

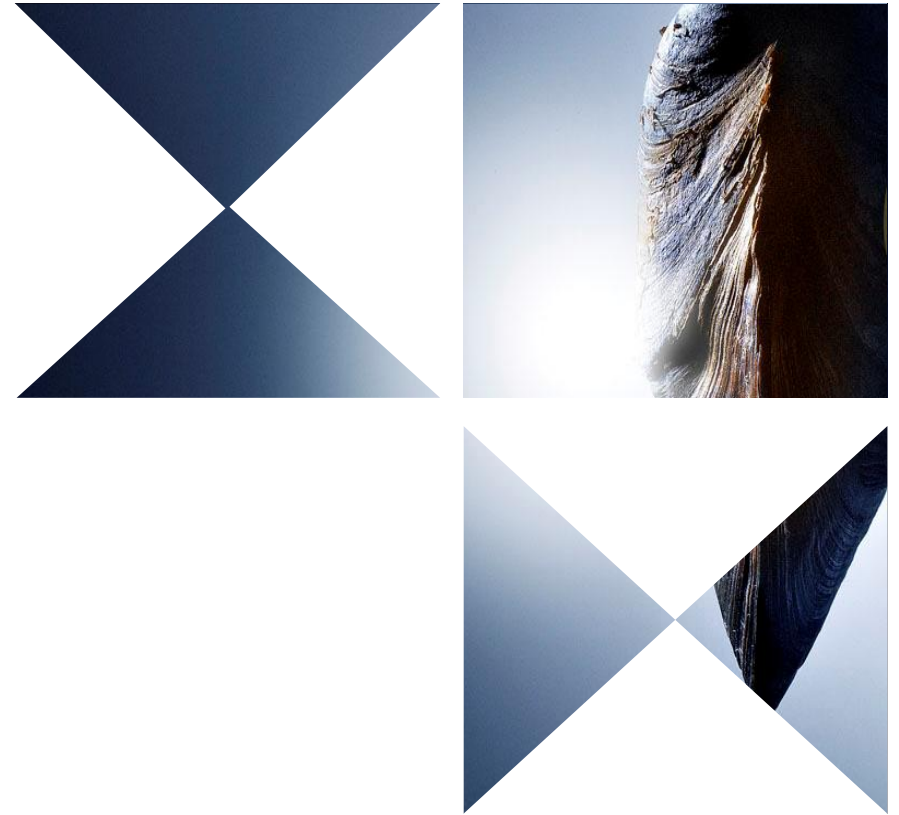
Arion Bank

Stefán Pétursson

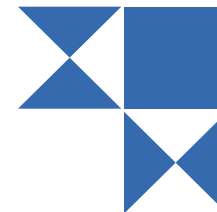
Chief Financial Officer

Ida Brá Benediktsdóttir

Head of Corporate Communications



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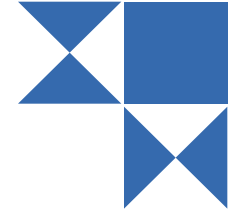


1. Financial statement 1H 2010
2. Funding and liquidity
3. Loans to individuals in foreign currencies
4. The strategic direction



Financial statement *1H 2010*

Profitable since establishment



Net earnings of ISK 7.9 bn. in H1 with an annualised ROE of 17.7%

- Operating income in H1 2010 was ISK 27.7 bn., equals 56% of the total in 2009
- Return on equity 17.7%
- Net interest income of ISK 10.3 billion and commission income of almost ISK 2.9 billion
- Other operational income / expenses high due to subsidiaries taken over and held for sale
- Cost / Income ratio of 56.0%

Income statement - consolidated		
Million ISK	H1 2010	2009
Net interest income	10.297	12.146
Change in valuation on loans and receivables	339	-296
Net interest income less val.on loans and receiv.	10.636	11.850
Net commission income	2.852	5.862
Net financial income	1.407	10.353
Other operating income	12.853	21.570
Operating income	27.748	49.635
Salaries and related cost	-6.208	-10.413
Other operating expenses	-12.102	-23.815
Net earnings before taxes	9.438	15.407
Income taxes	-1.501	-2.536
Net earnings	7.937	12.871

All numbers from 2009, used herein for comparison, are for the 12 months of 2009.

