166 in 2012. The average salary has increased by approximately 8.2%, which is 2.5% above the 5.7% increase in the salary index between periods. This above average increase is partly due to a bonus scheme which was set up during the year. The scheme is in compliance with FME regulations and a bonus can be a maximum of 25% of an employee's total salary. 40% of a bonus may not be paid out for three years. Approximately 100 employees belong to the scheme and the estimated total cost, salaries and related expenses, was ISK 494 million and this was expensed during the year.

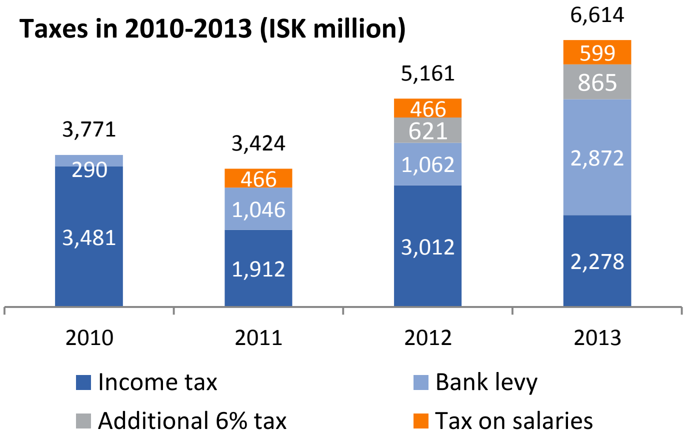
Other operating expenses amounted to ISK 11,858 million in 2013, compared with ISK 12,209 million in 2012. This represents a decrease of ISK 351 million and is largely explained by the reversal of an provision relating to litigation at the subsidiary Stefnir in 2013, which was accrued for in 2012. In other respects other operating expenses were as expected.

Net valuation change is broadly divided into three categories. Firstly, valuation increases on loans of ISK 9,099 million, mainly relating to loans to large companies. Secondly, loan impairment of ISK 8,940 million during the year. This impairment is largely related to loans which had been deemed illegal currency-linked loans and other loans to individuals and smaller companies. Thirdly, a ISK 839 million impairment relating to intangible assets linked to the Bank’s holding in the subsidiary Valitor.

Taxes

Income tax amounted to ISK 3,143 million, compared with ISK 3,633 million in 2012. Income tax, as presented in the annual financial statement, comprises 20% income tax on earnings and a separate 6% additional tax on financial institutions which is levied on the earnings of financial institutions above ISK 1 billion. The effective income tax rate was slightly lower in 2013 or 17.2%, compared with 18.0% in 2012.

Bank tax amounted to ISK 2,872 million, compared with ISK 1,062 million in 2012. The increase between years is attributable to the increase in the bank tax from 0.1285% to 0.376%. This tax rate was approved by the Icelandic parliament at the end of 2013 and part of the tax will be used to fund the government's debt relief programme.



The tax environment for Icelandic financial institutions has been very unstable in recent years and the tax burden has increased sharply, as seen in the accompanying diagram. New taxes which have only been imposed on financial institutions are playing an increasing role in the operations of these companies and comparisons with other business sectors are as a result impossible.

Discontinued operations

Net income from discontinued operations amounted to ISK 399 million, compared with ISK 1,607 million in 2012. In 2012 the Bank generated profit from the sale of a shareholding in Hagar and the sale of the Bank's share in N1. In 2013 the sales of assets had an insignificant effect, and the profit on other discontinued operations and foreclosure assets owned by the Bank was insignificant.

Fourth quarter 2013

The fourth quarter 2013 results were heavily influenced by the increase in the bank tax which was decided near the end of 2013. The tax, which is calculated on the liabilities of financial institutions, was set at 0.376% but had previously been 0.041%. Valuation changes on assets also had some effect, i.e. intangible assets, investment properties and associate companies. Return on equity was 7.4%, compared with 8.2% in the fourth quarter of 2012.

Income Statement				
In ISK million	**Q4 '13**	**Q4 '12**	**Diff.**	**Diff. %**
Net interest income	5,487	7,008	-1,521	-22%
Net commission income	2,939	2,695	244	9%
Net financial income	1,452	92	1,360	1478%
Net gain/ -loss on foreign exchange	-731	875	-1,606	-
Other income	3,615	4,952	-1,337	-27%
Operating income	**12,762**	**15,622**	**-2,860**	**-18%**
Salaries and related expense	-4,098	-3,646	-452	12%
Other operating expense	-3,114	-4,148	1,034	-25%
Net impairment	-561	-5,169	4,608	-89%
Net earnings before taxes	**4,989**	**2,659**	**2,330**	**88%**
Income tax	-292	-258	-34	13%
Bank levy	-2,572	-291	-2,281	784%
Net earnings from continuing operation	**2,125**	**2,110**	**15**	**1%**
Net gain/ -loss from discont. operation net of tax	402	409	-7	-2%
Net earnings	**2,527**	**2,519**	**8**	**0%**

Operating income in the fourth quarter decreased by 18% or ISK 2,860 million between years. More than half of this decrease is due to the drop in net interest income. Commission income increased slightly between years and net financial income increased significantly. However, there was an exchange rate loss in the fourth quarter, while the same period in 2012 saw strong exchange rate gains. Other operating income is slightly lower owing to lower valuation changes on investment properties and associate companies than in the same period of 2012.

