

ARION BANK'S FINANCIAL RESULTS FOR 2017

IMPROVEMENT IN CORE REVENUES

Arion Bank reported net earnings of ISK 14.4 billion in 2017, compared with ISK 21.7 billion in 2016. Return on equity was 6.6%, compared with 10.5% in 2016.

Total assets amounted to ISK 1,147.8 billion at the end 2017, compared with ISK 1,036.0 billion at the end of 2016. Shareholders' equity totalled ISK 225.6 billion, compared with ISK 211.2 billion at the end of 2016. The Bank has a strong financial position and the focus has been on maintaining good liquidity, both as the capital controls are lifted, and in preparation for the redemptions of public bonds in early 2018.

The Bank's capital ratio at the end of the year was 24.0%, compared with 26.8% at the end of 2016. The CET1 ratio decreased to 23.6% at the end of 2017, compared with 26.1% at the end of 2016. The decrease in CET1 is primarily due to the ISK 25 billion payment of a dividend or the purchase of own shares, which was approved at a shareholders' meeting on 12 February and will be exercised in the coming weeks.

Highlights of the income statement and key income related performance indicators:

<i>In ISK million</i>	2017	2016	Q4 2017	Q4 2016
Net interest income	29,835	29,900	7,265	7,843
Net commission income	15,357	13,977	4,654	3,763
Other income	8,186	10,669	2,005	2,580
Operating income	53,378	54,546	13,924	14,186
Operating expenses	(29,961)	(30,540)	(8,581)	(8,210)
Bank levy	(3,172)	(2,872)	(784)	(682)
Net impairment	186	7,236	1,448	409
Net earnings before taxes	20,431	28,370	6,007	5,703
Income tax expense	(5,806)	(6,631)	(1,735)	(1,227)
Net gain from discontinued operations, net of tax	(206)	0	(206)	0
Net earnings	14,419	21,739	4,066	4,476
KPI's:				
Return on equity (ROE)	6.6%	10.5%	7.3%	8.6%
Earnings per share (ISK)	7.20	10.57	2.02	2.19
Net interest margin (int. bearing assets)	2.9%	3.1%	2.7%	3.2%
Cost-to-income ratio	56.1%	56.0%	61.6%	57.9%

Highlights of the balance sheet and key performance indicators:

<i>In ISK million</i>	31.12.2017	31.12.2016	Diff	Diff%
Loans to customers	765,101	712,422	52,679	7%
Other assets	382,653	323,602	59,051	18%
Liabilities	922,021	824,640	97,381	12%
Equity	225,733	211,384	14,349	7%
Loans to Deposits ratio	165.5%	172.9%		
RWA / Total assets	66.8%	72.0%		
CET 1 ratio	23.6%	26.1%		

For detailed information on the accounts please refer to Arion Bank's Consolidated Interim Financial Statements for the year 2017 on the Bank's website, www.arionbanki.is.



HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK:

“The financial results for 2017 are satisfactory although one-off events did have an effect on the overall picture. The Bank’s core operations are sound, the revenue base is strong and the Bank is financially robust. This enables the Bank to make a special dividend payment of ISK 25 billion which was decided upon at a shareholders’ meeting on 12 February. This dividend payment is consistent with the Bank’s aim to optimize its capital ratio so that it is closer to the ratios of international banks and other Icelandic banks. Despite the dividend the bank’s capital position is strong and well above the requirements made by the regulators. The dividend forms part of the process of selling the Bank, which we expect to be one of the key developments of 2018. Listing Arion Bank on the stock market in Iceland, and even abroad, is one of the options under consideration. A decision on the next phase is likely to be taken in the next few weeks and months.

In March 2017 the first steps in the sale of the Bank were taken when three international investment funds and the investment bank Goldman Sachs came on board as shareholders of Arion Bank. The seller was Kaupthing, through its subsidiary Kaupskil, which sold approximately 30% of its interest in the Bank. The investment funds Attestor Capital and Taconic Capital Advisors were the largest investors and each acquired approximately 10% in the Bank. Attestor Capital then added to its share slightly after the Financial Supervisory Authority deemed the fund to be competent to own a qualifying holding. It was announced today that Kaupthing had sold a 5% stake in the Bank to Attestor Capital and Goldman Sachs and several funds managed by four Icelandic fund management companies. We are especially pleased to add Icelandic investors to our shareholder base.