Increasing net interest income

With capitalization from Kaupskil ehf. in January 2010 the CPI Cap became positive

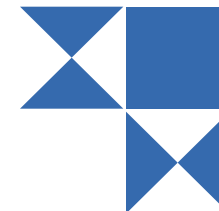
- Net interest income in H1 2010 was ISK 10.3 bn, equals 85.1% of the total in 2009
- The Icelandic Central Bank's interest rates decreased by 2% in H1 2010, falling from 8.5% to 6.5%
- Measured inflation during the period was 2.55%
- During the period the interest cap increased by ISK 4.3 bn, rising from ISK 35.7 bn on 31 December 2009 to ISK 40 bn on 30 June 2010
- The CPI (Consumer Price Index) balance was ISK 16.2 bn on 30 June 2010, compared with -14.7 bn on 31 December 2009. After the capitalization from Kaupskil ehf. in January 2010 the CPI balance became positive by ISK 18.3 bn.

Consumer Price Index (CPI) balance

CPI balance is the difference between consumer price indexed assets on the one hand and consumer priced indexed liabilities on the other.

Net interest income		
Million ISK	H1 2010	2009
Cash and balances with central bank	571	2.793
Loans and receivables	20.946	45.408
Securities	6.501	10.934
Compensation instrument	665	2.411
Other	102	5.359
Total interest income	28.785	66.905
Deposits	16.964	53.060
Borrowings	918	1.564
Subordinated loans	581	0
Securities	0	17
Other	25	118
Total interest expenses	18.488	54.759
Total net interest income	10.297	12.146

Change in valuation of loans and receivables



Net change in value of loans and receivables close to zero

- Value change of ISK 4.5 bn during the period. Main driver was fishing quota prices and higher EBITDA from companies compared to original valuation
- 80% of net increase in value of ring-fenced assets belongs to Kaupthing hf., or ISK 3.4 bn on 30 June 2010
- Main reason for additional impairment was change in value of real estate and rental income for real estate companies

Compensation instrument

Compensation for the value mismatch of assets and liabilities transferred from Kaupthing to Arion Bank

40 largest groups of the loan book valued separately and Kaupskil ehf. will get 80% of upside and Arion Bank 20%

Change in valuation on loans and receivables

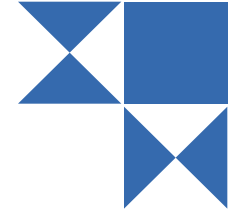
Million ISK	H1 2010	2009
Increase in value of loans and receivables	8.701	20.199
FX gain on loans and receivables from ISK income customers.	-686	1.535
Impairment on loans and receivables	-4.254	-11.474
Changes in compensation instrument*	-3.422	-10.556
Total change in value of loans and receivab.	339	-296

* Changes due to the Escrow and contingent value rights agreement

Increase in value of loans and receivables	H1 2010	2009
Increase in value of ring-fenced assets	7.187	17.827
Increase in value of loans to financial institutions	0	2.127
Increase in other loans	1.514	245
Total increase in value of loans and receiv.	8.701	20.199

Change in compensation instrument - calculation	H1 2010	2009
Increase in valuation of assets during the period	7.370	17.827
Impairment on loans	-3.092	-4.632
Total change on ring-fenced assets	4.278	13.195
Kaupthing share 80%	3.422	10.556
Arion Bank share 20%	856	2.639

Continued asset growth

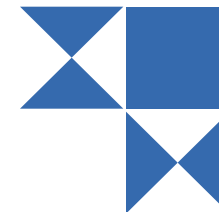


Capital ratio above the 16% requirement of the FME – the Bank also meets the FME/CBI stress test of 20% instantaneous withdrawal of deposits