Operating expenses are slightly lower than in the fourth quarter of 2012. Salary expenses have increased slightly from 2012, particularly on account of contractual salary increases, expenses relating to the performance plan and a 1.3% increase in the financial sector tax from the previous year. However, other operating expenses have decreased sharply, particularly on account of the reversal of a provision relating to litigation. Otherwise operating expenses are generally in line with budget.

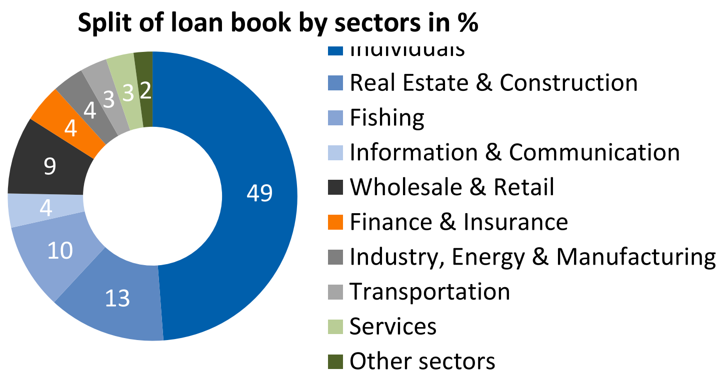
Balance sheet - highlights

Assets					
In ISK million	**31.12.2013**	**31.12.2012**	**Diff.%**	**31.12.2011**	**Diff.%**
Cash & balances with CB	37,999	29,746	28%	29,200	30%
Loans to credit institutions	102,307	101,011	1%	69,103	48%
Loans to customers	635,774	566,610	12%	561,550	13%
Financial assets	86,541	137,800	-37%	157,659	-45%
Investment properties	28,523	28,919	-1%	27,100	5%
Non-current assets & disp.groups HFS	10,046	11,923	-16%	23,886	-58%
Other assets	37,660	24,666	53%	23,623	59%
Total assets	**938,850**	**900,675**	**4%**	**892,121**	**5%**

Arion Bank had *total assets* of ISK 938,850 million at the end of 2013, compared with ISK 900,675 million at the end of 2012. This increase is similar to the rate of inflation during the year. The changes in individual asset classes during the year are mainly related to the settlement of the Drómi bond, whereby the Bank received loans to individuals in place of the bond which the Bank received in 2009 when SPRON deposits were transferred to Arion Bank. The Bank's liquidity has also improved in 2013 on account of increased deposits at the Central Bank of Iceland and more bond holdings, taking into account the settlement of the Drómi bond.

Loans to customers

Loans to customers amounted to ISK 635,774 million at the end of 2013, compared with ISK 566,610 million at the end of 2012. Loans to individuals increased by approximately ISK 50 billion at the end of the year when the Drómi bond was settled. New loans in 2013 increased by 60%, but loans paid off increased by virtually the same amount during the period. As a result the total increase in the Bank's loan portfolio is almost entirely due to the new loans relating to the settlement of the Drómi bond. The following diagram shows the percentage of loans to each sector.



Securities

Securities holdings amounted to ISK 86,541 million at the end of 2013, compared with ISK 137,800 million at the end of 2012.

Securities					
In ISK million	**31.12.2013**	**31.12.2012**	**Diff.%**	**31.12.2011**	**Diff.%**
Bonds	62,171	117,730	-47%	140,568	-56%
Shares and instruments w. variable income	17,449	16,844	4%	14,045	24%
Derivatives	1,070	788	36%	674	59%
Securities used for hedging	5,851	2,438	140%	2,372	147%
Securities total	**86,541**	**137,800**	**-37%**	**157,659**	**-45%**

Several changes occurred to securities holdings during the year, particularly in connection with the ISK 70 billion settlement of the Drómi bond. The Bank has, however, increased its liquid assets in the form of listed bonds, both Icelandic and international. The proportion of derivatives and securities bought as hedges has also increased between years.

Non-current assets and disposal groups held for sale

Non-current assets and disposal groups held for sale amounted to ISK 10,046 million at the end of 2013, compared with ISK 11,923 million at the end of 2012. The decrease is largely due to the sale of Fram Foods Ísland hf. and several large real estates. The main assets in this category are real estate and shareholdings in companies which have been acquired by the Bank in connection with the settlement of customers' loans.