Arion Bank continues to occupy a strong position on its key markets and the Bank has taken a decisive lead as a provider of cutting edge innovations in the retail banking market. This leading role has delivered better services, higher revenues, increased efficiency and enhanced customer satisfaction. During the year the Bank introduced a whole host of new digital services which were very well received by our customers. The digital mortgage application process has perhaps attracted the most attention, and customers can now undergo a credit assessment and perform the entire application process quickly and easily online. Our objective is to make life easier for our customers by offering them convenient banking and we aim continue along this path.

Arion Bank, along with individual, corporate and investor customers of the Bank, benefits from being a participant in an economy in robust health. The Bank’s target is for loan growth to outpace economic growth, and we achieved this objective in 2017 when loans to customers grew by 7% during the year. Loans to corporates grew by approximately 7% while loans to individuals were up more than 8%. Growth in loans to individuals can almost entirely be attributed to mortgages, despite fierce competition on this market from the pension funds. The swift and convenient service available in the Bank’s new digital application process for mortgages has been integral to our success on this market.

The operational setbacks and eventual bankruptcy of United Silicon left their mark on the annual results. Impairments on loans and investments in the company amounted to ISK 4 billion after tax. The Bank never intended to become a shareholder but as operational difficulties mounted the Bank had to step in and inject additional capital. The Bank has asked the administrator of the estate to foreclose on its collateral in the company with the aim of making necessary improvements to the plant and to sell it as quickly as possible. On the positive side we have detected strong interest in the plant from international investors in the silicon industry.

In 2017 Arion Bank paid off the remainder of the Kaupthing bond issued in 2016 which originally amounted to ISK 97 billion. Consequently, all funding linked to the founding of the Bank had been repaid and Arion Bank is now fully funded on the market and by deposits. Arion Bank is now a regular issuer of bonds on the international capital markets and international investors are taking increasing interest in the Bank as an investment option. The bonds issued by the Bank have performed well on the secondary market which underscores investors’ confidence in the Bank. In the autumn Standard & Poor’s upgraded the Bank’s credit rating to BBB+ from BBB with a stable outlook.

The outlook is good and it is clear that an eventful year is ahead. The Icelandic economy is flourishing and stability characterizes the Icelandic wider society. Arion Bank will continue to develop its services with the aim of making banking more convenient for our customers and the Bank is ready to fully engage in the tasks which await – strengthening the infrastructure and working with our customers in their undertakings.”



HIGHLIGHTS OF 2017

First quarter

- Origo (previously Nýherji) took over the administration of the Bank's IT systems. Approximately 20 employees transferred to Origo.
- Additional bond issues on the European market, when the Bank tapped its 5-year issue for another EUR 200 million (ISK 24 billion). Interest rates in this issue (1.55% fixed coupon) were better than the earlier issue (1.625%).
- The first steps in the sale process of the Bank were taken in March when three international investment funds, Attestor Capital, Taconic Capital Advisors and Och-Ziff Capital Management Group, and the investment bank Goldman Sachs became shareholders by acquiring a 30% stake in Arion Bank.

Second quarter

- 3-year bond issue in euros amounting to EUR 300 million (ISK 34 billion). The proceeds were used to pay off the bond held by Kaupthing since 2016 which was issued as part of the stability agreement between the government and the Kaupthing estate. Arion Bank is now fully funded on the market and by deposits – all debts linked to the government and Kaupthing have been fully repaid. Part of the issue was also used to repay one third of a bond issue in euros maturing in March 2018.
- Eva Cederbalk elected as the new chairman of the board of directors in June.
- Ida Brá Benediktsdóttir appointed managing director of Retail Banking

Third quarter

- Euromoney named Arion Bank as the best bank in Iceland.
- Arion Bank branch at Kringlan shopping mall reopened after extensive refurbishments. The branch is the first of its kind and the focus is on serving customers through digital channels and having longer opening hours.