- The Bank's total assets were ISK 842.2 bn. on 30 June 2010
- Deposits were ISK 600.9 bn. on 30 June 2010
- During the period the exchange rate of the ISK strengthened resulting in lower value on foreign assets and lower liabilities in FX
- Interest-bearing assets are approx. ISK 740.7 bn. on 30 June 2010 and interest-bearing liabilities ISK 700.6 bn.
- Deposits as ratio of loans to customers was 129.0%
- Capital ratio at the end of June was 16.4%
- Liquidity is strong and the Bank meets the FME/CBI stringent stress test of 20% instantaneous withdrawal of deposits

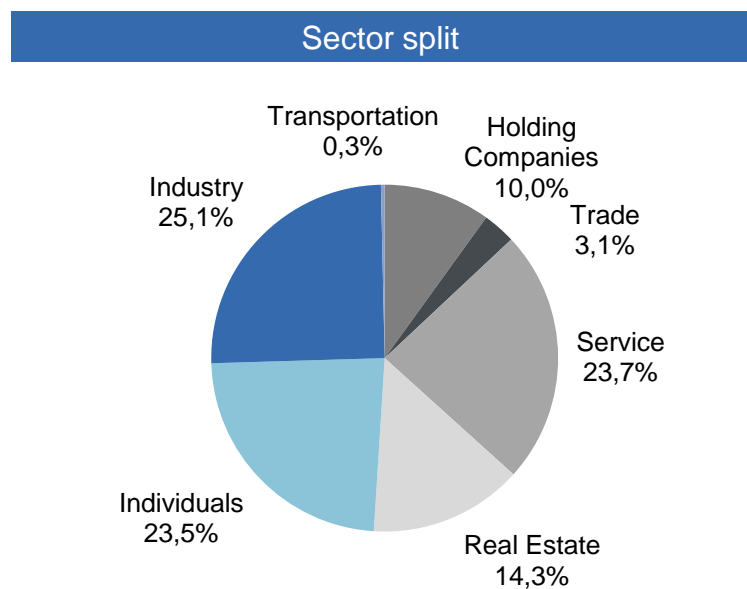
Consolidated Statement of Financial Position			
Million ISK	30.06.2010	8.01.2010	31.12.2009
Cash and balances with CB	33.259	41.906	41.906
Loans to credit institutions	42.803	38.470	38.470
Loans to customers	466.021	470.558	357.734
Financial assets	162.548	150.207	182.802
Compensation instrument	29.917	34.371	34.371
Intangible assets	2.970	3.512	3.512
Investments in associates	6.127	5.985	5.985
Other assets	98.606	92.564	92.564
Total assets	842.251	837.573	757.344
Deposits from cred. inst. and CB	107.508	99.219	113.647
Deposits	493.438	495.465	495.465
Borrowings	67.480	72.294	11.042
Subordinated loans	26.084	29.543	0
Other liabilities	46.101	47.156	47.156
Equity	101.640	93.896	90.034
Total liabilities and equity	842.251	837.573	757.344

Well diversified loan portfolio

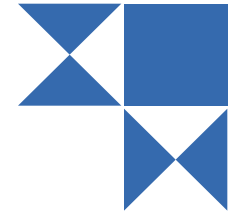


Restructuring of the loan book one of the most important near-term tasks

- The Bank's total loans to customers were ISK 466 bn. on 30 June 2010
- Loans were purchased at fair value by Arion Bank when it was established
 - Substantial difference between nominal value and book value
 - One of the most important tasks today is to restructure the loan book – both in regards to loans to individuals and corporations
 - Substantial progress being made with 2/3 of the larger companies already restructured and thousands of individuals have had their loans restructured
 - Restructuring work expected to be completed by mid year 2011



