Interim Consolidated Financial Statements

1 January - 31 March 2013

Unaudited

Arion Bank
Borgartún 19
105 Reykjavík
Iceland

Reg. no. 581008 - 0150

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ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Interim Financial Statements of Arion Bank for the period ended 31 March 2013 include the Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Arion Bank is a group of undertakings which provide comprehensive financial services to companies, institutions and private customers. These services include corporate and retail banking, investment banking and asset management. Within the Group are subsidiaries in investment property management, credit card and insurance services.

Kaupskil ehf., a company owned by Kaupthing hf. (formerly Kaupthing Bank hf.), holds 87% of the shares in Arion Bank. The remaining shareholding of 13% is held by the Icelandic State Financial Investments on behalf of the Icelandic government.

Operations during the period

Net earnings amounted to ISK 1,409 million for the period ended 31 March 2013. The Group's equity amounted to ISK 132,286 million at the end of the period, including share capital of ISK 2,000 million. The capital adequacy ratio of the Group, calculated according to the Act on Financial Undertakings, was 23.9%. By law this ratio is required to be no lower than 8.0%, but the Icelandic Financial Supervisory Authority ("FME") makes more stringent requirements. The Bank comfortably meets these requirements. The Bank's liquidity position was strong with the liquidity ratio and cash ratio being 35% and 27% respectively at the end of the period, compared with the regulatory minimum of 20% and 5% respectively.

Operating results in the first quarter show stability in regular operations. Net interest income and operational expenses are in line with budget, however net earnings are colored by the volatility of the Icelandic currency and one-time expenses. The Icelandic króna strengthened during the period compared to weakening in Q1 2012 which contributes ISK 2.5 billion to the difference in net earnings compared to same period last year. Other differences consist of loss from discontinued operations compared to gains in Q1 2012 and an ISK 500 million fine set on Valitor by the Icelandic Competition Authority. Valtior has appealed the fine to the Competition Appeals Committee.

No major changes have taken place on the Balance Sheet during the quarter. Total loans to customers are unchanged from year-end 2012 despite considerable changes in valuation. The amount of losses on loans and impairment due to recalculation of loans higher than expected are met by revaluation of loans where forseen payments exceed previous estimates. Uncertainty regarding the valuation of the loan book for various reasons will remain in the near-term periods.

The Bank completed its third non-indexed covered bonds offering in January by issuing ISK 1.8 billion worth of bonds. In February the Bank was the first Icelandic bank since 2007 to complete international bond offering, issuing NOK 500 million (ISK 11 billion) of unsecured bonds that will be traded on the Oslo exchange later in 2013.

Assets under management increased considerably during the year 2012 and have continued to grow in the first quarter 2013 with an increase of 6.5% in Q1 2013. The Bank has in recent periods successfully attracted new customers and the market has contributed by positive progress.

Outlook

The Bank is well positioned to grow and its strong balance sheet will enable it to be an active participant in the growth of the Icelandic economy. As debt recovery cases decrease, traditional banking activities are becoming more characteristic for the Bank's operations. This creates opportunities for further streamlining yet at the same time greater potential for generating earnings. The Bank aims to be a relationship bank and a fundamental aspect of this is to know the needs of the customers and how to respond to them.

The international bond offering in February represented the first phase in raising international funding since the Bank was founded and the next step is to apply for a credit rating from an international rating agency.

A general election was held in Iceland on 27 April. The government of last four years was unable to retain its majority in Parliament and a new coalition government of the Independence Party and the Progressive Party has been formed. The new government, with a strong majority and a four year term lying ahead, has a possibility to add to stability and continuity in the Icelandic economy, thus creating more favorable conditions for added investment and economic growth.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Interim Financial Statements for the period ended 31 March 2013 have been prepared in accordance with International Financial Reporting Standards (IAS 34 *Interim Financial Reporting*) as endorsed by the European Union.

It is our opinion that the Interim Financial Statements give a true and fair view of the financial performance of the Group for the period ended 31 March 2013, its financial position as at 31 March 2013 and its cash flows for the period ended 31 March 2013.

Further, in our opinion the Interim Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the Interim Financial Statements of Arion Bank for the period ended 31 March 2013 and confirm them by means of their signatures.

Reykjavík, 23 May 2013

Board of Directors

Monica Caneman
Chairman

Agnar Kofoed-Hansen

Gudrún Johnsen

Måns Höglund

Björg Arnardóttir

Jón G. Briem

Thóra Hallgrímsdóttir

Chief Executive Officer

Höskuldur H. Ólafsson

INTERIM STATEMENT OF COMPREHENSIVE INCOME
FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2013

	Notes	2013 1.1.-31.3.	2012 1.1.-31.3.
Interest income		16,472	15,298
Interest expense		(10,184)	(9,084)
Net interest income	9	6,288	6,214
Increase in book value of loans and receivables	10	2,373	119
Impairment of loans and receivables	11	(2,695)	(195)
Net interest income less valuation changes on loans and receivables		5,966	6,138
Fee and commission income		3,660	3,806
Fee and commission expense		(1,211)	(1,470)
Net fee and commission income	12	2,449	2,336
Net financial income (expense)	13-16	570	346
Net foreign exchange gain (loss)	17	(1,397)	1,083
Share of profit (loss) of associates	35	-	5
Other operating income	18	1,176	947
Operating income		8,764	10,855
Salaries and related expense	20	(3,322)	(3,045)
Administration expense		(2,605)	(2,105)
Depositors' and investors' guarantee fund	46	(187)	(238)
Depreciation and amortisation		(262)	(217)
Other operating expense	21	(223)	(197)
Earnings before tax		2,165	5,053
Income tax expense	22	(586)	(1,061)
Bank Levy	23	(91)	(268)
Net earnings from continuing operations		1,488	3,724
Net gain (loss) from discontinued operations, net of tax	24	(79)	727
Net earnings		1,409	4,451
Attributable to:			
Shareholders of Arion Bank		1,697	4,311
Non-controlling interest		(288)	140
Net earnings		1,409	4,451
Other comprehensive income:			
Exchange difference on translating foreign subsidiaries	44	(1)	2
Total comprehensive income for the period		1,408	4,453
Earnings per share			
Basic and diluted earnings per share from attributable to the shareholders of Arion Bank (ISK)	25	0.89	1.79

The notes on pages 9 to 51 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 31 March 2013 5 Amounts are in ISK millions

INTERIM STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2013

Assets	Notes	31.3.2013	31.12.2012	31.3.2012
Cash and balances with Central Bank	26	28,099	29,746	18,030
Loans and receivables to credit institutions	27-28	103,444	101,011	65,955
Loans and receivables to customers	29-30	565,526	566,610	584,154
Bonds and debt instruments	31-32	125,526	117,730	142,493
Shares and equity instruments with variable income	31	16,975	16,844	15,096
Derivatives	31,42	1,179	788	1,313
Securities used for hedging	31	1,853	2,438	2,102
Investment property	34	28,112	28,919	25,867
Investments in associates	35	7,061	7,050	2,992
Property and equipment		6,353	6,311	6,186
Intangible assets		5,108	4,941	4,863
Tax assets	36	507	463	629
Non-current assets and disposal groups held for sale	37	10,877	11,923	21,852
Other assets	38	6,845	5,901	7,840
Total Assets		907,465	900,675	899,372
Liabilities				
Due to credit institutions and Central Bank	31	21,617	32,990	37,032
Deposits	31	462,255	448,683	462,193
Financial liabilities at fair value	31	11,298	13,465	8,098
Tax liabilities	36	3,483	3,237	3,333
Non-current liabilities and disposal groups held for sale	37	758	1,769	4,444
Other liabilities	39	39,322	40,348	39,105
Borrowings	31,40	204,394	195,085	192,109
Subordinated liabilities	31,41	32,052	34,220	34,047
Total Liabilities		775,179	769,797	780,361
Equity				
Share capital	43	2,000	2,000	2,000
Share premium	43	73,861	73,861	73,861
Other reserves	44	1,638	1,639	1,639
Retained earnings		51,269	49,572	37,261
Total Shareholders' Equity		128,768	127,072	114,761
Non-controlling interest		3,518	3,806	4,250
Total Equity		132,286	130,878	119,011
Total Liabilities and Equity		907,465	900,675	899,372

The notes on pages 9 to 51 are an integral part of these Interim Financial Statements.

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INTERIM STATEMENT OF CHANGES IN EQUITY
FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2013

	Share capital and share premium	Other reserves	Retained earnings	**Total Share-holders' equity**	Non-controlling interest	**Total equity**
Changes in equity from 1 January to 31 March 2013						
Equity 1 January 2013	75,861	1,639	49,572	127,072	3,806	130,878
Total comprehensive income for the period		(1)	1,697	1,696	(288)	1,408
Equity 31 March 2013	75,861	1,638	51,269	128,768	3,518	132,286
Changes in equity from 1 January to 31 March 2012						
Equity 1 January 2012	75,861	1,637	32,950	110,448	4,110	114,558
Total comprehensive income for the period		2	4,311	4,313	140	4,453
Equity 31 March 2012	75,861	1,639	37,261	114,761	4,250	119,011

The notes on pages 9 to 51 are an integral part of these Interim Financial Statements.

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CONDENSED INTERIM STATEMENT OF CASH FLOWS FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2013

	Notes	2013 1.1.-31.3.	2012 1.1.-31.3.
Cash flows from (used in) operating activities:			
Earnings before tax		2,165	5,053
Adjustments to reconcile earnings before income tax to net cash from (used in) operating activities:			
Non-cash items included in net earnings before income tax and other adjustments	51	1,282	(1,138)
Changes in operating assets and liabilities	52	(11,583)	(20,050)
Income taxes paid		(396)	(1,054)
Net cash from (used in) operating activities		(8,532)	(17,189)
Net cash from (used in) investing activities		492	3,753
Net increase (decrease) in cash and cash equivalents		(8,040)	(13,436)
Cash and cash equivalents at beginning of the period		105,173	82,815
Cash and cash equivalents acquired through business combinations		-	5
Effect of exchange rate changes on cash and cash equivalents		(5,330)	2,347
Cash and cash equivalents at the end of the period		91,803	71,731
Cash and cash equivalents comprises			
Cash in hand and demand deposits		49,133	24,629
Due from credit institutions		51,220	60,169
Mandatory reserve with Central Bank		(8,550)	(7,926)
Cash and cash equivalents at the end of the period		91,803	76,872
Non-cash investing and financing transactions:			
Assets acquired through foreclosure on collateral from customers with view to resale		303	546
Settlement of loans and receivables through foreclosure on collateral from customers with view to resale		(303)	(546)

The notes on pages 9 to 51 are an integral part of these Interim Financial Statements.

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

ACCOUNTING POLICIES

General information

1. Reporting entity

Arion banki hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion banki hf. is located at Borgartún 19, Reykjavík. The Interim Financial Statements for the period ended 31 March 2013 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

The Interim Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 23 May 2013.

2. Basis of preparation

a) *Statement of compliance*

The Interim Financial Statements are consolidated and have been prepared in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting as endorsed by the European Union. The Interim Financial Statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with Arion Bank´s annual Financial Statements for the year 2012. The statements are available at Arion Bank's website www.arionbanki.is.

b) *Basis of measurement*

The Interim Financial Statements are prepared on the historical cost basis except for the following:

– Financial assets and financial liabilities held for trading are measured at fair value; and
– Investment properties are measured at fair value.

Non-current assets and disposal groups classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell. Immediately before the initial classification, or where the assets and liabilities are not within the scope of IFRS 5, the carrying amounts are measured in accordance with applicable IFRS.

c) *Functional and presentation currency*

The Financial Statements are presented in Icelandic Krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million unless otherwise stated.

d) *Use of estimates and judgements*

The preparation of the Financial Statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, contingent liabilities as well as income and expenses in the Financial Statements presented. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may affect the Financial Statements.

Estimates and underlying assumptions are reviewed on an on going basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised and in any future periods affected.

Judgements made by management that have an effect on the Interim Financial Statements and estimates with a risk of material adjustment within the next financial year are discussed in Note 4 in these Interim Financial Statements and in the annual Financial Statements for 2012.

Significant accounting policies

The accounting policies adopted in the preparation of these Financial Statements are consistent with those followed in the preparation of the Group's annual Financial Statements for the year ended 31 December 2012.

3. Going concern assumption

The Interim Financial Statements are prepared on a going concern basis. The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. In making this assessment, management has taken into consideration the risk exposures facing the Group which are further described in the Risk Management Disclosures in the Group's Financial Statements for the year 2012.

NOTES TO THE INTERIM FINANCIAL STATEMENTS

4. Significant accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the risk management disclosures, provided elsewhere in these Interim Financial Statements.

Key sources of estimation uncertainty

i) Impairment losses on loans and receivables

The Group reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Statement of Comprehensive Income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

ii) Foreign loan portfolio

In 2011 the Group recognised the estimated impact of the Supreme Court judgement of 15 February 2012 on the foreign loan portfolio. In 2012 the Group has estimated the impactsof the Supreme Court judgements of 15 June, 18 October and 1 November 2012, dealing with foreign loans or currency linked loans.

As set out in Note 50 of these Interim Financial Statements, the Group recognised impairment of the foreign loan portfolio at the end of the respective periods for the estimated loss arising from the above judgments. The Group remains exposed to uncertainty regarding the foreign loan portfolio arising from firstly, the Group's interpretation of the above judgments, and secondly, the outcome of future legal decisions and new or amended government legislation.