Fourth quarter

- Lýður Thór Thorgeirsson appointed managing director of Investment Banking.
- Standard & Poor's upgraded the Bank's credit rating to BBB+. The ratings upgrade increases the number of potential investors in the Bank and helps reduce the Bank's funding costs.
- Steinunn Kristín Thórdardóttir elected on to the board of directors in November.

During the year

- Arion Bank introduced a whole range of new digital products which have proven popular among our customers. Credit assessments and mortgage application processes are now fully digital. The Bank is a market leader in Iceland in offering digital solutions.
- A major client, United Silicon, experienced operational difficulties and Arion Bank is involved as a creditor and participant in a share capital increase. The company's operating difficulties resulted in the Bank fully impairing its shareholding during the second quarter. The company was granted a moratorium on payments in August and the Bank, as its main creditor and lienholder, guaranteed payments during the moratorium period. Arion Bank also took possession of a considerable number of shares in United Silicon and subsequently became the company's largest shareholder with 2/3 of the share capital. The Bank funded a number of inspections of the company's operations but the company filed for bankruptcy in 2018 and is now being restructured.
- Arion Bank continued to issue covered bonds and commercial paper on a regular basis. A total of ISK 29.9 billion were issued in covered bonds and ISK 20 billion in commercial paper during the year.
- The Bank has placed great importance on having a diverse funding base. To this end it has held smaller private placements to international investors in various currencies with durations of 1-5 years at favourable terms. These issues totalled ISK 19.6 billion in 2017.
- Preparations continued for the sale of Kaupthing's stake in the Bank. Listing the Bank on a stock market is one of the options under consideration and this work will continue in 2018.



INCOME STATEMENT

<i>In ISK million</i>	2017	2016	Diff	Diff%
Net interest income	29,835	29,899	(64)	(0%)
Net commission income	15,357	13,978	1,379	10%
Net financial income	4,091	5,162	(1,071)	(21%)
Net insurance income	2,093	1,396	697	50%
Share of profit of associates	(925)	908	(1,833)	-
Other operating income	2,927	3,203	(276)	(9%)
Operating income	53,378	54,546	(1,168)	(2%)
Salaries and related expense	(17,189)	(16,659)	(530)	3%
Other operating expenses	(12,772)	(13,881)	1,109	(8%)
Bank levy	(3,172)	(2,872)	(300)	10%
Net impairment	186	7,236	(7,050)	-
Net earnings before taxes	20,431	28,370	(7,939)	(28%)
Income tax expense	(5,806)	(6,631)	825	(12%)
Discontinued operations, net of tax	(206)	0	(206)	-
Net earnings	14,419	21,739	(7,320)	(34%)

Operating income amounted to ISK 53.4 billion, compared with ISK 54.5 billion in 2016. Net commission income and net insurance income increased between years and net interest income was stable. However, Arion Bank's write down of its investment in United Silicon had a considerable impact on operating income in 2017, reducing net financial income (shares and bonds) as well as the share of profit of associates by a total of ISK 1.9 billion.

Net interest income decreased slightly between years. The net interest margin as a percentage of average interest-bearing assets was 2.9% in 2017, compared with 3.1% in 2016. Interest-bearing assets increased by ISK 96 billion from year-end 2016 but high amounts of cash and cash equivalents in foreign currency, which bear low interest rates, and low inflation compared with 2016, mean that net interest income remains relatively unchanged between years.

Net commission income increased by 10% between years, primarily due to increased activity in cards and payment solutions, which increased by 16%, and an increase in commission income due to a rise in lending activity, both new lending and prepayment of loans. Other commissions are similar to last year or slightly higher.

Net financial income amounted to ISK 4,091 million, compared with ISK 5,162 million for 2016. Positive market changes in equity holdings is the main reason for the positive contribution from net financial income while the profit from the sale of the equity share in Visa Europe was the main reason behind last year's positive figures. The Bank's investment in shares and bonds related to United Silicon had a negative effect on net financial income by ISK 965 million in 2017.