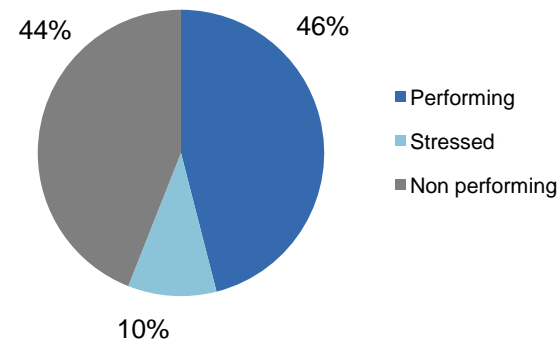
Performance of loan book by book value



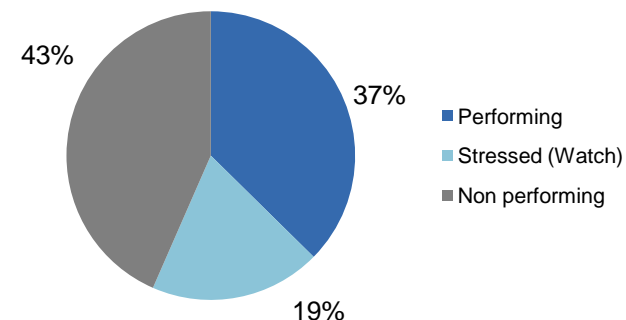
During 2010 there has been an increase in loans categorised as stressed (watch list) at the cost of performing loans

- Main reasons for the increase in stressed (watch listed) loans
 - A fair part of loans injected on 8 January were originally categorised as performing but have now been put on watch list
 - Stricter conditions for loans to be categorised as performing
 - An increase in loans that are between 30 and 90 days in default
- Non-performing are loans that are:
 - More than 90 days in default.
 - The borrower is currently in restructuring
 - Have received specific provisions.
 - The borrower has taken advantage of payment holidays of both principal and interest payments.
- Stress loans are those that are:
 - Between 30 and 90 days in default.
 - The borrower has taken advantage of payment holidays, paying only interests.

Loan book by book value 8 Jan 2010

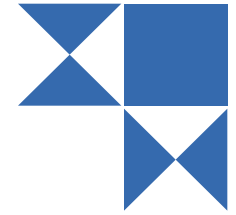


Loan book by book value 30 Sep 2010



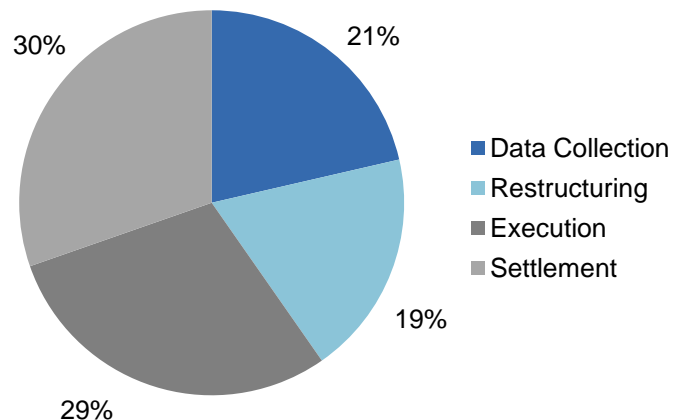
Companies in recovery

201 companies are currently going through the recovery process

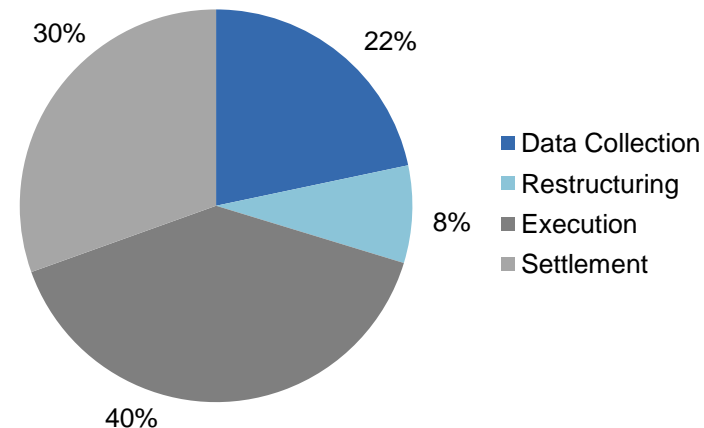


- Number of companies in the recovery process is 201
 - 137 from Corporate Banking and 64 from Retail Banking