Management judgment is required in the determination of the loans that require recalculation, and the estimated loss is based on assumptions that may be revised by future court decisions. In addition, the outcome of future legal decisions and new or amended government legislation may require recalculation of other categories of foreign loans that the Group has not previously considered vulnerable. This will be determined by future court rulings and government actions, for which it is not currently possible to predict an outcome.

iii) Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could have impact on the reported fair value of financial instruments.

iv) Assets classified as held for sale

The Group classifies assets as held for sale if the assets are available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets and the sale is considered highly probable. For the sale to be highly probable management must be committed to sell the assets and be actively looking for a buyer, the assets must be actively marketed at a price that is reasonable in relation to their fair value and the sale is expected to be completed within one year. An extension of the period required to complete a sale does not preclude an asset or disposal group from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and there is sufficient evidence that the Group remains committed to its plan to sell the assets or disposal groups.

When classifying assets as held for sale the Group has determined that the requirements of IFRS 5 have been met.

4. cont.

As set out in Note 21 in the annual Financial Statements for the year 2012, disposal groups being legal entities acquired exclusively with view to resale are measured at the lower of carrying amount and fair values less costs to sell. For the most part, fair values at the date of classification of these legal entities were calculated using valuation models based on discounted future cash flows that incorporated significant non-market observable inputs and assumptions. The use of reasonably possible alternative inputs and assumptions to these models, in particular changes to the discount rate employed (representing the required rate of return on equity), could have impact on the fair value of these disposal groups.

v) Fair value of Investment Property

As the property market in Iceland is relatively inactive and assets are often quite dissimilar it is difficult to obtain reliable estimates of fair values of investment properties. The international financial crises and the financial crisis in Iceland had significant influence on the real estate market in Iceland. The effects of that resulted in a relatively passive market and with disparate properties on the market it can be complicated to use prices from recent market transactions in order to determine values of comparable properties. This being the case there is uncertainty about the actual fair value of the properties.

vi) Intangible assets

The value of intangible assets with indefinite useful lives is not amortised, but the assets are tested for impairment at least once a year.

The Group

5. Shares in subsidiaries in which Arion Bank held a direct interest at the end of the year were as follows:

			Equity interest in %	
Company:	Country	Currency	31.3.2013	31.12.2012
AFL - sparisjódur, Adalgata 34, Siglufjördur	Iceland	ISK	99.3	99.3
ALT ehf., Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
Arion Bank Mortgages Institutional Investor Fund, Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
EAB 1 ehf., Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
Eignabjarg ehf., Álfheimar 74, Reykjavík	Iceland	ISK	100.0	100.0
Eignarhaldsfélagið Landey ehf., Hátún 2b, Reykjavík	Iceland	ISK	100.0	100.0
Einkaklúbburinn ehf., Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
Gen hf., Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
GIR Fund Management Ltd., Walker House Mary Street, George Town.	Cayman Isl.	ISK	100.0	100.0
Kaupthing Management Company S.A., 35a, avenue J.F. Kennedy	Luxemb.	EUR	100.0	100.0
Landfestar ehf., Álfheimar 74, Reykjavík	Iceland	ISK	100.0	100.0
NS1 ehf., Borgarbraut 14, Borgarnes	Iceland	ISK	100.0	100.0
Okkar líftryggingar hf., Sóltún 26, Reykjavík	Iceland	ISK	100.0	100.0
Stefnir hf., Borgartún 19, Reykjavík	Iceland	ISK	100.0	100.0
Tekjuvernd ehf., Hlídarsmári 17, Kópavogur	Iceland	ISK	100.0	100.0
Valitor Holding hf., Laugavegur 77, Reykjavík	Iceland	ISK	60.8	60.8

In addition the Bank holds subsidiaries classified as a Non-current assets and disposal groups held for sale, see Note 37.

6. Changes within the group

In March 2013 Fram Foods ehf. sold its subsidiary Fram Foods Ísland hf. Fram Foods ehf. is a wholly owned subsidiary of Eignabjarg ehf. Fram Foods Ísland hf. was classified as non-current assets and disposal groups held for sale at year-end 2012. The effects from the sale of this entity has minor effects on the Statement of Comprehensive Income.

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

OPERATING SEGMENT REPORTING

7. Segment information is presented in respect of the Group's operating segments based on the Group´s management and internal reporting structure. Segment performance is evaluated based on earnings before tax.

Inter segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

Segment capital expenditure is the total cost incurred dureing the period to acquire property and equipment and intangible assets.

Operating segments

The Group comprises six main operating segments:

Corporate Banking provides services to the Bank's larger corporate clients. Its role is to provide comprehensive financial services and tailored services to meet the needs of each company. Corporate Banking offers diverse solutions relating to loans and other services required by companies. The division is also responsible for the financial restructuring of companies which need it.

Retail Banking, Arion Bank Mortgages Institutional Investor Fund and AFL Spairsjodur provide a comprehensive range of services, including advice on deposits and loans, savings, payment cards, pension savings, insurance, securities, funds and more. To maximize operational efficiency the branch network is divided into seven clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Customers of Retail Banking's 25 branches all around Iceland are over 100,000.

The Asset Management division comprises Institutional Asset Management, Private Banking and Investment Services. Asset Management is the fund distributor for Stefnir, an independently operating financial company owned by Arion Bank. Stefnir manages a broad range of mutual funds, investment funds and institutional investor funds. Asset Management offers investment options suited to every investor's needs, including pension savings, other regular savings, investments or asset management. Asset Management also offers funds from other leading global fund management companies.

Investment Banking is divided into Corporate Advisory, Capital Markets and Research. Corporate Advisory advises clients on securities offerings and the admission of securities for trading on regulated securities markets and also provides M&A advisory services. Capital Markets handles securities brokerage and foreign exchange trading for the Bank's clients. Research publishes regular analyses of listed securities, the major business sectors, markets and the Icelandic economy and also produces economic forecasts. Investment Banking's clients are private individuals, companies and institutions.

Treasury is responsible for the Bank's liquidity management as well as currency and interest rate management. The other main functions of Treasury are the internal pricing of interest rates and currency and liaison with other financial institutions.

Other divisions and Subsidiaries include Proprietary trading and market making in domestic securities and currencies. The subsidiaries are Eignabjarg ehf., Eignarhaldsfélagið Landey ehf., Landfestar ehf., Okkar líftryggingar hf., Valitor holding hf. and other smaller entities of the Group.

Headquarters: Overhead, Risk Management, Accounting, Legal, Operations and Corporate Development.

8. Summary of the Group's business segments:

1.1.-31.3.2013	Corporate Banking	Retail Banking	Asset Management and Stefnir	Investment Banking	Treasury	Other divisions and Subsidiaries	Headquarters and Elimination	Total
Net interest income	2,162	2,499	161	25	1,893	(472)	20	6,288
Other income	(984)	(524)	756	2,437	(832)	1,405	218	2,476
Operating income	1,178	1,975	917	2,462	1,061	933	238	8,764
Operating expense	(180)	(1,413)	(324)	(153)	(62)	(1,682)	(2,785)	(6,599)
Earnings before tax	998	562	593	2,309	999	(749)	(2,547)	2,165
Net seg. rev. from ext. customers	3,452	5,525	87	2,414	(4,285)	1,563	8	8,764
Net seg. rev. from other segments	(2,274)	(3,550)	830	48	5,346	(630)	230	-
Operating income	1,178	1,975	917	2,462	1,061	933	238	8,764
Depreciation and amortisation	-	45	-	-	-	47	170	262
Total assets	244,374	325,785	4,953	26,002	225,675	80,676	-	907,465
Total liabilities	205,274	298,314	2,019	21,842	195,361	52,369	-	775,179
Allocated equity	39,100	27,471	2,934	4,160	30,314	28,307	-	132,286
1.1.-31.3.2012								
Net interest income	2,713	2,453	487	68	977	(443)	(41)	6,214
Other income	57	1,136	552	338	1,018	1,490	50	4,641
Operating income	2,770	3,589	1,039	406	1,995	1,047	9	10,855
Operating expense	(198)	(1,395)	(293)	(145)	(44)	(1,296)	(2,431)	(5,802)
Earnings before tax	2,572	2,194	746	261	1,951	(249)	(2,422)	5,053
Net seg. rev. from ext. customers	4,666	2,828	(114)	365	(1,912)	4,916	106	10,855
Net seg. rev. from other segments	(1,896)	761	1,153	41	3,907	(3,869)	(97)	-
Operating income	2,770	3,589	1,039	406	1,995	1,047	9	10,855
Depreciation and amortisation	-	39	-	-	-	57	121	217
Total assets	283,449	310,170	4,381	17,094	198,578	85,700	-	899,372
Total liabilities	238,098	286,481	3,964	17,366	163,281	71,171	-	780,361
Allocated equity	45,351	23,689	417	(272)	35,297	14,529	-	119,011

The vast majority of the revenues from external customers is attributable to customers in Iceland.

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Net interest income

9. Interest income and interest expense is specified as follows:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Cash and balances with Central Bank	319	171
Loans and receivables	13,720	12,884
Securities	2,278	2,147
Other	155	96
Interest income	16,472	15,298
Deposits	(5,560)	(4,935)
Borrowings	(4,265)	(3,646)
Subordinated liabilities	(335)	(430)
Other	(24)	(73)
Interest expense	(10,184)	(9,084)
Net interest income	6,288	6,214
Net interest income from assets and liabilities at fair value	2,278	2,147
Interest income from assets not at fair value	14,194	13,151
Interest expense from liabilities not at fair value	(10,184)	(9,084)
Net interest income	6,288	6,214

Increase in book value of loans and receivables

10. Increase in book value of loans and receivables is specified as follows:

Increase in book value of loans to corporates	2,234	62
Increase in book value of loans to individuals	139	57
Increase in book value of loans and receivables	2,373	119

The increase in book value of loans and receivables is determined in accordance with the accounting policy presented in Note 8 a) in the annual Financial Statements for 2012. Increase in book value of loans and receivables consists of adjustment to reflect actual and estimated cash flows.

Impairment of loans and receivables

11. Impairment of loans and receivables is specified as follows:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Impairment (reversal) of loans and receivables to credit institutions	(31)	29
Impairment of loans and receivables to customers	2,726	166
Impairment of loans and receivables	2,695	195

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

Net fee and commission income

12. Fee and commission income and expense is specified as follows:

	2013	2012
Fee and commission income	1.1.-31.3.	1.1.-31.3.
Asset management	873	523
Cards	1,685	2,246
Collection and payment services	250	234
Investment banking	214	123
Interbank clearing	173	175
Lending and guarantees	186	249
Other fee and commission income	279	256
Fee and commission income	3,660	3,806
Fee and commission expense		
Asset management	(47)	(57)
Cards	(863)	(1,062)
Collection and payment services	(4)	(5)
Investment banking	(12)	(18)
Interbank clearing	(173)	(180)
Other fee and commission expense	(112)	(148)
Fee and commission expense	(1,211)	(1,470)
Net fee and commission income	2,449	2,336

Asset management fees are earned by the Group on trust and fiduciary activities where the Group holds or invests assets on behalf of the customers.

Net financial income (expense)

13. Net financial income (expense) is specified as follows:

	2013	2012
	1.1.-31.3.	1.1.-31.3.
Dividend income	4	2
Net gain (loss) on financial assets and financial liabilities classified as held for trading	122	(53)
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	444	397
Net financial income (expense)	570	346

14. Dividend income is specified as follows:

Dividend income on trading assets	4	2
Dividend income	4	2

15. Net gain (loss) on financial assets and financial liabilities held for trading is specified as follows:

Net gain (loss) on equity instruments and related derivatives	216	98
Net gain (loss) on interest rate instruments and related derivatives	2	(277)
Net gain (loss) on other derivatives	(96)	126
Net gain (loss) on financial assets and financial liabilities held for trading	122	(53)

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16. Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss is specified as follows:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Net gain (loss) on interest rate instruments designated at fair value	107	403
Net gain (loss) on equity instruments designated at fair value	337	(6)
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	444	397

Net foreign exchange gain (loss)

17. Net foreign exchange gain (loss) is specified as follows:

From loans and receivables	(7,489)	5,456
From cash and cash equivalents	(5,330)	2,347
From deposits and borrowings	8,677	(5,708)
From subordinated liabilities	2,194	(1,941)
On bonds, equity instruments and derivatives	834	789
On other assets and liabilities	(283)	140
Net foreign exchange gain (loss)	(1,397)	1,083

Other operating income

18. Other operating income is specified as follows:

Rental income from investment properties	559	488
Fair value changes on investment property	-	33
Realised gain on investment property	133	17
Earned premiums, net of reinsurance	255	214
Net gain (loss) on disposals of assets other than held for sale	5	18
Other income	224	177
Other operating income	1,176	947

Personnel and salaries

19. The Group's total number of employees is as follows:

Average number of full time equivalent positions during the period	1,187	1,157
Full time equivalent positions at the end of the period	1,187	1,179

The Parent company's total number of employees is as follow:

Average number of full time equivalent positions during the period	950	918
Full time equivalent positions at the end of the period	950	930

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

20. Salaries and related expense are specified as follows:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Salaries	2,538	2,349
Defined contribution pension plans	342	323
Salary related expense	442	373
Salaries and related expense	3,322	3,045

Salaries and related expense for the Parent company are specified as follows:

Salaries	2,009	1,876
Defined contribution pension plans	271	253
Salary related expense	361	261
Salaries and related expense	2,641	2,390

Other operating expense

21. Other operating expense is specified as follows:

Direct operating expense derived from rental-earning investment properties	141	115
Claims incurred, net of reinsurance	82	82
Other operating expense	223	197

Tax expense

22. Income tax recognised in the Statement of Comprehensive Income is specified as follows:

Current tax expense		
Current period	894	832
Deferred tax expense		
Changes in temporary differences	(308)	229
Total income tax expense	586	1,061

The Icelandic corporation tax rate is 20%. Effective tax rate of the Group is 27.0% and reconciles as follows:

	1.1.-31.3.2013		1.1.-31.3.2012	
Earnings before tax		2,165		5,053
Income tax using the Icelandic corporation tax rate	20.0%	433	20.0%	1,010
Additional 6% tax on financial institutions	10.4%	225	4.5%	228
Non-deductible expense	4.8%	103	1.9%	96
Tax exempt revenues	(5.2%)	(112)	(6.6%)	(333)
Tax incentives not recognised in the Statement of Comprehensive Income	(7.1%)	(154)	0.0%	-
Non-deductible taxes	0.0%	-	1.2%	60
Other changes	4.2%	91	0.0%	-
Effective tax rate	27.0%	586	21.0%	1,061

Financial institutions pay 6% additional tax on taxable profit exceeding ISK 1,0 billion. It is presumed that the tax rates remain unchanged.