Net insurance income amounted to ISK 2,093 million, compared with ISK 1,396 million in 2016. The increase is primarily due to the acquisition of the insurance company Vördur at the end of September 2016 and the positive performance of the insurance operation in general.

Share in the profit of associates and impairment was negative by ISK 925 million, compared with positive ISK 908 million in 2016. This change is mainly due to the ISK 907 million impairment of the Bank's equity holdings in United Silicon in 2017, as the company was classified as an associated company for part of the year. In comparative figures for 2016 the Bank reported a profit from the sale of equity holdings in Bakkavor Group Ltd.

Other operating income was ISK 2,927 million in 2017, compared with ISK 3,203 million in 2016. Fair value changes on investment property affect other operating income in 2017, while profit from the sale of assets had a greater effect on income in 2016.

Operating expenses amounted to ISK 29,961 million, compared with ISK 30,540 million in 2016. The Bank's cost-to-income ratio was 56.1%, compared with 56.0% in 2016. Higher operating expenses in 2017 compared with the previous year are partly related to the subsidiary Vördur, which became part of the Group in late 2016, and higher expenses due to the growth of international operations at the subsidiary Valitor. The increase in operating



expenses is partly offset by the reversal of a liability the Bank had recognized against the Depositors' and Investors' Guarantee Fund in the amount of ISK 2,669 million. The Bank has received confirmation from the Fund that the claim will not be collected. The Cost-to-Total Assets ratio was 2.7% in 2017, compared with 3.0% in 2016.

Salaries and related expenses amounted to ISK 17,189 million, an increase of 3% from the previous year. The increase is mainly due to the acquisition of Vördur and the increased number of employees at the subsidiary Valitor. The average salary per employee decreased by close to 1% between years, but at the same time the salary index in Iceland rose by approximately 7%. The reasons for this include changes in the composition of employees with the arrival of new subsidiaries, and the strengthening of the ISK against foreign currencies, as Valitor, the Bank's largest subsidiary, has some of its operations abroad. Full-time equivalent positions at the end of the year totalled 1,284 at the Group, 45 more than at the end of 2016. The increase is largely a result of Valitor's investments in the UK. The decrease in number of FTEs is ongoing at the parent company, mainly due to the outsourcing of projects, for example in IT operations and the effect of increasing digitalization and automation which has been a focus at the Bank.

Other operating expenses amounted to ISK 12,772 million, an 8% decrease from 2016. As stated above, this decrease is mainly due to the reversal of a liability to the Depositors' and Investors' Guarantee Fund of ISK 2,669 million, but some of the increase is related to the new subsidiary Vördur, the growth of the international operations of Valitor and higher IT expenses due to the outsourcing of segments of the Bank's IT operation in 2017.

Net valuation change was positive by ISK 186 million, compared with ISK 7,236 million in 2016. Prepayments of mortgage loans and composition payments from corporate customers and final loan payments from bankrupt entities, which had previously been impaired, had positive impacts, whereas impairments on loans to United Silicon amounting to ISK 2,962 million had a negative impact, as described above.

Income tax amounted to ISK 5,806 million, compared with ISK 6,631 million in 2016. Income tax, as reported in the annual financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1 billion. The effective income tax rate was 28.4%, compared with 23.4% in 2016. The high tax rate for the year is due to the high proportion of income from the parent company, which calculates an additional 6% tax on income above ISK 1 billion and thus the effective income tax rate is higher.



Fourth quarter of 2017

The financial results for the fourth quarter of 2017 were good. Return on equity was 7.3%, compared with 8.6% in the fourth quarter of 2016.