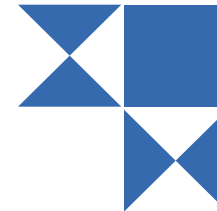
Status of recovery cases by number



Status of recovery cases by book value



Development of recovery cases



180 recovery cases have been closed or are in collection process

- Main changes to status of recovery cases

Date	Collecting / Processing data	Restructuring	Execution	Settlement Process	Collection Process	Closed	Total
23.09.2009	69	45	42	0	24	2	182
20.11.2009	81	54	56	8	51	19	269
22.01.2010	80	58	52	6	61	49	306
12.03.2010	73	60	53	8	73	53	320
10.05.2010	28	72	58	25	88	59	330
30.09.2010	43	38	59	61	45	135	381

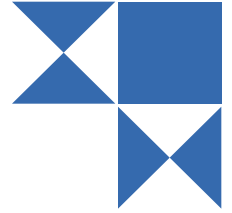
- Closed cases are completed through one of the following:
 - Refinancing
 - Sold
 - Foreclose on collateral
 - Payment in full
- We expect major restructuring cases to be decided and processed before mid year 2011



Funding and liquidity

Funding strategy

Foreign funding within the near to medium term



- Currently Arion Bank is mainly funded with domestic deposits
- The objective is to diversify the funding with domestic bond issuance
- Medium-term objective is to have access to foreign funding
- The Bank will enter discussions with ratings agencies in the new year
- The Bank's relationships and funding efforts will be strengthened
- The Bank will step up its investor relations activities in 2011

External prerequisites for foreign funding

- Stability within the Icelandic economy
- Solution to the Icesave dispute
- Benchmark issue by the Icelandic state

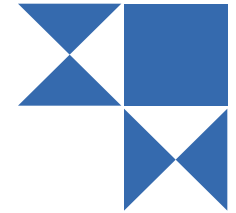
Internal prerequisites for foreign funding

- Clear vision and strategy
- 2-3 full years of operational history
- International credit ratings