Arion Bank Interim Consolidated Financial Statements 31 March 2013 18 Amounts are in ISK millions

NOTES TO THE INTERIM FINANCIAL STATEMENTS

23. Bank Levy

Bank levy is calculated according to law. The levy is 0.041% on total debt excluding tax liabilities at end of the period. Non-financial subsidiaries are exempt from this tax. Additional temporary levy of 0.0875% is assessed for the years 2012 and 2013 to meet the funding of a special interest relief provided to individual tax payers. The additional levy was fully expensed in the years 2011 and 2012.

Net gain (loss) from discontinued operations, net of tax

24. Net gain (loss) from discontinued operations, net of tax is specified as follows:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Net gain (loss) from legal entities	12	803
Net loss on revaluation and disposal of real estate	(91)	(43)
Other assets	-	(33)
Net gain (loss) from discontinued operations, net of tax	(79)	727

Net gain (loss) from legal entities comprises the Group's share of net profit after tax from operations of legal entities that were classified as held for sale during the period.

Earnings per share

25. Earnings per share are specified as follows:

	Discontinued operations			
	Excluded		Included	
	2013 1.1.-31.3.	2012 1.1.-31.3.	2013 1.1.-31.3.	2012 1.1.-31.3.
Net earnings attributable to the shareholders of Arion Bank	1,776	3,584	1,697	4,311
Weighted average share capital:				
Weighted average number of outstanding shares for the period, million	2,000	2,000	2,000	2,000
Basic earnings per share	0.89	1.79	0.85	2.16
Diluted earnings per share	0.89	1.79	0.85	2.16
Number of outstanding shares at the end of the period, million	2,000	2,000	2,000	2,000
Number of total shares at the end of the period, million, diluted	2,000	2,000	2,000	2,000

There were no instruments at the end of the period that could potentially dilute basic earnings per share.

Arion Bank Interim Consolidated Financial Statements 31 March 2013 19 Amounts are in ISK millions

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Cash and balances with Central Bank

26. Cash and balances with Central Bank are specified as follows:

	31.3.2013	31.12.2012	31.3.2012
Cash on hand	3,187	3,495	3,717
Cash with Central Bank	16,362	17,514	5,949
Mandatory reserve deposit with Central Bank	8,550	8,737	8,364
Cash and balances with Central Bank	28,099	29,746	18,030

The mandatory reserve deposit with Central Bank is not available for the Group to use in its daily operations.

Loans and receivables to credit institutions

27. Loans and receivables to credit institutions specified by types of loans:

Bank accounts	72,254	84,164	62,065
Money market loans	24,817	13,763	853
Overdrafts	-	-	1
Other loans	7,146	3,888	3,839
Provision on loans and receivables	(773)	(804)	(803)
Loans and receivables to credit institutions	103,444	101,011	65,955

28. Changes in the provision for losses on loans and receivables to credit institutions are specified as follows:

Balance at the beginning of the period	804	774	774
Provision for losses (reversal) during the period	(31)	70	29
Write-offs during the period	-	(40)	-
Provision for losses on loans and receivables to credit institutions	773	804	803

Loans and receivables to customers

29. Loans and receivables to customers specified by types of loans:

31.3.2013	Individuals	Corporates	Total
Overdrafts	17,729	19,172	36,901
Credit cards	8,724	720	9,444
Mortgage loans	195,895	5,488	201,383
Subordinated loans	-	541	541
Other loans and receivables	40,145	330,440	370,585
Provision on loans and receivables	(15,248)	(38,080)	(53,328)
Loans and receivables to customers	247,245	318,281	565,526

31.12.2012			
Overdrafts	17,236	18,470	35,706
Credit cards	10,302	769	11,071
Mortgage loans	190,897	4,376	195,273
Subordinated loans	-	573	573
Other loans and receivables	43,560	340,208	383,768
Provision on loans and receivables	(19,222)	(40,559)	(59,781)
Loans and receivables to customers	242,773	323,837	566,610

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

29. cont.

31.3.2012	Individuals	Corporates	Total
Overdrafts	16,921	15,947	32,868
Credit cards	11,063	950	12,013
Mortgage loans	186,208	3,800	190,008
Subordinated loans	-	583	583
Other loans and receivables	33,561	367,857	401,418
Provision on loans and receivables	(13,296)	(39,440)	(52,736)
Loans and receivables to customers	234,457	349,697	584,154

The total book value of pledged loans at the end of the period was ISK 172 billion (31.12.2012: ISK 167 billion and 31.3.2012: ISK 168 billion). Pledged loans comprised mortgage loans to individuals, loans to municipals and loans to state related entities that were pledged against amounts borrowed.

Further analysis of loans and receivables is provided in Risk Management Disclosures.

30. Changes in the provision for losses on loans and receivables to customers are specified as follows:

1.1.-31.3.2013

	Specific	FX rulings	Collective	Total
Balance at the beginning of the period	41,499	14,942	3,341	59,782
Provision for losses during the period	2,310	292	124	2,726
Write-offs during the period	(2,170)	(6,251)	(8)	(8,429)
Transferred to liabilities	-	(815)	-	(815)
Payment of loans previously written off	64	-	-	64
Balance at the end of the period	41,703	8,168	3,457	53,328

1.1.-31.12.2012

Balance at the beginning of the year	32,953	13,823	9,513	56,289
Provision for losses during the year	11,818	5,744	(118)	17,444
Write-offs during the year	(3,830)	-	(6,054)	(9,884)
Transferred to liabilities	-	(4,625)	-	(4,625)
Payment of loans previously written off	557	-	-	557
Balance at the end of the year	41,498	14,942	3,341	59,781

1.1.-31.3.2012

Balance at the beginning of the period	32,953	13,823	9,513	56,289
Provision for losses during the period	(2,128)	1,766	528	166
Write-offs during the period	(913)	-	(2,876)	(3,789)
Payment of loans previously written off	70	-	-	70
Balance at the end of the period	29,982	15,589	7,165	52,736

Arion Bank Interim Consolidated Financial Statements 31 March 2013 21 Amounts are in ISK millions

NOTES TO THE INTERIM FINANCIAL STATEMENTS

Financial assets and financial liabilities

31. Financial assets and financial liabilities are specified as follows:

31.3.2013	Amortised cost	Trading	Designated at fair value	Total
Loans and receivables				
Cash and balances with Central Bank	28,099	-	-	28,099
Loans and receivables to credit institutions	103,444	-	-	103,444
Loans and receivables to customers	565,526	-	-	565,526
Loans and receivables	697,069	-	-	697,069
Bonds and debt instruments				
Listed	-	4,090	42,973	47,063
Unlisted	-	2,881	75,582	78,463
Bonds and debt instruments	-	6,971	118,555	125,526
Shares and equity instruments with variable income				
Listed	-	722	2,354	3,076
Unlisted	-	1,412	8,401	9,813
Bond funds with variable income	-	2,495	1,591	4,086
Shares and equity instruments	-	4,629	12,346	16,975
Derivatives				
OTC derivatives	-	1,179	-	1,179
Derivatives	-	1,179	-	1,179
Securities used for hedging				
Bonds and debt instruments	-	869	-	869
Shares and equity instruments	-	984	-	984
Securities used for hedging	-	1,853	-	1,853
Other financial assets	5,708	-	-	5,708
Financial assets	702,777	14,632	130,901	848,310
Liabilities at amortised cost				
Due to credit institutions and Central Bank	21,617	-	-	21,617
Deposits	462,255	-	-	462,255
Borrowings	204,394	-	-	204,394
Subordinated liabilities	32,052	-	-	32,052
Liabilities at amortised cost	720,318	-	-	720,318
Financial liabilities at fair value				
Short position in bonds	-	11,111	-	11,111
Derivatives	-	187	-	187
Financial liabilities at fair value	-	11,298	-	11,298
Other financial liabilities	32,787	-	-	32,787
Financial liabilities	753,105	11,298	-	764,403

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31. cont.

31.12.2012	Amortised cost	Trading	Designated at fair value	Total
Loans and receivables				
Cash and balances with Central Bank	29,746	-	-	29,746
Loans and receivables to credit institutions	101,011	-	-	101,011
Loans and receivables to customers	566,610	-	-	566,610
Loans and receivables	697,367	-	-	697,367
Bonds and debt instruments				
Listed	-	2,132	42,441	44,573
Unlisted	-	3,515	69,642	73,157
Bonds and debt instruments	-	5,647	112,083	117,730
Shares and equity instruments with variable income				
Listed	-	374	2,446	2,820
Unlisted	-	1,037	8,682	9,719
Bond funds with variable income	-	2,623	1,682	4,305
Shares and equity instruments	-	4,034	12,810	16,844
Derivatives				
OTC derivatives	-	788	-	788
Derivatives	-	788	-	788
Securities used for hedging				
Bonds and debt instruments	-	1,460	-	1,460
Shares and equity instruments	-	978	-	978
Securities used for hedging	-	2,438	-	2,438
Other financial assets	5,030	-	-	5,030
Financial assets	702,397	12,907	124,893	840,197
Liabilities at amortised cost				
Due to credit institutions and Central Bank	32,990	-	-	32,990
Deposits	448,683	-	-	448,683
Borrowings	195,085	-	-	195,085
Subordinated liabilities	34,220	-	-	34,220
Liabilities at amortised cost	710,978	-	-	710,978
Financial liabilities at fair value				
Short position in bonds	-	12,490	-	12,490
Derivatives	-	975	-	975
Financial liabilities at fair value	-	13,465	-	13,465
Other financial liabilities	35,141	-	-	35,141
Financial liabilities	746,119	13,465	-	759,584

Arion Bank Interim Consolidated Financial Statements 31 March 2013 23 Amounts are in ISK millions

31. cont.

31.3.2012	Amortised cost	Trading	Designated at fair value	Total
Loans and receivables				
Cash and balances with Central Bank	18,030	-	-	18,030
Loans and receivables to credit institutions	65,955	-	-	65,955
Loans and receivables to customers	584,154	-	-	584,154
Loans and receivables	668,139	-	-	668,139
Bonds and debt instruments				
Listed	-	1,160	53,592	54,752
Unlisted	-	61	87,680	87,741
Bonds and debt instruments	-	1,221	141,272	142,493
Shares and equity instruments with variable income				
Listed	-	220	1,415	1,635
Unlisted	-	722	8,434	9,156
Bond funds with variable income	-	2,314	1,991	4,305
Shares and equity instruments	-	3,256	11,840	15,096
Derivatives				
OTC derivatives	-	1,313	-	1,313
Derivatives	-	1,313	-	1,313
Securities used for hedging				
Bonds and debt instruments	-	1,204	-	1,204
Shares and equity instruments	-	898	-	898
Securities used for hedging	-	2,102	-	2,102
Other financial assets	6,933	-	-	6,933
Financial assets	675,072	7,892	153,112	836,076
Liabilities at amortised cost				
Due to credit institutions and Central Bank	37,032	-	-	37,032
Deposits	462,193	-	-	462,193
Borrowings	192,109	-	-	192,109
Subordinated liabilities	34,047	-	-	34,047
Liabilities at amortised cost	725,381	-	-	725,381
Financial liabilities at fair value				
Short position in bonds	-	7,682	-	7,682
Derivatives	-	416	-	416
Financial liabilities at fair value	-	8,098	-	8,098
Other financial liabilities	33,358	-	-	33,358
Financial liabilities	758,739	8,098	-	766,837

Included in unlisted Bonds and debt instruments designated at fair value is the Drómi bond, which the Group received when acquiring deposits from SPRON hf. in March 2009.

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32. Bonds and debt instruments designated at fair value specified by issuer:	31.3.2013	31.12.2012	31.3.2012
Financial and insurance services	69,883	70,142	69,065
Governments	47,607	40,679	64,273
Corporates	1,065	1,262	7,934
Bonds and debt instruments designated at fair value	118,555	112,083	141,272

The total amount of pledged bonds at the end of the period was ISK 21.3 billion (31.12.2012: ISK 35.7 billion and 31.3.2012: ISK 22.1 billion). Pledged bonds comprised Icelandic Government Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

33. Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and
Level 3: valuation techniques which include significant inputs that are not based on observable market data.