<i>In ISK million</i>	Q4 2017	Q4 2016	Diff	Diff%
Net interest income	7,265	7,843	(578)	(7%)
Net commission income	4,654	3,763	891	24%
Net financial income	1,620	824	796	97%
Net insurance income	324	733	(409)	(56%)
Share of profit of associates	(8)	198	(206)	(104%)
Other operating income	69	826	(757)	(92%)
Operating income	13,924	14,186	(263)	(2%)
Salaries and related expense	(4,565)	(4,407)	(158)	4%
Other operating expenses	(4,016)	(3,803)	(213)	6%
Bank levy	(784)	(682)	(102)	15%
Net impairment	1,448	409	1,039	254%
Net earnings before taxes	6,007	5,703	304	5%
Income tax expense	(1,735)	(1,227)	(508)	41%
Discontinued operations, net of tax	(206)	0	(206)	-
Net earnings	4,066	4,476	(410)	(9%)

Operating income in the fourth quarter was ISK 13,924 million, which is 2% lower than the same period in 2016. Net interest income decreased by 7% between years, mainly due high amounts of cash and cash equivalents in foreign currency which bear low interest rates. Net commission income increased by 24%, mainly due to increased activity in cards and payment solutions, especially at new subsidiaries of Valitor in the UK. Net financial income was ISK 1,620 million as a result of the positive performance of listed shares and bonds during the quarter. Other operating income decreased due to negative fair value changes in investment properties, compared with positive fair value changes during the same period in 2016.

Operating expenses increased by 5% between quarters as a result of increased activities, especially at the subsidiaries.

Net change in valuation was positive in the fourth quarter and amounted to ISK 1,448 million, compared with ISK 409 million during the same period in 2016. This is mainly due to prepayments of mortgage loans and positive economic developments which contribute to a lower loan provision.



Earnings of operating segments

Arion Bank divides its operations into five profit centers plus subsidiaries and support units. The Bank's profit centers are Asset Management, Corporate Banking, Investment Banking, Retail Banking and Treasury.

All of the Bank's profit centers made a profit before income tax in 2017, except Investment Banking.

2017 In ISK million	Asset Management	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other div., headq. and subsidiaries	Total
Net interest income	502	6,002	240	15,502	6,536	1,053	29,835
Net commission income	4,011	1,171	1,298	4,703	(312)	4,486	15,357
Other income	164	1,370	(71)	946	(8)	5,785	8,186
Operating income	4,677	8,543	1,467	21,151	6,216	11,324	53,378
Operating expenses	(2,157)	(2,781)	(1,432)	(11,039)	(726)	(11,826)	(29,961)
Bank levy	(182)	(671)	(39)	(1,097)	(1,183)	0	(3,172)
Net impairment	0	(1,794)	(53)	2,489	70	(526)	186
Net earnings before taxes	2,338	3,297	(57)	11,504	4,377	(1,028)	20,431

2016 In ISK million	Asset Management	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other div., headq. and subsidiaries	Total
Net interest income	535	6,436	1,104	14,992	6,093	740	29,900
Net commission income	3,863	1,082	1,808	3,537	(345)	4,033	13,978
Other income	(53)	356	834	1,173	412	7,946	10,668
Operating income	4,345	7,874	3,746	19,702	6,160	12,719	54,546
Operating expenses	(2,304)	(2,991)	(1,766)	(12,283)	(1,065)	(10,131)	(30,540)
Bank levy	(209)	(609)	(41)	(980)	(1,033)	0	(2,872)
Net impairment	0	33	1,704	5,557	7	(65)	7,236
Net earnings before taxes	1,832	4,307	3,643	11,996	4,069	2,523	28,370

Asset Management comprises Institutional Asset Management, Private Banking, Investment Services and Pension Fund Administration. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. In addition, the division is the main distributor of funds managed by Stefmir hf. to individuals, companies and institutional investors as well as distributing funds managed by international fund management companies. Asset Management also administers pension funds. Stefmir hf. is an independently operating financial company owned by Arion Bank. Stefmir manages a broad range of mutual funds, investment funds and institutional investor funds.