Liabilities and equity

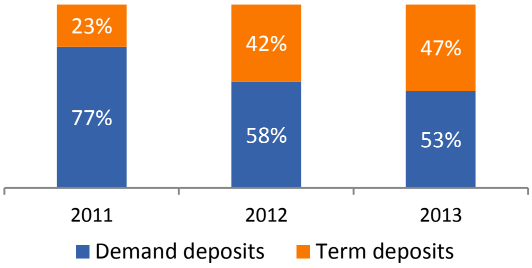
Liabilities and equity					
In ISK million	**31.12.2013**	**31.12.2012**	**Diff.%**	**31.12.2011**	**Diff.%**
Due to credit institutions & CB	28,000	32,990	-15%	16,160	73%
Deposits from customers	471,866	448,683	5%	489,995	-4%
Non current liab. & disp.groups HFS	567	1,769	-68%	4,950	-89%
Financial liabilities at fair value	8,960	13,465	-33%	4,907	83%
Other liabilities	48,024	43,585	10%	42,243	14%
Borrowings	204,568	195,085	5%	187,203	9%
Subordinated liabilities	31,918	34,220	-7%	32,105	-1%
Equity	144,947	130,878	11%	114,558	27%
Total liabilities and equity	**938,850**	**900,675**	**4%**	**892,121**	**5%**

Total liabilities amounted to ISK 793,903 million at the end of 2013, compared with ISK 769,797 million at the end of 2012. The increase is primarily attributable to bond issues in Iceland and abroad during the period, while deposits have also increased.

Deposits

Total deposits amounted to ISK 499,866 million at the end of the year, compared with ISK 481,673 million at the end of 2012. Ever since Arion Bank was founded in 2008, deposits have been at the core of the Bank's funding strategy. Deposits have tended to fluctuate depending on the availability of other investment options. With the capital controls in place and in an uncertain economic environment investors have turned to products in which they had previously only invested to a limited extent. Deposits in the Icelandic system have been at an historical high in recent years. Systematic efforts have been made to increase the proportion of term deposits at the Bank in order to ensure more secure funding. At the end of 2013 47% of total loans were term deposits, compared with 42% at the end of 2012 and 23% at the end of 2011.

Split of term and demand deposits in %



Borrowings

Borrowings amounted to ISK 204,568 million at the end of 2013, compared with ISK 195,085 million at the end of 2012. This increase is chiefly explained by the Bank's issue of ISK 6.3 billion in CPI linked and fixed rate covered bonds, which are listed on NASDAQ OMX Iceland, and NOK 500 million (approx. ISK 11 billion) in bonds which were sold to international investors and have been listed on the Oslo Stock Exchange. However, the appreciation of the Icelandic króna and repayments of long-term liabilities have reduced borrowings. At the beginning of the year the Bank was assigned a rating by the international ratings agency Standard & Poor's, the first Icelandic bank to obtain a rating for more than five years. The Bank was rated BB+ and this will increase Arion Bank's opportunities on the credit markets both in Iceland and abroad in nearest future.

Subordinated liabilities

Subordinated liabilities amounted to ISK 31,918 million at the end of 2013, compared with ISK 34,220 million at the end of 2012. The change is solely related to changes in the exchange rate of foreign currencies to which the loans are linked.

Equity

Total equity amounted to ISK 144,947 million at the end of 2013, compared with ISK 130,878 million at the end of 2012. The change relates entirely to the financial results for 2013. The capital ratio calculated in accordance with the rules of the Icelandic financial supervisory authority was 23.6% at the end of the year. The statutory minimum is 8%. The capital ratio at the end of 2012 was 24.3% and the decrease between years is due to the settlement of the Drómi bond which was guaranteed by the ministry of finance and economic affairs. This instrument was replaced by loans to individuals which have a higher risk-weighting.

Key performance indicators

Key performance indicators	2013	2012	2011
Return on equity (ROE)	9.2%	13.8%	10.5%
Return on total assets (ROA)	1.4%	1.9%	1.4%
Net interest margin (int.bearing assets)	2.9%	3.4%	3.4%
Net interest margin (total assets)	2.6%	3.1%	2.9%
Cost-to-income ratio	57.3%	49.8%	52.5%
Cost-to-Total assets ratio	2.8%	2.8%	2.7%
Effective tax rate	17.2%	18.0%	21.0%
CAD-ratio	23.6%	24.3%	21.2%
Tier 1 ratio	19.2%	19.1%	16.4%
Problem loans	6.3%	12.5%	16.5%
RWA/Total Assets	76.8%	73.0%	78.7%
Loans to deposit ratio	134.7%	126.3%	114.6%
The Group's average number of employees	1,159	1,166	1,217
The Group’s employees at year end	1,145	1,190	1,158
The parent’s average number of employees	923	927	928
The parent’s employees at year end	911	949	858

Financial calendar for 2014

The Bank’s AGM and interim financial statements are scheduled for publication on the below dates.

Annual general meeting 2014	20 March 2014
First quarter 2014	21 May 2014
Second quarter 2014	27 August 2014
Third quarter 2014	20 November 2014

This calendar may be subject to change.