Further information regarding fair value measurement are set out in Note 71 in the annual Financial Statements for the year 2012.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

31.3.2013	Level 1	Level 2	Level 3	Total
Financial assets designated at FV through P/L	4,560	124,855	1,487	130,902
Financial assets held for trading	5,733	8,875	22	14,630
	10,293	133,730	1,509	145,532
Financial liabilities held for trading	11,111	187	-	11,299
31.12.2012				
Financial assets designated at FV through P/L	3,702	119,277	1,914	124,893
Financial assets held for trading	4,226	8,660	21	12,907
	7,928	127,937	1,935	137,800
Financial liabilities held for trading	12,490	975	-	13,465
31.3.2012				
Financial assets designated at FV through P/L	6,674	144,357	2,081	153,112
Financial assets held for trading	3,252	4,618	22	7,892
	9,926	148,975	2,103	161,004
Financial liabilities held for trading	7,682	416	-	8,098

The classification of assets between financial assets designated at fair value through profit or loss and financial assets held for trading in 2013 is consistent with the classification used in 2012.

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33. cont.

The following table shows transfers from Level 1 to Level 2 on the fair value hierarchy for financial assets and financial liabilities which are recorded at fair value:

	31.3.2013	31.12.2012	31.3.2012
Financial assets designated at FV through PL	-	-	916

The financial assets were transferred from Level 1 to Level 2 in 2012 as they ceased to be actively traded during the year and fair values were consequently obtained using valuation techniques using observable market inputs.

There have been no transfers from Level 2 to Level 1 in 2013 and 2012.

Movements in Level 3 financial instruments measured at fair value

The level of the fair value hierarchy of financial instruments is determined at the beginning of each reporting period. The following table shows the movements of Level 3 financial assets and financial liabilities:

	31.3.2013	31.12.2012	31.3.2012
Balance at the beginning of the period	1,937	2,021	2,021
Gain (loss) recognised in Statement of Comprehensive Income	35	191	73
Acquisition	-	105	-
Disposal	(372)	(391)	-
Transfers into Level 3	-	9	9
Transfers out of Level 3	(91)	-	-
Balance at the end of the period	1,509	1,935	2,103

The following table shows the line items in the Statement of Comprehensive Income where gain (loss) related to fair value measurements in Level 3 is recognised:

	2013 1.1.-31.3.	2012 1.1.-31.12.	2012 1.1.-31.3.
Net interest income	27	151	44
Net financial income (expense)	27	3	1
Net foreign exchange gain (loss)	(19)	37	28
Gain (loss) recognised in the Statement of Comprehensive Income	35	191	73

The following table presents the carrying amounts and fair values of financial assets and financial liabilities that are not carried at fair value in the Interim Financial Statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

31.3.2013

Financial assets not carried at fair value	Carrying value	Fair value	Unrealised gain (loss)
Cash and balances with Central bank	28,099	28,099	-
Loans and receivables to credit institutions	103,444	103,444	-
Loans and receivables to customers	565,526	553,935	(11,590)
Other financial assets	5,708	5,708	-
Financial assets not carried at fair value	702,777	691,186	(11,590)

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33. cont.

Financial liabilities not carried at fair value	Carrying value	Fair value	Unrealised gain (loss)
Due to credit institutions and Central bank	21,617	21,617	-
Deposits	462,255	462,775	(520)
Borrowings	204,394	201,505	2,889
Subordinated loans	32,052	32,052	-
Other financial liabilities	32,787	32,787	-
Financial liabilities not carried at fair value	753,105	750,736	2,369

Net unrealised loss not recognised in the Statement of Comprehensive Income (9,221)

31.12.2012

Financial assets not carried at fair value			
Cash and balances with Central bank	29,746	29,746	-
Loans and receivables to credit institutions	101,011	101,011	-
Loans and receivables to customers	566,610	555,468	(11,142)
Other financial assets	5,030	5,030	-
Financial assets not carried at fair value	702,397	691,255	(11,142)

Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	32,990	32,990	-
Deposits	448,683	449,047	(364)
Borrowings	195,085	195,562	(478)
Subordinated loans	34,220	34,220	-
Other financial liabilities	35,141	35,141	-
Financial liabilities not carried at fair value	746,119	746,960	(842)

Net unrealised loss not recognised in the Statement of Comprehensive Income (11,984)

Comparative information for 31 March 2012 is not available.

As financial assets and financial liabilities predominantly bear interest at floating rates, the difference between book values and fair value of financial assets and financial liabilities is deemed to be immaterial.

Investment property

34. Investment property is specified as follows:	31.3.2013	31.12.2012	31.3.2012
Balance at the beginning of the period	28,918	27,100	27,100
Additions during the period	97	3,729	186
Disposals during the period	(903)	(3,494)	(1,452)
Fair value adjustments	-	1,584	33
Investment property	28,112	28,919	25,867

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

Investments in associates

35. The Group´s interest in its principal associates are as follows:

	31.3.2013	31.12.2012	31.3.2012
Audkenni hf., Borgartún 31, 105 Reykjavík, Iceland	20.0%	20.0%	20.0%
Bakkavör Group Ltd., West Marsh Road, Spalding, Lincolnshire, United Kingdom	30.1%	30.1%	-
Farice ehf., Smáratorg 3, 201 Kópavogur, Iceland	43.5%	43.5%	43.5%
GO fjárfesting ehf., Undirheimar, 845 Flúdir, Iceland	30.0%	30.0%	30.0%
Klakki ehf., Ármúli 3, 108 Reykjavík, Iceland	36.3%	36.3%	44.9%
Kríuvarp ehf., Borgartún 35, 105 Reykjavík, Iceland	-	-	25.0%
Reiknistofa bankanna hf., Kalkofnsvegur 1, 150 Reykjavík, Iceland	23.3%	23.3%	23.3%
Reitir fasteignafélag hf., Kringlan 4-12, 103 Reykjavík, Iceland	42.7%	42.7%	42.7%
Sementsverksmidjan ehf., Mánabraut 20, 300 Akranes, Iceland	23.6%	23.6%	23.6%
SMI ehf., Smáratorg 3, 210 Kópavogur, Iceland	39.1%	39.1%	39.1%
Ölgerdin Egill Skallagrímsson ehf., Grjótháls 7-11, 110 Reykjavík, Iceland	-	-	20.0%

Investments in associates are specified as follows:

Carrying amount at the beginning of the period	7,050	2,987	2,987
Additions during the period	11	1,658	-
Share of profit (loss) of associates and reversal of impairment	-	2,405	5
Investment in associates	7,061	7,050	2,992

Tax assets and tax liabilities

36. Tax assets and tax liabilities are specified as follows:

	31.3.2013		31.12.2012		31.3.2012	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Current tax	12	2,404	17	1,899	11	2,067
Deferred tax	495	1,079	446	1,338	618	1,266
Tax assets and tax liabilities	507	3,483	463	3,237	629	3,333

Non-current assets and disposal groups held for sale

37. Non-current assets and disposal groups held for sale are specified as follows:

	31.3.2013	31.12.2012	31.3.2012
Legal entities	432	1,733	8,342
Associates	6,384	6,384	8,773
Real estates	4,029	3,275	2,669
Other assets	32	531	2,068
Non-current assets and disposal groups held for sale	10,877	11,923	21,852

The legal entities are subsidiaries that were acquired exclusively with view to resale and are classified as disposal groups held for sale in accordance with IFRS 5.

The associate classified as disposal groups held for sale in accordance with IFRS 5 is HB Grandi hf.

Real estates and other assets classified as non-current assets are generally the result of foreclosures on companies and individuals.

Liabilities associated with the legal entities held for sale are as follows:	31.3.2013	31.12.2012	31.3.2012
Legal entities, total liabilities	758	1,769	4,444

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

Other assets

38. Other assets are specified as follows:

	31.3.2013	31.12.2012	31.3.2012
Accounts receivable	4,028	4,084	2,737
Prepaid expenses	925	687	2,771
Accrued income	499	456	659
Unsettled securities trading	833	125	675
Sundry assets	560	549	998
Other assets	6,845	5,901	7,840

Unsettled securities trading was settled in less than three days from the reporting date.

Other liabilities

39. Other liabilities are specified as follows:

Accounts payable	17,930	19,318	17,875
Provision for paid-up FX loans	5,440	4,625	-
Depositors' and investors' guarantee fund	2,890	2,919	2,932
Insurance claim	2,235	2,138	2,139
Withholding tax	406	1,926	546
Unsettled securities trading	738	842	2,941
Sundry liabilities	9,683	8,580	12,672
Other liabilities	39,322	40,348	39,105

Unsettled securities trading was settled in less than three days from the reporting date.

Borrowings

40. Borrowings are specified as follows:

Covered bonds	128,617	124,992	121,672
Bonds issued	19,273	8,909	9,927
Other loans	56,504	61,184	60,510
Borrowings	204,394	195,085	192,109

The Group did not repurchase any own debts in during the first quarter of 2013 (2012: nil).

At the end of 2011 Arion Bank took over the issuance of covered bonds which had originally been issued by Kaupthing hf. in 2006 to 2008. The bonds in question are covered bonds amounting to ISK 121.7 billion, net outstanding, with security in mortgages and bank deposits in an institutional investment fund, Arion Bank Mortgages Institutional Investor Fund. It is a four-series issue, with two 25-year series and two 40-year series maturing in 2031, 2033, 2045 and 2048. The bonds are inflation-indexed with fixed 3.75% to 4.00% interest. Currently repayment of principal is approximately ISK 1.5 billion a year and total payment including repayment of principal,

In January 2013 Arion Bank issued non-indexed fixed rate covered bonds from its EUR 1.0 billion covered bond programme. The bond issue is nominated in Icelandic Krona, the amount issued was ISK 1.8 billion in the Series ARION CBI 15 and the programme was admitted for trading on NASDAQ OMX Iceland 22 February 2012. The bond bears 6.50% interest and matures in 2015.

The Bank has issued total ISK 6.7 billion from this EUR 1.0 billion covered bond programme, ISK 4.2 billion non-indexed with fixed 6.50% interest rate and ISK 2.5 billion inflation indexed with fixed 3.60% interest.

Book value of listed bonds was ISK 9,938 million at the end of the period. Market value of those bonds was ISK 10,621 million.

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Subordinated liabilities

41. Subordinated liabilities are specified as follows:

	31.3.2013	31.12.2012	31.3.2012
Tier II capital	32,052	34,220	34,047
Subordinated liabilities	32,052	34,220	34,047

The interest on the loan is 3 month Euribor/Libor +400 bps to the year 2015 and thereafter 3 month Euribor/Libor +500 bps.

Derivatives

42. Derivatives at fair value are specified as follows:

	Fair value	
31.3.2013	Assets	Liabilities
Forward exchange rate agreements, unlisted	247	70
Interest rate and exchange rate agreements, unlisted	427	-
Bond swap agreements, unlisted	49	65
Share swap agreements, unlisted	23	44
Options - purchased agreements, unlisted	433	8
Derivatives	1,179	187
31.12.2012		
Forward exchange rate agreements, unlisted	250	92
Interest rate and exchange rate agreements, unlisted	71	792
Bond swap agreements, unlisted	17	42
Share swap agreements, unlisted	16	49
Options - purchased agreements, unlisted	434	-
Derivatives	788	975
31.3.2012		
Forward exchange rate agreements, unlisted	888	77
Interest rate and exchange rate agreements, unlisted	389	246
Bond swap agreements, unlisted	36	89
Share swap agreements, unlisted	-	4
Derivatives	1,313	416

Equity

43. Share capital and share premium

According to the Parent Company's Articles of Association, total share capital amounts to ISK 2,000 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per share at Shareholders' meetings.

	Number (million)	31.3.2013	Number (million)	31.12.2012	Number (million)	31.3.2012
Issued share capital	2,000	75,861	2,000	75,861	2,000	75,861
	2,000	75,861	2,000	75,861	2,000	75,861

Share premium represents excess of payment above nominal value that Shareholders have paid for shares issued by Arion banki hf.

NOTES TO THE INTERIM FINANCIAL STATEMENTS

44. Other reserves are specified as follows:	31.3.2013	31.12.2012	31.3.2012
Statutory reserve	1,637	1,637	1,637
Foreign currency translation reserve	1	2	2
Other reserves	1,638	1,639	1,639

OFF BALANCE SHEET INFORMATION

Obligations

45. The Group has granted its customers guarantees, unused overdraft and loan commitments. These items are specified as follows:

	31.3.2013	31.12.2012	31.3.2012
Guarantees	9,557	9,185	8,402
Unused overdrafts	35,108	34,545	33,613
Loan commitments	37,944	36,001	27,878

46. Depositors' and Investors' Guarantee fund

The Group expensed ISK 187 million during the period to meet payments requirements to the Depositors' and Investors' Guarantee fund according to act no 98/1999 as amended in 2012.

The Icelandic parliament has discussed a bill on a new Depositors' and Investors' Guarantee Fund, without conclusion of the matter. Due to uncertainty of the shape of future legislation the liability brought forward from previous years is not changed from the balance of ISK 2,669 million. The Group has granted the Fund a guarantee for obligations amounting to ISK 3,210 million.

Pledged assets

47. The Group has pledged assets against liabilities as follows:	31.3.2013	31.12.2012	31.3.2012
Assets which have been pledged as collateral against borrowings	253,594	244,653	240,222
Assets which have been pledged as collateral against loans from banks and short positions	21,294	35,701	22,103
Pledged assets against liabilities	274,888	280,354	262,325

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 254 billion at the end of the period (31.12.2012: ISK 245 billion and 31.3.2012: ISK 240 billion). Those assets were mainly pool of mortgage loans to individuals, loans to municipals and loans to state related entities. The book value of those borrowings was ISK 185 billion at the end of the period (31.12.2012: ISK 185 billion and 31.3.2012: ISK 182 billion).