Asset Management

In ISK million	2017	2016	Difference
Net interest income	502	535	(6.2%)
Net commission income	4,011	3,863	3.8%
Other income	164	(53)	-
Operating income	4,677	4,345	7.6%
Operating expenses	(2,157)	(2,304)	(6.4%)
Bank levy	(182)	(209)	(12.9%)
Net earnings before taxes	2,338	1,832	27.6%

The operations of Asset Management are stable and net earnings are good. The increase in operating income between years is mainly due to performance-based commission. Assets under management at year-end amounted to ISK 985 million and decreased by 7% from year-end 2016.



Corporate Banking provides comprehensive financial services and integrated solutions across the Bank's divisions to larger corporate clients in Iceland. Corporate Banking provides a full range of lending products, deposit accounts, payment solutions as well as value-added digital corporate solutions to meet the needs of each customer.

<i>In ISK million</i>	2017	2016	Difference
Net interest income	6,002	6,436	(6.7%)
Net commission income	1,171	1,082	8.2%
Other income	1,370	356	284.8%
Operating income	8,543	7,874	8.5%
Operating expenses	(2,781)	(2,991)	(7.0%)
Bank levy	(671)	(609)	10.2%
Net impairment	(1,794)	33	-
Net earnings before taxes	3,297	4,307	(23.5%)

The net interest margin at Corporate Banking is slightly lower compared with last year as a result of increasing competition in the corporate market. Net commission income is in line with the level of activity in the market. Other income is mainly from valuation change in Investment properties. The negative net valuation changes in the loan portfolio can be primarily attributed to impairments on loans and claims against United Silicon in the third quarter, totalling approximately ISK 3 billion.

Investment Banking is composed of Capital Markets, Corporate Finance and Research. The Investment Banking division provides a full range of investment banking products and services, including equity and fixed income brokerage, initial public offerings, capital markets and M&A advisory to a broad range of customers, including corporate customers, professional investors, asset management companies and pension funds. Arion Bank's research team provides independent analysis on financial markets and the domestic economy.

<i>In ISK million</i>	2017	2016	Difference
Net interest income	240	1,104	(78.3%)
Net commission income	1,298	1,808	(28.2%)
Other income	(71)	834	(108.5%)
Operating income	1,467	3,746	(60.8%)
Operating expenses	(1,432)	(1,766)	(18.9%)
Bank levy	(39)	(41)	(4.9%)
Net impairment	(53)	1,704	(103.1%)
Net earnings before taxes	(57)	3,643	(101.6%)

In 2016 a significant part of Investment banking assets were reclassified to other divisions, mainly to the CEO's Office, which is a part of the headquarters in the segment reporting. Therefore changes in net interest income and other income are quite significant between years. Net commission income, which is the main source of income for the department, was lower, partially due to extensive work on various internal projects such as restructurings. Revenues due to brokerage of shares and bonds by the Capital Markets have been strong and the Bank has been at the forefront in trading on NASDAQ Iceland in recent years.



Retail Banking provides a comprehensive range of services, including deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into five clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Retail Banking's 24 branches all around Iceland have a total of more than 100,000 customers. Arion Bank Mortgages Institutional Investor Fund is a part of Arion Bank's retail operations.

<i>In ISK million</i>	2017	2016	Difference
Net interest income	15,502	14,992	3.4%
Net commission income	4,703	3,537	33.0%
Other income	946	1,173	(19.4%)
Operating income	21,151	19,702	7.4%
Operating expenses	(11,039)	(12,283)	(10.1%)
Bank levy	(1,097)	(980)	11.9%
Net impairment	2,489	5,557	(55.2%)
Net earnings before taxes	11,504	11,996	(4.1%)

Operating income from the period increased by 7.4% between years and the strong focus over the last few years on fee generating operations is resulting in higher income. Operating expenses decreased between years, mainly due to reversal of a liability the Bank had recognized against the Depositors' and Investors' Guarantee Fund. The positive outcome in Net impairment is mainly due to prepayments of mortgages as the interest environment is favorable for customers, while the high positive valuation change on loans in 2016 was due to the revaluation of a mortgage portfolio which was acquired at year-end 2011.

Treasury is responsible for the Bank's liquidity, currency and interest rate management. Other functions of Treasury are funds' transfer pricing and hedging and pricing of financial products.