Assets are primarily pledged against borrowings associated with the acquisition of the pledged assets. Two major events are most significant. Assets were acquired from the Central Bank of Iceland in conjunction with the recapitalization of Arion Bank on 8 January 2010 and a portfolio of mortgages was acquired from Kaupthing hf. and is pledged against a structured covered bond that Arion Bank took over as issuer of from Kaupthing hf. at the end of 2011.

The Group has pledged bonds against short term lending from the Central Bank of Iceland and against short positions, related to swap agreements, to hedge market risk of those assets.

Assets under management and under custody

48. Assets under management and assets under custody are specified as follows:	31.3.2013	31.12.2012	31.3.2012
Assets under management	873,356	819,684	659,024
Assets under custody	1,403,746	1,378,454	1,716,230

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

Legal Matters

49. Due to the current economic climate in Iceland litigation against the Group has been uncommonly frequent. The Group has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Group makes adjustments, if appropriate, to account for any adverse effects which the claims may have on its financial standing. At the end of the year, the Group had several unresolved legal claims.

i) Contingent liabilities

Investigation by the Icelandic Competition Authority

The Icelandic Competition Authority (ICA) has opened a formal investigation into alleged abuse of a dominant position and collusion between all card issuers in Iceland, including the Group, following a complaint by Kortathjónustan hf., a credit card payment acquirer, made in 2009. The ICA has also opened a formal investigation into the alleged abuse of their alleged collective dominant position by the three largest retail banks, including the Bank. The investigation was initiated by separate complaints from BYR hf. and MP banki hf. made in 2010. The ICA received a similar complaint from Tryggingamidstödin hf. in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition. The complaint from Tryggingamidstödin hf. concerns the banks' alleged tying of banking services and insurances. The Group has made objections to all of the complaints. The extent of the investigations and outcome of the cases is still uncertain as well as any effect on the Group. However, if the Group will be deemed to have violated the competition law, it could result in a fine or restrictions set on the Bank by the ICA.

Legal proceedings regarding FX loans

The Bank has received a letter from a company stating that the company suffered significant damage, both directly and indirectly, on account of the Bank's actions to satisfy a debt, which resulted in the forced sale of the company's pledged assets. This action was taken as a result of the defaulting of currency-linked loans. In the letter it is requested that the Bank state its position to its liability for damages in the aforementioned circumstances. The Bank is now examining this matter but preliminary estimate is that if the Bank is considered liable for the damage, it will not be material for the Bank.

Two borrowers have issued summons against the Group and where they claim that a clause in their mortgage loan, where it is stated that the bond shall bear a variable interest rate which the Group was authorised to change unilaterally, is illegal and unbinding. The borrowers base their claim on e.g. that the Group neglected its duty to inform them on the basis for the said interest rate and in what circumstances the Group could change the rate. If the courts side with the borrowers in the case, it could have a negative effect on the Group's loan portfolio with variable interest rates in ISK and foreign currency (i.e. foreign currency-linked loans in ISK).

49. cont.

ii) Other legal disputes

Legal proceedings regarding Drómi hf.

One significant court case is a case between Drómi hf. and the Bank. Following a decision issued by the Icelandic Financial Supervisory Authority (FME) on 21 March 2009, the Bank acquired the deposits of SPRON hf. According to the decision the resolution committee of SPRON hf. is supposed to establish a specific limited liability company owned by SPRON hf., later Drómi hf., designed to receive all the assets of SPRON hf. and all security interests, including all liens, guarantees and other comparable interests linked to SPRON hf.'s claims. The subsidiary was then supposed to take over all SPRON hf.'s obligations to the Bank relating to the acquisition of SPRON hf.'s deposit obligations and was supposed to issue a bond to the Bank as compensation for the deposit obligations. This obligation to the Bank was documented with an agreement on repaying the debt. The agreement states that the interest rate on the debt principal shall be determined by the FME at any given time. The FME decided that the debt should bear a given annual interest rate plus an interest premium until the debt has been paid in full. It was also specified that the FME was permitted to review the decision upon request by the parties every six months. In a letter dated 2 December 2009 Drómi hf. insisted that the FME review its former interest rate decision. On 4 February 2011 the FME decided that the debt should bear an annual interest rate which should be the original given interest rate plus the original given interest premium from the takeover date until 30 June 2010, but without an interest premium from that time until the debt has been paid in full. The Bank has brought legal action against the FME and Drómi hf. in an attempt to annul the FME's decision of 4 February 2011. On 4 May 2011 Drómi hf. brought legal action against the FME and the Bank. Drómi hf. principally demands the annulment of all decisions by the FME on interest rates, and secondly demands a different interest rate from the outset. In two judgments pronounced on 7 November 2012, the District Court acquitted Drómi hf. and the FME of the Bank's claims in its case, and also acquitted the Bank and the FME of Drómi hf's. claims in its case. Both cases have been appealed to the Supreme Court of Iceland.

Legal proceedings regarding Stefnir hf.

The winding-up committee of Landsbanki Íslands hf. has brought legal action against Stefnir hf. in Reykjavík District Court. The legal action is based on the winding-up committee's demand to rescind Landsbankinn's payment of money market deposits which matured early in October 2008 to two funds managed by Stefnir hf. The amount involved is ISK 450 million plus interest. Stefnir hf. has previously stated its opinion that the winding-up committee's claims are baseless. Given the fact that court rulings in similar cases have not been unanimous the group has made provision for these cases. Court hearings have taken place and judgement is expected.

Legal proceedings regarding FX loans

With a summons, presented to the Bank on 14 November 2012, Hagar hf., a listed company, claimed from the Bank ISK 1,152 million plus interest from 19 October 2009 until the date of payment, minus a payment of ISK 515 million made on 19 December 2011. The summons followed Hagar hf.'s announcement on the Icelandic Stock Exchange from 21 March 2012, whereby Hagar hf. announced that it had decided to take legal action against the Bank regarding Hagar hf.'s foreign currency linked loans, which it had reimbursed in full to the Bank in October 2009. Hagar hf.'s foreign currency linked loans were recalculated by the Bank in accordance with the Bank's notification of 15 June 2011. The outcome of the recalculation showed that the Bank owed Hagar hf. ISK 515 million, which the Bank subsequently paid to Hagar hf. After the Supreme Court of Iceland had passed its judgment of 15 February 2012 (in case no. 600/2011), Hagar hf. expressed its view to the Bank that, in light of the above judgment, Hagar hf. believed it had a further claim against the Bank regarding said foreign currency linked loans. The Bank has rejected Hagar hf.'s claim and will defend the case in court.

Legal proceedings regarding CPI loans

Recently, there has been discussion in the media where it has been claimed that the indexation of the principal of mortgage loans to consumers to the Consumer Price Index (CPI) is possibly illegal and therefore the appreciation of the principal of each loan, due to the rise of the CPI, should be annulled. Reportedly, there are three court cases in motion regarding this issue, but the Bank is not a party to those cases. If successful in a court case, one possible outcome is that a debtor would receive a part or all of the CPI-indexation of his loan annulled. The Group considers the possibility of this happening remote, and has therefore made no provision due to this.

NOTES TO THE INTERIM FINANCIAL STATEMENTS

The uncertainty regarding the book value of foreign currency lending

50. In two very similar judgments on 16 June 2010, the Supreme Court of Iceland stated that two car loans were in fact loans in Icelandic Krona indexed to a foreign currency exchange rate (rather than loan agreements denominated in foreign currency) and that Act No. 38/2001 on Interest and Price Indexation made such indexation illegal. These judgments were mainly based on the wording of the respective loan documents. In a judgment on 16 September 2010, the Supreme Court of Iceland stated that a loan agreement, which was ruled to be in Icelandic Krona indexed to a foreign currency exchange rate, should bear the non-indexed Icelandic Krona interest rate posted by the Central Bank of Iceland.

On 18 December 2010, the Icelandic Parliament passed an act (Act No. 151/2010) removing legal uncertainty on how to recalculate interest on loans in Icelandic Krona indexed to a foreign currency exchange rate. According to the law, the principal of such loans shall be recalculated from the start date bearing the non-indexed interest rate for the Icelandic Krona posted by the Central Bank of Iceland. Furthermore, the law required that banks recalculate foreign-currency mortgage loans for personal residents before 28 March 2011. As applicable, the loan principal shall be adjusted to the outcome of the recalculation or if the borrower has overpaid, the amount shall be reimbursed. In accordance with the act, the Group recalculated all mortgage loans for personal residents in foreign currency to individuals.

In two similar judgments on 14 February 2011, the Supreme Court stated that two foreign currency loans to small SMEs were in fact loans in Icelandic Krona and indexed to a foreign currency exchange rate. Therefore, these loans were in breach of Act No. 38/2001 on Interest and Price Indexation. The Supreme Court passed another two similar judgments on 8 March 2011 dealing with foreign currency loans. In a ruling on 9 June 2011, the Supreme Court, by a 4-3 vote, stated that a foreign currency loan to a corporate entity was in fact a loan in Icelandic Krona and indexed to a foreign currency exchange rate.

The Group announced on 15 June 2011 that recent rulings made by the Supreme Court provide a precedent for the Group to follow, and that the loans that fall under the conditions set forth by the Supreme Court in its rulings would be recalculated. The Group recalculated around 2,000 loans, to both individuals and corporates. The recalculation came in addition to the recalculation of foreign currency linked mortgage loans which was done in 2010. Therefore, the lion’s share of the Group’s foreign currency linked loans to individuals has been recalculated into ISK denominated loans.

On 15 February 2012, the Supreme Court passed a judgment in the case of Frjálsi fjárfestingarbankinn hf. (Frjálsi). In the judgment, it was stated that loans, which are deemed to be illegal foreign currency-linked loans, can be recalculated with the non-indexed interest rate set by the Central Bank of Iceland, however Frjálsi could not claim from the borrower a higher payment of interest of the loan than the interest the borrower actually paid, if the borrower has paid according to Frjálsi´s payment slips. As the judgment dealt with a dispute which rose from special circumstances the Group considered, at the time, that its precedent was not entirely clear. However, the Group estimated that the loss to the Group‘s foreign loan portfolio arising from the judgment was ISK 13.8 billion. In calculating this estimate, the Group elected to follow the methodology prescribed in an impact analysis conducted by the FME. From the four scenarios prescribed in the FME’s analysis, the Group has selected the one considered to be the most plausible interpretation of the judgment.

On 18 October 2012, the Supreme Court pronounced a judgment in the case Borgarbyggd v Arion Bank. The case tested some of the questions raised by the court’s judgment of 15 February 2012, including whether the principle of that case applied to legal entities. In this case the Supreme Court applied the same principle as in the judgment from February, i.e. that a financial institution could not demand from the borrower higher interest than the borrower actually paid according to payment slips. This applied irrespective of whether it involved a legal entity or not. It can therefore be said that the legal uncertainty relating to the judgment from February has been significantly reduced.

The Group issued a press release on 2 November 2012 announcing that the Group had decided to recalculate foreign currency-linked loans, which were similar to the loan disputed in the judgment of 18 October 2012. The loans in question were loans to individuals and smaller companies where there was a payment slip for payment of interest and capital in accordance with each loan’s original terms.

50. cont.

The first Supreme Court of Iceland judgment which discussed the legality of a loan owned by Arion Bank hf. was pronounced on 15 June 2012, in the case the Bank v Háttur ehf. The case concerned the legality of the company's loan agreement where the loan amount is specified as "the equivalent to" a certain amount in Icelandic Krona in CHF (70%) and JPY (30%); the loan amount was disbursed to the borrower in foreign currency and the majority of the loan was repaid in foreign currency. The majority of the Supreme Court concluded that it was a legitimate FX loan, particularly with reference to the name of the loan agreement, the specification of the loan amount and interest and the way in which the loan was paid out and how repayments and interest were repaid, as it was considered that both parties had discharged their duties with amounts in foreign currencies having changed hands. The Supreme Court came to the same conclusion in a judgment pronounced on 1 November 2012, in the case of Arion Bank v P. Arnason fasteignir ehf. In that case, the loan amount is specified as "the equivalent to" a certain amount in Icelandic Krona in USD (25%), CHF (30%), JPY (20%) and EUR (25%); the loan amount was disbursed to the borrower in foreign currency, but the loan had been repaid in Icelandic Krona. In its reasoning the Supreme Court stated that according to the loan agreement between the parties, the borrower was intended to repay the loan in foreign currencies, irrespective of whether he actually did. As both parties had or were intended to discharge their duties with foreign currency changing hands, the Supreme Court considered the loan to be a legitimate loan in foreign currencies. The Group believes that comparable loan agreements with companies and individuals at the Group are subject to the precedent set by both these judgments. It is therefore clear that a decision has been reached by the courts on the legality or, in some circumstances, illegality of the majority of the Group's FX loans to companies and individuals.

In light of the aforementioned judgments, the Group has provisioned a total amount of ISK 19.9 billion of wich ISK 6.3 billion have been written-off in Q1 2013. The remaining balance of ISK 13.6 billion is divided into ISK 8.2 billion provision against loans that are still on the Group's balance sheet and ISK 5.4 billion liability to meet payment obligations related to loans that have been paid up.

On 18 April 2013, the Bank decided to recalculate loans where the loan amount is specified as "the equivalent to" a certain amount in Icelandic Krona in a certain foreign currency (one or more) and, when the currencies are more than one, the percentage in each currency; the loan amount was disbursed to the borrower in Icelandic Krona and two or more repayments were done in foreign currency. In total the decision applies to about 75 loans. The effect on the loan portfolio by this decision is within the provision mentioned above.

In a judgment of 23 April 2013, the Supreme Court considered that two loans, where the loan amount was stipulated as the "the equivalent to" a certain amount in Icelandic Krona in foreign currency or Icelandic Krona which the parties would decide on later, were in fact foreign currency-linked loans in Icelandic Krona. The Bank is evaluating the judgment's reasoning and effect on the Bank's loan portfolio.

Conclusion

Although there is more clarity in the matters of FX loans, due to the judgments pronounced by the Supreme Court of Iceland since the Group's last annual Financial Statements there still remains uncertainty regarding foreign currency linked loans in three respects:

Firstly, the estimation uncertainty associated with the Group's interpretation of the impact of the Supreme Court of Iceland judgments of 15 February and 18 October 2012. Uncertainty exists with regard to, firstly, the Group's preliminary determination of the specific loans that require recalculation and, secondly, uncertainty with regard to assumptions used in the method of recalculation of loans to customers that were determined to fall within the scope of the judgment. As noted above, this uncertainty is somewhat mitigated by the use of FME prescribed methodology. In the event the Group's interpretation of the judgments of 15 February and 18 October 2012 were to change, the loss could be greater or less than the current estimate of ISK 19.9 billion.

Secondly, there have been claims that currency-linked loans to consumers should, from the date they have been recalculated and until the loans are repaid, bear their contractual interest rates, and not the non-indexed interest rate for the Icelandic Krona posted by the Central Bank of Iceland, as stipulated in Act No. 151/2010. This will probably be determined by future court rulings, for which it is currently not possible to predict the outcome.

Thirdly, the legal uncertainty over the outcome of future legal decisions and new or amended government legislation that may require the recalculation of other categories of foreign currency loans that the Group has not previously considered as vulnerable. This will be determined by future court rulings and government actions, for which it is not currently possible to predict an outcome. Some uncertainty still exists over the impact of the above matters on the carrying value of the Group's portfolio of foreign currency linked loans at the end of the year.

Nevertheless, the Group considers its porfolio of foreign currency linked loans fully provisioned for the most likely outcome.

NOTES TO THE INTERIM FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOW

51. Non-cash items included in net earnings before income tax and other adjustments:

	2013 1.1.-31.3.	2012 1.1.-31.3.
Increase in book value of loans and receivables	(2,373)	(119)
Impairment of loans and receivables	2,695	195
Depreciation and amortisation	262	217
Share of loss (profit) of associates and fair value change	-	(5)
Investment property, fair value change	-	(33)
Net foreign exchange loss (gain)	1,397	(1,083)
Net loss (gain) on financial assets and liabilities at fair value through profit or loss	(565)	(397)
Net loss (gain) on disposal of property and equipment	(1)	(18)
Net loss (gain) on disposal of investment property	(133)	(17)
Impairment loss on remeasurement to fair value of HFS legal entities	-	122
	1,282	(1,138)

52. Changes in operating assets and liabilities are specified as follows:

Mandatory reserve with Central Bank of Iceland	187	196
Loans and receivables to credit institutions	(14,682)	3,280
Loans and receivables to customers	(6,468)	(17,463)
Bonds and debt instruments	(7,084)	(705)
Shares and equity instruments	159	(1,254)
Derivatives and financial liabilities at fair value	(1,575)	3,008
Other assets	(937)	1,220
Due to credit institutions and Central Bank of Iceland	(11,373)	20,872
Deposits	17,812	(30,599)
Borrowings	13,752	1,958
Subordinated liabilities	26	-
Other liabilities	(1,400)	(563)
	(11,583)	(20,050)

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RISK MANAGEMENT DISCLOSURES

Introduction

53. As a financial institution, the Group faces various risks arising from its day to day operations. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability as well as to be able to ensure that the Group's exposure to risk remains within acceptable levels.

Further information regarding risk management is available in the annual Financial Statements for 2012 and in the Pillar 3 Risk Disclosures for 2012, published on the Bank's website, www.arionbanki.is.

Credit risk

54. Credit risk

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations.

Credit risk arises anytime the Group commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. The main sources of credit risk are the Group's loan portfolio, commitments and guarantees and derivatives trading.

55. Maximum exposure to credit risk

The following table shows the maximum exposure to credit risk for the components of the Statement of Financial Position, at the end of the reporting period before the effect of mitigation due to collateral agreements or other credit enhancements.

Maximum exposure to credit risk related to on-balance sheet items:

	31.3.2013	31.12.2012	31.3.2012
Cash and balances with Central Bank	28,099	29,746	18,030
Loans and receivables to credit institutions	103,444	101,011	65,955
Loans and receivables to customers	565,526	566,610	584,154
Bonds and debt instruments	125,526	117,730	142,493
Derivatives	1,179	788	1,313
Bonds and debt instruments, hedging	869	1,460	1,204
Other assets with credit risk	5,708	5,030	6,933
Total on-balance sheet maximum exposure to credit risk	830,351	822,375	820,082

Maximum exposure to credit risk related to off-balance sheet items:

	31.3.2013	31.12.2012	31.3.2012
Financial guarantees	9,557	9,185	8,402
Unused overdrafts	35,108	34,545	33,613
Loan commitments	37,944	36,001	27,878
Total off-balance sheet maximum exposure to credit risk	82,610	79,731	69,893
Maximum exposure to credit risk	912,961	902,106	889,975

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

56. Loans and receivables to customers specified by sectors:

	31.3.2013	31.12.2012	31.3.2012
Individuals	43.8%	42.8%	40.1%
Real estate activities and construction	12.6%	12.1%	11.6%
Fishing industry	11.0%	12.0%	13.5%
Information and communication technology	5.0%	5.1%	4.4%
Wholesale and retail trade	9.5%	9.8%	9.9%
Financial and insurance activities	4.6%	4.4%	6.8%
Industry, energy and manufacturing	4.0%	4.0%	4.8%
Transportation	3.6%	3.8%	3.6%
Services	3.4%	3.3%	3.0%
Public sector	1.6%	1.8%	1.3%
Agriculture and forestry	0.9%	0.9%	1.0%
	100.0%	100.0%	100.0%

57. Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty and the exposure type. The main types of collateral obtained are as follows:

- Retail loans to individuals: Mortgages in residential properties.
- Corporate loans: Charges over real estate properties, fishing vessels and other fixed and current assets, inventory and trade receivables, cash and securities.
- Derivative exposures: Cash or treasury bills.

Collateral value is monitored and additional collateral requested in accordance with the underlying agreement. Collateral value is reviewed in line with the adequacy of the allowance for impairment losses.

Collateral held by the Bank against different types of financial assets is specified as follows:

31.3.2013	Cash and securities	Real estates	Fishing vessels	Other collateral	Total collateral	Unsecured ratio %
Cash and balances with Central Bank	-	-	-	-	-	100.0%
Loans and receivables to credit institutions	-	-	-	-	-	100.0%
Loans and receivables to customers:						
Individuals	513	195,591	39	360	196,503	19.2%
Real estate activities and construction	589	45,339	6	557	46,491	36.0%
Fishing industry	1,518	2,052	51,677	5,425	60,672	3.9%
Information and communication technology	79	341	-	18,291	18,711	36.3%
Wholesale and retail trade	2,290	11,767	7	20,189	34,253	38.7%
Financial and insurance activities	8,934	605	-	10	9,549	55.3%
Industry, energy and manufacturing	158	4,394	1	3,362	7,915	69.0%
Transportation	67	456	51	1,284	1,858	91.1%
Services	163	2,589	73	1,721	4,546	74.9%
Public sector	30	3,188	-	101	3,319	64.8%
Agriculture and forestry	5	1,378	-	84	1,467	63.5%
Bond, debt instruments and derivatives	1,341	-	-	68,617	69,958	45.0%
Collateral held against different types of financial assets	15,687	267,700	51,854	120,001	455,242	44.6%

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57. cont.

31.12.2012	Cash and securities	Real estates	Fishing vessels	Other collateral	Total collateral	Unsecured ratio %
Cash and balances with Central Bank	-	-	-	-	-	100.0%
Loans and receivables to credit institutions	-	-	-	-	-	100.0%
Loans and receivables to customers:						
Individuals	556	212,357	40	219	213,172	11.3%
Real estate activities and construction	675	49,416	6	702	50,799	25.9%
Fishing industry	1,877	2,325	58,274	6,222	68,698	0.0%
Information and communication technology	78	547	-	18,312	18,937	34.7%
Wholesale and retail trade	1,909	12,705	-	8,550	23,164	58.2%
Financial and insurance activities	9,924	532	-	8,876	19,332	0.0%
Industry, energy and manufacturing	140	6,659	1	1,189	7,989	64.8%
Transportation	71	503	19	904	1,497	93.1%
Services	252	2,785	57	1,973	5,067	70.5%
Public sector	29	3,261	-	91	3,381	62.1%
Agriculture and forestry	10	1,569	-	12	1,591	59.1%
Bond, debt instruments and derivatives	1,219	-	-	68,628	69,847	42.0%
Collateral held against different types of financial assets	16,740	292,659	58,397	115,678	483,474	40.1%

The information is for loans and collateral at the Bank only.

Comparative information for 31 March 2012 is not available.

58. Credit quality by class of financial assets is specified as follows:

31.3.2013	Neither past due nor impaired	Past due but not impaired	Individu-ally impaired*	Total
Cash and balances with Central Bank	28,099	-	-	28,099
Loans and receivables to credit institutions	103,444	-	-	103,444
Loans and receivables to customers:				
Loans to corporates	274,222	16,602	27,457	318,281
Loans to individuals	206,777	29,361	11,107	247,245
Bonds and debt instruments	125,526	-	-	125,526
Derivatives	1,179	-	-	1,179
Bonds and debt instruments used for hedging	869	-	-	869
Other assets with credit risk	5,708	-	-	5,708
Credit quality of loans and receivables	745,824	45,963	38,564	830,351

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58. cont.

31.12.2012	Neither past due nor impaired	Past due but not impaired	Individu-ally impaired*	Total
Cash and balances with Central Bank	29,746	-	-	29,746
Loans and receivables to credit institutions	101,011	-	-	101,011
Loans and receivables to customers:				
Loans to corporates	275,837	17,851	30,149	323,837
Loans to individuals	200,080	22,845	19,848	242,773
Bonds and debt instruments	117,730	-	-	117,730
Derivatives	788	-	-	788
Bonds and debt instruments used for hedging	1,460	-	-	1,460
Other assets with credit risk	5,030	-	-	5,030
Credit quality of loans and receivables	731,682	40,696	49,997	822,375
31.3.2012				
Cash and balances with Central Bank	18,030	-	-	18,030
Loans and receivables to credit institutions	65,955	-	-	65,955
Loans and receivables to customers:				
Loans to corporates	279,020	26,299	51,016	356,335
Loans to individuals	179,302	27,229	21,288	227,819
Bonds and debt instruments	142,493	-	-	142,493
Derivatives	1,313	-	-	1,313
Bonds and debt instruments used for hedging	1,204	-	-	1,204
Other assets with credit risk	6,933	-	-	6,933
Credit quality of loans and receivables	694,250	53,528	72,304	820,082

* The figures for individually impaired reflects both impairment due to legal uncertainty related to foreign currency loans as well as impairment due to a deterioration in the borrower's credit quality.

59. Past due but not impaired loans by class of loans and receivables:

31.3.2013	Up to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans and receivables to corporates	5,687	1,388	357	9,170	16,602
Loans and receivables to individuals	11,977	4,835	2,770	9,779	29,361
Past due but not impaired loans and receivables	17,664	6,223	3,127	18,949	45,963
31.12.2012					
Loans and receivables to corporates	6,285	951	322	10,293	17,851
Loans and receivables to individuals	8,719	3,558	287	10,281	22,845
Past due but not impaired loans and receivables	15,004	4,509	609	20,574	40,696
31.3.2012					
Loans and receivables to corporates	14,168	1,976	258	9,897	26,299
Loans and receivables to individuals	4,405	8,316	293	14,215	27,229
Past due but not impaired loans and receivables	18,573	10,292	551	24,112	53,528

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59. cont.

The majority of the past due but not impared loans have been acquired at discount. These loans are not considered to be impaired unless the specific allowance exceeds the discount received.

60. Collateral repossessed

During the period, the Group took possession of real estates with the carrying value of ISK 302.7 million and other assets with the value of ISK 1.5 million, all which the Group is in the process of selling, see Note 37.