<i>In ISK million</i>	2017	2016	Difference
Net interest income	6,536	6,093	7.3%
Net commission income	(312)	(345)	(9.6%)
Other income	(8)	412	(101.9%)
Operating income	6,216	6,160	0.9%
Operating expenses	(726)	(1,065)	(31.8%)
Bank levy	(1,183)	(1,033)	14.5%
Net impairment	70	7	900.0%
Net earnings before taxes	4,377	4,069	7.6%

Operating income from Treasury increased slightly between years, mainly due to higher interest income from cash balances at Central Bank and other liquidity but there was a loss from Other income, mainly due to mark to market changes on derivatives which are used for hedging but are not in hedge accounting.



BALANCE SHEET

Arion Bank's **total assets** increased by 11% from year-end 2016. The main reason for the increase is the growth in cash and balances with the Central Bank and loans to customers. Loans to credit institutions increased, mainly due to increased cash.

<i>In ISK million</i>	31.12.2017	31.12.2016	Diff	Diff%
Cash & balances with CB	139,819	87,634	52,185	60%
Loans to credit institutions	86,609	80,116	6,492	8%
Loans to customers	765,101	712,422	52,679	7%
Financial assets	109,448	117,456	(8,008)	(7%)
Investment property	6,613	5,358	1,255	23%
Investments in associates	760	839	(78)	(9%)
Intangible assets	13,848	11,057	2,791	25%
Other assets	25,555	21,142	4,414	21%
Total assets	1,147,754	1,036,024	111,730	11%

Cash and cash balances with Central Bank amounted to ISK 139,819 million at the end of the year, compared with ISK 87,634 million at the end of 2016. The increase is mainly due to increased deposits, primarily in Retail Banking but new borrowings during the year also had a positive effect on liquidity.

Loans to customers totalled ISK 765,101 million at the end of 2017, representing a 7.4% increase from year-end 2016. Loans to corporates increased by 6.7%, mainly in the real estate sector and transportation. Loans to individuals increased by 8.3% during the year, primarily mortgage loans despite strong competition from the pension funds in that market.

Financial assets amounted to ISK 109,448 million at the end of 2017, compared with ISK 117,456 million at the end of 2016. The composition of financial assets has changed as shares have been sold, for example the entire shareholdings in Fasteignafélagið Reitir hf. and Síminn hf. have been sold, but the increase is related to new investment in international debt funds as a part of liquidity management.

Liabilities increased from year-end, which is primarily a result of deposits and new borrowings. **Equity** increased as a result of the positive financial results of 2017.

<i>In ISK million</i>	31.12.2017	31.12.2016	Diff	Diff%
Due to credit institutions & CB	7,370	7,987	(617)	(8%)
Deposits from customers	462,161	412,064	50,097	12%
Financial liabilities at fair value	3,601	3,726	(125)	(3%)
Other liabilities	63,891	61,387	2,504	4%
Borrowings	384,998	339,476	45,522	13%
Shareholders equity	225,605	211,212	14,393	7%
Non-controlling interest	128	172	(44)	(26%)
Total liabilities and equity	1,147,754	1,036,024	111,730	11%

Deposits from customers amounted to ISK 462,161 million at the end of 2017, compared with ISK 412,064 million at the end of 2016, an increase of more than 12%. The increase is mainly due to new deposits from retail customers.

Borrowings amounted to ISK 384,998 million at the end of 2017. In January, Arion Bank tapped its EUR 300 million November 2016 issue for a further EUR 200 million. The proceeds of the tap were partially used to repay the resettable EMTN bonds held by Kaupthing, which were fully repaid and replaced with market funding in June. At the end of June, Arion Bank issued new senior unsecured bonds for a total of EUR 300 million. The bonds are 3-year instruments and were sold at rates corresponding to a 0.88% margin over interbank rates. The proceeds from the issue were used to buy back EUR 100 million of notes maturing in 2018. The Bank participated in eight international private placement issues in 2017, amounting to ISK 19.6 billion in NOK and SEK. The Bank has also continued to issue covered bonds in the Icelandic market, a total of ISK 29.9 billion in 2017.