61. Impaired loans and receivables to customers specified by sector:

	Loans impaired due to borrower credit quality		Loans impaired due to FX-loan court rulings			
31.3.2013	Impair-ment amount	Loan carrying amount	Impair-ment amount	Loan carrying amount	Total im-pairment amount	Total loan carrying amount
Individuals	12,207	19,476	1,401	5,239	13,608	24,715
Real estate activities and construction	4,623	10,313	748	1,939	5,371	12,252
Fishing industry	3,120	6,696	1,785	4,604	4,905	11,300
Information and communication technology	7,559	11,338	108	132	7,667	11,470
Wholesale and retail trade	5,181	8,892	2,226	4,136	7,407	13,028
Financial and insurance activities	6,725	8,538	1,054	1,375	7,779	9,913
Industry, energy and manufacturing	533	1,184	222	444	755	1,628
Transportation	34	39	21	42	55	81
Services	931	1,759	325	542	1,256	2,301
Public sector	29	38	91	141	120	179
Agriculture and forestry	762	1,174	187	395	949	1,569
	41,704	69,447	8,168	18,989	49,872	88,436
31.12.2012						
Individuals	13,143	19,397	5,032	18,626	18,175	38,023
Real estate activities and construction	4,684	10,091	1,586	4,139	6,270	14,230
Fishing industry	2,361	4,343	2,648	6,913	5,009	11,256
Information and communication technology	7,561	11,192	187	307	7,748	11,499
Wholesale and retail trade	5,295	8,399	2,639	5,638	7,934	14,037
Financial and insurance activities	6,405	8,363	1,142	1,492	7,547	9,855
Industry, energy and manufacturing	604	1,152	483	999	1,087	2,151
Transportation	35	40	36	120	71	160
Services	744	1,168	505	1,328	1,249	2,496
Public sector	30	38	262	406	292	444
Agriculture and forestry	636	895	422	1,391	1,058	2,286
	41,498	65,078	14,942	41,359	56,440	106,437

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61. cont.

31.3.2012	Loans impaired due to borrower credit quality		Loans impaired due to FX-loan court rulings			
	Impair-ment amount	Loan carrying amount	Impair-ment amount	Loan carrying amount	Total im-pairment amount	Total loan carrying amount
Individuals	5,756	10,290	6,524	23,278	12,280	33,568
Real estate activities and construction	5,041	12,711	1,597	3,980	6,638	16,691
Fishing industry	1,020	9,128	2,583	3,318	3,603	12,446
Information and communication technology	7,388	2,590	171	453	7,559	3,043
Wholesale and retail trade	3,067	7,993	2,467	9,981	5,534	17,974
Financial and insurance activities	5,138	16,939	57	111	5,195	17,050
Industry, energy and manufacturing	537	3,469	408	2,919	945	6,388
Transportation	37	101	54	121	91	222
Services	769	2,125	553	1,001	1,322	3,126
Public sector	95	816	692	970	787	1,786
Agriculture and forestry	1,133	4,091	483	1,488	1,616	5,579
	29,981	70,253	15,589	47,620	45,570	117,873

This note refines the presentation of impairments by separating those that are due to the uncertainty related to foreign currency loans from impairments that are due to deteriorating borrower credit quality. At 31 March 2013, a provision of ISK 13,608 million had been made for losses due to court rulings for illegal FX loans, in addition to the ISK 6,251 previously written of for this reason. ISK 8,168 million of provisions are due to loans with a carrying value of ISK 18,989 million that are still on the Group's balance sheet. The balance of ISK 5,440 million is due to loans which have been paid up and is accounted for in the Statement of Financial Position as other liabilities. This balance will be paid out following the calculation of the loans.

62. Large exposure

A large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10% of the Group's capital base net of eligible collateral according to FME rules No 216/2007.

The legal maximum for individual large exposures is 25% of capital base and the sum of all large exposures cannot exceed 400% of capital base.

The largest exposure to a group of connected clients at the end of the period was ISK 30 billion (31.12.2012: ISK 29 billion and 31.3.2012: ISK 33 billion) before taking account of eligible collateral, excluding claim on Drómi. The Group has four large exposures at the end of the period (31.12.2012: four exposures and 31.3.2012: five exposures) net of eligible collateral.

	31.3.2013		31.12.2012		31.3.2012	
no.	Gross	Net	Gross	Net	Gross	Net
1 Drómi	44%	0%	43%	0%	47%	0%
2	19%	19%	18%	18%	19%	18%
3	18%	18%	18%	17%	28%	23%
4	13%	13%	14%	14%	20%	20%
5	11%	11%	11%	11%	20%	12%
6	<10%	<10%	<10%	<10%	11%	11%
Sum of exposure gross > 10%	105%	61%	104%	60%	135%	74%

No large exposure exceeds the legal limit of 25% of the Group's capital base at the end of the period. The Ministry of Finance has pledged that Arion Bank will be held harmless from the exposure due to the bond claim on Drómi. The FME has ruled that the Group can use the hold harmless statement as a credit enhancement towards the claim on Drómi. Consequently, the Group finds that the net exposure on Drómi is zero.

The sum of all large exposures is 105% of the Group's capital base before collateral mitigation or 61% net of eligible collateral, which is well below the 400% legal maximum.

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Market risk

63. Market risk

Market risk is the current or prospective risk that changes in financial market prices and rates will cause fluctuations in the value and cash flows of financial instruments.

64. Interest rate risk in the non-trading book

The following table shows the sensitivity of net present value of interest bearing assets and liabilities to changes in interest rates by currency and interest fixing period in million of ISK in the Group. Risk is quantified as the net change in value of interest bearing assets and liablities, when assuming a simultaneous parallel shift upwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income.

31.3.2013		0-1Y	1-5Y	5-10Y	10-20Y	>20Y
CPI Indexed linked	ISK	(24)	(618)	(268)	(1,976)	762
Non Indexed linked	ISK	(120)	(434)	33	(27)	(16)
	EUR	54	(2)	-	-	-
	Other	13	(5)	-	-	-
31.12.2012						
CPI Indexed linked	ISK	(35)	(603)	(282)	(1,980)	811
Non Indexed linked	ISK	(102)	(433)	57	-	(10)
	EUR	71	(3)	-	-	-
	Other	(35)	(6)	(50)	-	-

Comparative information for 31 March 2012 is not available.

65. Interest rate risk in the trading book

Interest rate risk in the trading book is quantified in the same way as that of the non-trading book.

31.3.2013		0-1Y	1-5Y	5-10Y	10-20Y	>20Y
CPI Indexed linked	ISK	-	(14)	(129)	(32)	(294)
Non Indexed linked	ISK	(56)	(13)	(52)	(5)	-
	EUR	(1)	-	-	-	-
	Other	(1)	-	-	-	-
31.12.2012						
CPI Indexed linked	ISK	-	(19)	(80)	(5)	(270)
Non Indexed linked	ISK	(50)	(17)	(8)	(36)	-
	EUR	(5)	-	-	-	-
	Other	(2)	-	-	-	-

Comparative information for 31 March 2012 is not available.

66. The table below analyses the Group's assets and liabilities at carrying amount by residual maturity.

31.3.2013 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	28,099	19,549	-	8,550	-	-	-
Loans and receivables to credit institutions	103,444	72,055	31,140	-	249	-	-
Loans and receivables to customers	565,526	4,083	56,102	80,897	205,861	218,583	-
Bonds and debt instruments	125,526	8,089	18	6,273	69,001	42,145	-
Shares and equity instruments	16,975	-	-	-	-	-	16,975
Derivatives	1,179	-	751	-	222	206	-
Assets leg	*30,960*	-	*14,058*	-	*11,274*	*5,628*	-
Liabilities leg	*(29,781)*	-	*(13,305)*	-	*(11,053)*	*(5,423)*	-
Securities used for hedging	1,853	870	-	-	-	-	983
Investment property	28,112	-	-	-	-	-	28,112
Investments in associates	7,061	-	-	-	-	-	7,061
Property and equipment	6,353	-	-	-	-	-	6,353
Intangible assets	5,108	-	-	-	-	-	5,108
Tax assets	507	-	3	9	495	-	-
Non-current assets held for sale	10,877	-	-	-	-	-	10,877
Other assets	6,845	89	3,828	668	1,104	18	1,138
Assets 31.3.2013	907,465	104,735	91,842	96,397	276,932	260,952	76,607
Liabilities							
Due to credit institutions and Central Bank	21,617	10,818	4,186	6,564	49	-	-
Deposits	462,255	259,156	135,307	37,498	24,516	5,778	-
Financial liabilities at fair value	11,298	8	11,284	6	-	-	-
Assets leg	*(10,316)*	*8*	*(10,013)*	*(311)*	-	-	-
Liabilities leg	*10,503*	-	*10,186*	*317*	-	-	-
Short position on bonds	*11,111*	-	*11,111*	-	-	-	-
Tax liabilities	3,483	-	601	1,803	1,079	-	-
Non-current liabilities held for sale	758	-	-	-	-	-	758
Other liabilities	39,322	306	23,219	5,914	3,186	162	6,535
Borrowings	204,394	-	1,838	2,376	27,146	173,034	-
Subordinated liabilities	32,052	-	-	-	-	32,052	-
Liabilities 31.3.2013	775,179	270,288	176,435	54,161	55,976	211,026	7,293
Off-balance sheet items:							
Guarantees	9,557	1,851	1,961	3,509	1,017	1,219	-
Unused overdraft	35,108	713	8,519	10,261	15,535	80	-
Loan commitments	37,944	-	13,813	13,015	11,116	-	-
Off-balance sheet items	82,609	2,564	24,293	26,785	27,668	1,299	-
Net interest sensitivity gap	49,677	(168,117)	(108,886)	15,451	193,288	48,627	69,314

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66. cont.

31.12.2012 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	29,746	21,121	-	8,625	-	-	-
Loans and receivables to credit institutions	101,011	84,033	16,721	-	257	-	-
Loans and receivables to customers	566,610	3,000	47,511	92,258	208,232	215,609	-
Bonds and debt instruments	117,730	7,034	-	25	69,087	41,584	-
Shares and equity instruments	16,844	-	-	-	-	-	16,844
Derivatives	788	-	693	23	72	-	-
Assets leg	*18,737*	-	*16,739*	*444*	*1,554*	-	-
Liabilities leg	*(17,949)*	-	*(16,046)*	*(421)*	*(1,482)*	-	-
Securities used for hedging	2,438	1,460	-	-	-	-	978
Investment property	28,919	-	-	-	-	-	28,919
Investments in associates	7,050	-	-	-	-	-	7,050
Property and equipment	6,311	-	-	-	-	-	6,311
Intangible assets	4,941	-	-	-	-	-	4,941
Tax assets	463	-	-	17	446	-	-
Non-current assets held for sale	11,923	-	-	-	-	-	11,923
Other assets	5,901	64	2,500	2,047	401	18	871
Assets 31.12.2012	900,675	116,712	67,425	102,995	278,495	257,211	77,837
Liabilities							
Due to credit institutions and Central Bank	32,990	12,742	12,360	7,659	229	-	-
Deposits	448,683	268,016	118,584	34,890	24,947	2,246	-
Financial liabilities at fair value	13,465	-	12,575	98	480	312	-
Assets leg	*(25,677)*	-	*(6,037)*	*(4,533)*	*(9,646)*	*(5,461)*	-
Liabilities leg	*26,652*	-	*6,122*	*4,631*	*10,126*	*5,773*	-
Short position on bonds	*12,490*	-	*12,490*	-	-	-	-
Tax liabilities	3,237	-	474	1,425	1,338	-	-
Non-current liabilities held for sale	1,769	-	-	-	-	-	1,769
Other liabilities	40,348	492	25,952	5,180	3,207	308	5,209
Borrowings	195,085	601	1,865	2,858	31,686	158,075	-
Subordinated liabilities	34,220	-	-	-	-	34,220	-
Liabilities 31.12.2012	769,797	281,851	171,810	52,110	61,887	195,161	6,978
Off-balance sheet items:							
Guarantees	9,185	1,806	3,639	1,462	939	1,339	-
Unused overdraft	34,545	691	8,971	11,768	13,035	80	-
Loan commitments	36,001	1,051	19,201	5,816	9,932	1	-
Off-balance sheet items	79,731	3,548	31,811	19,046	23,906	1,420	-
Net interest sensitivity gap	51,147	(168,687)	(136,196)	31,839	192,702	60,630	70,859

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66. cont.

31.3.2012 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	18,030	9,666	-	8,364	-	-	-
Loans and receivables to credit institutions	65,955	62,170	3,533	-	252	-	-
Loans and receivables to customers	584,154	20,244	54,262	81,677	210,261	217,710	-
Bonds and debt instruments	142,493	2,867	38	19,507	79,159	40,922	-
Shares and equity instruments	15,096	-	-	-	-	-	15,096
Derivatives	1,313	-	868	37	408	-	-
Assets leg	*19,736*	-	*15,081*	*528*	*4,127*	-	-
Liabilities leg	*(18,423)*	-	*(14,213)*	*(491)*	*(3,719)*	-	-
Securities used for hedging	2,102	1,205	-	-	-	-	897
Investment property	25,867	-	-	-	-	-	25,867
Investments in associates	2,992	-	-	-	-	-	2,992
Property and equipment	6,186	-	-	-	-	-	6,186
Intangible assets	4,863	-	-	-	-	-	4,863
Tax assets	629	-	-	-	-	-	629
Non-current assets held for sale	21,852	-	-	-	-	-	21,852
Other assets	7,840	347	4,552	1,517	419	97	908
Assets 31.3.2012	899,372	96,499	63,253	111,102	290,499	258,729	79,290
Liabilities							
Due to credit institutions and Central Bank	37,032	11,222	23,168	2,642	-	-	-
Deposits	462,193	306,252	83,176	39,903	29,811	3,051	-
Financial liabilities at fair value	8,098	-	7,852	-	246	-	-
Assets leg	*(11,035)*	-	*(10,840)*	-	*(195)*	-	-
Liabilities leg	*11,451*	-	*11,010*	-	*441*	-	-
Short position bonds	*7,682*	-	*7,682*	-	-	-	-
Tax liabilities	3,333	-	-	3,333	-	-	-
Non-current liabilities held for sale	4,444	-	-	-	-	-	4,444
Other liabilities	39,105	4,365	5,564	23,648	(446)	228	5,746
Borrowings	192,109	-	3,419	3,263	16,602	168,825	-
Subordinated liabilities	34,047	-	-	-	-	34,047	-
Liabilities 31.3.2012	780,361	321,839	123,179	72,789	46,213	206,151	10,190
Off-balance sheet items:							
Guarantees	8,402	1,439	893	1,431	3,152	1,487	-
Unused overdraft	33,613	969	9,429	8,837	14,350	28	-
Loan commitments	27,878	377	4,864	9,381	12,444	812	-
Off-balance sheet items	69,893	2,785	15,186	19,649	29,946	2,327	-
Net interest sensitivity gap	49,118	(228,125)	(75,112)	18,664	214,340	50,251	69,100

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67. Inflation risk

The Group is exposed to inflation risk when there is a mismatch between inflation linked assets and liabilities. The total amount of indexed assets is ISK 261.0 billion (31.12.2012: ISK 262.0 billion and 31.3.2012: ISK 246.9 billion) and the total amount of indexed liabilities is ISK 219.2 billion (31.12.2012: ISK 216.8 billion and 31.3.2012: ISK 224.5 billion).