Shareholders' equity amounted to ISK 225,605 million at the end of 2017, compared with ISK 211,212 million at the end of 2016. The increase is explained by the financial results for the year. No dividend payment was made



in 2017. The CET 1 ratio was 23.6% at the end of the year, compared with 26.1% at the end of 2016. The decrease is chiefly due to the proposed dividend payment and share buyback, approved at a shareholders' meeting on 12 February and to be carried out in the coming weeks. Excluding this, the CET 1 ratio would have been 26.8%. The Bank's capital ratios and liquidity ratios are nevertheless strong and well above the statutory minimums and the benchmarks set by the regulators.

EVENTS AFTER THE END OF THE REPORTING PERIOD AND UP TO PUBLICATION

At a shareholders' meeting on 12 February the board of directors of Arion Bank was given a mandate and the authorization to acquire up to 10% of issued shares in the Bank, in one or more transactions. This authorization is valid until 15 April 2018.

At the same shareholders' meeting approval was given for a conditional dividend payment of up to ISK 25 billion, which is contingent on Kaupskil, which owns 57% of the issued share capital in the Bank, having previously sold no less than 2% in Arion Bank in a private placement. This conditional authorization is valid until 15 April 2018.

At the shareholders' meeting it was also approved that the aforementioned acquisition of shares and dividend would be a maximum of ISK 25 billion.

On 14 February 2018 an announcement was made on the sale by Kaupskil of 5.34% of outstanding shares in Arion Bank to a number of funds managed by four Icelandic fund management companies, who come on board as new investors, and Trinity Investments (Attestor Capital LLP) and Goldman Sachs, who are increasing their stakes in the Bank. If the sale goes ahead, the conditions for the aforementioned dividend payment is therefore fulfilled.



KEY PERFORMANCE INDICATORS

	2017	2016
Return on equity (ROE)	6.6%	10.5%
Return on total assets (ROA)	1.3%	2.1%
Net interest margin (int. bearing assets)	2.9%	3.1%
Net interest margin (total assets)	2.7%	2.9%
Cost-to-income ratio	56.1%	56.0%
Cost-to-Total assets ratio	2.7%	3.0%
Effective tax rate	28.4%	23.5%
CAD ratio	24.0%	26.7%
CET 1 ratio	23.6%	26.1%
Problem loans	1.0%	1.6%
Gross impaired loans/Gross loans	1.6%	3.2%
RWA/Total assets	66.8%	72.0%
Loans to deposit ratio	165.5%	172.9%
The Group's average number of employees	1,250	1,201
The Group's employees at the end of the period	1,284	1,239
The Parent's average number of employees	830	889
The Parent's employees at the end of the period	844	869

FINANCIAL TARGETS

In late 2016 Arion Bank approved the following medium-term targets, for the next four to five years.

- *CET 1 Ratio* Decrease to circa 17%
- *Loan Growth* Prudent lending to outpace economic growth in the next few years
- *RoE* Exceed 10%
- *Dividend Policy* Payout ratio of circa 50% of net earnings attributable to shareholders
- *Cost to Income Ratio* Reduce to circa 50%

CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a conference call in English on Thursday 15 February at 1:00 pm GMT (2:00 pm CET), where Stefán Pétursson, Chief Financial Officer, will discuss the highlights of the Bank's financial results. People interested in participating can contact ir@arionbanki.is to obtain dial-in information.

For further information please contact Haraldur Gudni Eidsson of Arion Bank's Communications division at haraldur.eidsson@arionbanki.is, tel. +354 444 7108, or Sture Stolen in Investor Relations at ir@arionbanki.is.

FINANCIAL CALENDAR FOR 2018

The Bank's Interim Financial Statements are scheduled for publication as stated below.

Annual Report for 2017	1 March 2018
Annual General Meeting	15 March 2018
First quarter 2018	2 May 2018
Second quarter 2018	1 August 2018
Third quarter 2018	31 October 2018

This calendar may be subject to change.