31.3.2013	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI indexed linked				
Loans and receivables to customers	2,376	54,515	194,094	250,985
Bonds and debt instruments	-	190	4,156	4,346
Off-balance sheet position	-	1,105	4,564	5,669
Assets, CPI indexed linked	2,376	55,810	202,814	261,000
Liabilities, CPI indexed linked				
Deposits	62,792	23,562	5,266	91,620
Borrowings	44	499	127,009	127,552
Liabilities, CPI indexed linked	62,836	24,061	132,275	219,172
Net on-balance sheet position	(60,460)	30,644	65,975	36,159
Net off-balance sheet position	-	1,105	4,564	5,669
CPI Balance 31.3.2013	(60,460)	31,749	70,539	41,828
CPI Balance 31.12.2012	(60,232)	18,321	87,051	45,140
CPI Balance 31.3.2012	(71,082)	17,214	76,292	22,424

68. Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Group is primarily exposed to currency risk through a currency mismatch between assets and liabilities. The liabilities of the Group are predominantly ISK denominated deposits whereas the Group's assets consist largely of foreign currency denominated loans to customers. Net exposures per currency are monitored centrally in the Bank.

The following table shows the breakdown of assets and liabilities by currency at the end of the reporting period. Note that net real position is not relevant for 31 March 2013 and 31 December 2012.

Assets	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Cash and balances with Central Bank	17,920	6,084	397	510	461	1,442	1,285	28,099
Loans to credit institutions	22,768	25,730	14,235	1,194	11,747	2,338	25,432	103,444
Loans and receivables to customers	440,741	46,387	22,136	18,149	6,065	9,871	22,177	565,526
Bonds and debt instruments	124,878	-	648	-	-	-	-	125,526
Shares and equity instruments	10,138	5,663	926	-	211	-	37	16,975
Derivatives	567	432	31	7	122	15	5	1,179
Securities used for hedging	1,853	-	-	-	-	-	-	1,853
Investment property	28,112	-	-	-	-	-	-	28,112
Investments in associates	7,061	-	-	-	-	-	-	7,061
Property and equipment	6,353	-	-	-	-	-	-	6,353
Intangible assets	5,108	-	-	-	-	-	-	5,108
Tax assets	507	-	-	-	-	-	-	507
Non-current assets held for sale	10,877	-	-	-	-	-	-	10,877
Other assets	6,035	544	195	-	34	-	37	6,845
Assets 31.3.2013	682,918	84,840	38,568	19,860	18,640	13,666	48,973	907,465

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68. cont.

Liabilities	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Due to credit inst. and Central Bank ..	19,212	997	193	-	42	1,172	1	21,617
Deposits	381,061	27,741	11,913	370	10,862	1,110	29,198	462,255
Financial liabilities at fair value	11,237	-	-	1	-	9	51	11,298
Tax liabilities	3,483	-	-	-	-	-	-	3,483
Non-current liabilities held for sale	758	-	-	-	-	-	-	758
Other liabilities	32,480	2,520	1,386	282	728	1,291	635	39,322
Borrowings	135,351	2,659	20,123	20,167	6,615	9,076	10,403	204,394
Subordinated liabilities	-	25,833	2,483	-	3,736	-	-	32,052
Equity	132,286	-	-	-	-	-	-	132,286
Liabilities 31.3.2013	715,868	59,750	36,098	20,820	21,983	12,658	40,288	907,465
Net on-balance sheet position	(32,950)	25,090	2,470	(960)	(3,343)	1,008	8,685	
Net off-balance sheet position	14,153	(13,867)	2,707	(259)	5,992	(1,245)	(7,481)	
Net position 31.3.2013	(18,797)	11,223	5,177	(1,219)	2,649	(237)	1,204	
31.12.2012								
Net on-balance sheet position	(32,510)	16,235	1,258	(6)	274	3,388	11,361	
Net off-balance sheet position	14,347	(8,624)	3,667	1,239	3,321	(3,672)	(7,800)	
Net position 31.12.2012	(18,163)	7,611	4,925	1,233	3,595	(284)	3,561	
31.3.2012								
Net on-balance sheet position	(52,737)	15,359	12,295	7,340	(681)	11,858	6,566	
Net off-balance sheet position	2,351	1,883	(2,909)	-	4,564	(6,902)	1,013	
Net position 31.3.2012	(50,386)	17,242	9,386	7,340	3,883	4,956	7,579	
Loans to customers with ISK income .	12,933	(2,302)	(991)	(5,920)	(91)	(3,426)	(203)	
Net real position 31.3.2012	(24,191)	5,788	8,276	1,025	2,793	(122)	6,431	

Liquidity risk

69. An important source of funding for the Group is deposits from individuals, corporations and institutional investors. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits.

Secured liquidity

The Bank calculates its secured liquidity ratio from cash on hand and cash balances with the Central Bank of Iceland, Treasury notes and Housing Financing Fund bonds which are held specifically as liquidity reserves and other eligible assets for repo transactions with the Central Bank and compare it with the total interest bearing liabilities.

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69. cont.

The FME has set a guideline for minimum secured liquidity ratio and a minimum cash ratio. These guidelines stipulates that the Bank should have adequate liquidity reserves to withstand an instantaneous deposit outflow of 20% (Secured liquidity ratio), and that cash and cash equivalents shall amount to at least 5% (Cash ratio) of on-demand deposits. The Bank’s ratios during the period were as follows, compared to last year:

	31.3.2013		31.12.2012		31.3.2012	
	Liquidity ratio	Cash ratio	Liquidity ratio	Cash ratio	Liquidity ratio	Cash ratio
Period-end	35%	27%	33%	31%	30%	14%
Maximum	39%	36%	37%	31%	37%	23%
Minimum	32%	20%	28%	10%	30%	11%
Average	35%	27%	32%	17%	34%	15%

Deposit stickiness

The Group's deposit base has been split into seven different categories depending on its stickiness. The term stickiness of deposit defines the past stability of deposit and the projected behaviour over time. A deposit is described as being sticky if it has shown to be a stable funding for the Group in the past and is expected to remain stable in the future. Every depositor within a specific group shares common characteristics that can be used as a measure of stickiness. The criteria for different levels or categories of stickiness include, but not limited to, behaviour of depositor over time, behaviour of depositor in stressed condition, the depositors business relationship with the Group and the maturity of the deposit. These criteria's are based both on qualitative and quantitative methods.

– Due to Central Bank: Excluded from stickiness categorisation;
– Capital controls: Deposits from customers believed to be waiting for the lifting of capital controls;
– Resolution process: Deposits from customers in a resolution process;
– Investors: Deposits from investors who may withdraw when other investment opportunities appear or competitor offers higher deposits rate;
– Deposits - legal entities: Deposits from legal entities with no other business relationship with the Group and not quantified as an active investor;
– Deposits - retail individual: Deposits from retail individual with no other business relationship with the Group and not quantified as an active investor;
– Deposits - legal entities with business relationship: Deposits from legal entities with business relationship with the Group; and
– Deposits - retail individual with business relationship: Deposits from retail individual with business relationship with the Group.

The table below shows the split between different levels of the Group's deposit stickiness at the end of the period, compared to last year, according to the Group's classification. The rating 7 means the stickiest deposits and the rating 1 the least sticky.

% of deposit base:

	31.3.2013		31.12.2012		31.3.2012	
Stickiness rating						
Due to Central Bank		-		12,358		-
1 Capital controls	2%	8,467	2%	8,746	2%	11,653
2 Resolution process	16%	79,526	18%	82,338	14%	70,767
3 Investors	25%	120,461	21%	101,827	24%	117,656
4 Deposits - legal entities	13%	63,737	14%	63,445	14%	71,055
5 Deposits - retail individuals	11%	53,867	11%	53,239	12%	59,237
6 Deposits - legal entities with business relationship	15%	70,567	16%	73,098	17%	82,364
7 Deposits - retail individuals with business relationship	18%	87,247	18%	86,622	17%	86,493
Total	100%	483,872	100%	481,673	100%	499,225

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Capital management

70. The capital base at 31 March 2013 amounts to ISK 158,694 million. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 23.7%, exceeding the minimum legal requirement of 8%.

The Group uses the standardised approach to calculate the capital requirements for credit risk and market risk and basic indicator approach for operational risk.

The Bank carries out an on-going process, the Internal Capital Adequacy Assessment Process (ICAAP), with the aim to ensure that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Group's risk across all risk types and ensure that the Group has sufficient capital in accordance to its risk profile. FME supervises the Group, receives the Group's internal estimation on the capital adequacy (ICAAP) and sets capital requirements for the Group as a whole.

The Group is subject to capital requirements which are specified by the FME following the Supervisory Review and Evaluation Process (SREP). The Group's capital base exceeds the FME's SREP requirements (2012: the same).

A reclassification of securities was made in 2012, from the trading book into the banking book in precise compliance with the Basel II standard. Now only securities in the Bank's proprietary trading book are classified in the trading book, while other securities are classified in the banking book.

The table shows the Group's RWA calculations:	31.3.2013	31.12.2012	31.3.2012
Capital Base			
Share capital	2,000	2,000	2,000
Share premium	73,861	73,861	73,861
Other reserves	1,638	1,639	1,639
Retained earnings	51,269	49,572	37,261
Non-controlling interests	3,518	3,806	4,250
Total Equity	132,286	130,878	119,011
Deduction from Tier 1 capital	(5,630)	(5,404)	(5,491)
Total Tier 1 capital	126,656	125,474	113,520
Tier 2 capital	32,038	34,220	34,047
Total Capital base	158,694	159,694	147,567
Risk weighted assets			
Credit risk	560,844	557,964	576,596
Market risk FX	21,278	20,063	41,577
Market Risk Other	8,303	7,407	31,103
Operational risk	72,329	72,329	58,976
Total Risk weighted assets	662,754	657,763	708,252
Tier 1 ratio	19.1%	19.1%	16.0%
Capital adequacy ratio	23.9%	24.3%	20.8%
Official Tier 1 ratio*	18.9%	19.1%	15.4%
Official Capital adequacy ratio*	23.7%	24.3%	20.2%

* Official capital ratio is based on reviewed retained earnings at 31 March 2013

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NOTES TO THE INTERIM FINANCIAL STATEMENTS

OTHER INFORMATION

Related parties

71. The Group has a related party relationship with Kaupskil ehf., Kaupthing hf., the Group's associates, the Board of Directors of Arion Bank, management personnel of the Bank and close family members of individuals referred to above.

Icelandic State Financial Investments (ISFI, a separate state institution under the Ministry of Finance) manages a 13% stake in Arion Bank. ISFI and related entities are defined as related parties and balances and transactions with these entities are included in the tables below under Shareholders with significant influence over the Group.

No unusual transactions took place with related parties during the period. Transactions with related parties have been conducted on an arm's length basis. There have been no further guarantees provided or received for related party receivables or payables.

31.3.2013

Balances with related parties:	Assets	Liabilities	Net balance
Shareholders with significant influence over the Group	-	(1,976)	(1,976)
Shareholders with control over the Group	758	(57,984)	(57,226)
Board of Directors and key Management personnel	128	(76)	52
Associates and other related parties	55,599	(17,867)	37,732
	56,485	(77,903)	(21,418)

31.12.2012

Balances with related parties:	Assets	Liabilities	Net balance
Shareholders with significant influence over the Group	-	(1,960)	(1,960)
Shareholders with control over the Group	704	(61,095)	(60,391)
Board of Directors and key Management personnel	129	(128)	1
Associates and other related parties	53,737	(16,379)	37,358
	54,570	(79,562)	(24,992)

31.3.2012

Balances with related parties:	Assets	Liabilities	Net balance
Shareholders with significant influence over the Group	-	(1,735)	(1,735)
Shareholders with control over the Group	483	(57,263)	(56,780)
Board of Directors and key Management personnel	172	(303)	(131)
Associates and other related parties	59,170	(27,625)	31,545
	59,825	(86,926)	(27,101)

Events after Balance Sheet date

72. Events after Balance Sheet date

a) On 30 April 2013 creditors of Skipti hf. reached an agreement on financial restructuring of Skipti hf. Arion bank, the largest creditor, will convert some of its claims to shares and if the agreement will be carried through the Bank will hold close to 40% of shares in Skipti hf. The agreement between the creditors will be finalized in the second quarter of 2013 and is expected to have positive effects on the Group's earnings.

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