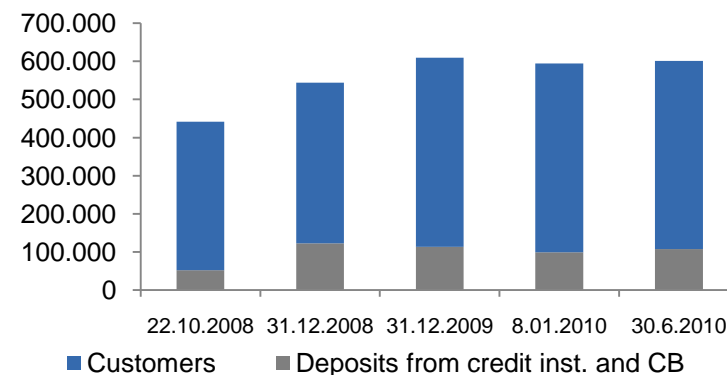
Liquidity and deposits

Arion Bank has a liquidity ratio of 27.4%

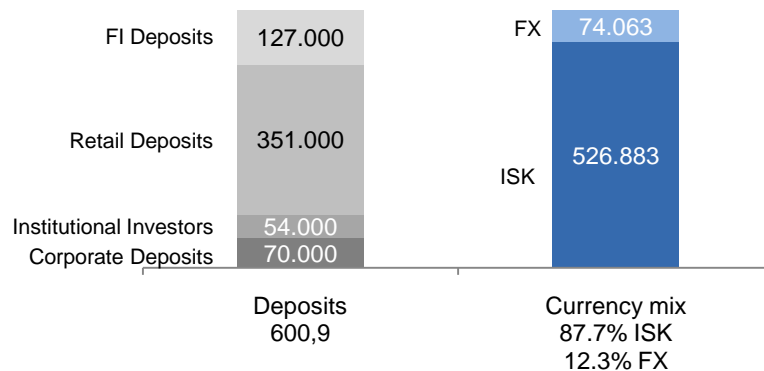
- The Bank meets the FME/CBI stress tests of 20% instantaneous withdrawal of deposits and 5% cash ratio
- Around 70% of deposits were from retail and corporate customers at end of 2009
- Deposits grew in the first half of 2009 due to acquisitions of two savings banks



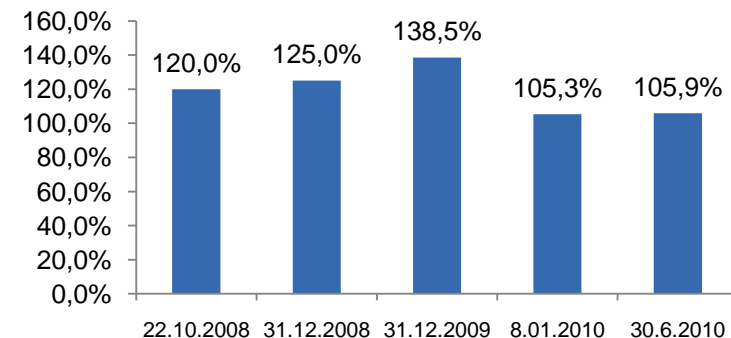
Deposit Development



Breakdown of deposits and liquidity 30 June 2010



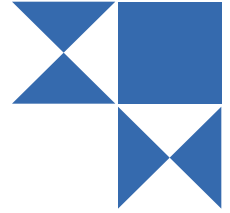
Deposit / Loans to customers





Loans to individuals in *foreign currencies*

The crux of the dispute is the distinction between FX-denominated and FX-linked loans



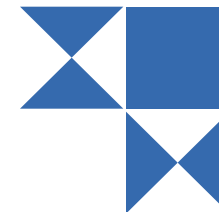
- For years Icelandic financial institutions offered loans in foreign currencies to the general public
 - Most borrowers had no income in foreign currencies
 - The availability of these loans was a reaction to the market's demand for alternatives to inflation-indexed, ISK-denominated loans during a period of high inflation and high interest rates
- The financial institutions that offered their customers FX loans believed that these loans complied with Icelandic law
- The Icelandic Financial Supervisory Authority (FME) and the Central Bank of Iceland (CBI) never made any attempts to halt this development
- At a later point the question arose whether these FX loans were in fact FX-denominated or ISK-denominated and linked to foreign currencies

Uncertainty

Icelandic law dictated that lending in foreign currencies was legal but lending in ISK and linking the principal and repayments on the loan to foreign currencies was illegal

Which loans are in fact FX-denominated and therefore legal and which are ISK-denominated but linked to foreign currencies and therefore illegal?

Great uncertainty followed recent rulings by the Icelandic courts



	District Court	Supreme Court	Uncertainty
Case A	Ruling: An FX automobile loan deemed <i>legal</i>	Ruling: The decision of the District Court overruled and FX auto loan deemed <i>illegal</i>	Which FX loans are legal and which are not?
Case B	Ruling: An FX auto loan deemed <i>illegal</i> The loan deemed to be an ISK-denominated loan linked to foreign currencies	Ruling: The decision of the District Court confirmed and the FX automobile loan deemed <i>illegal</i>	What should the interest rate be on the illegal FX loans? Should they be as stated in each contract, low FX interests, or in line with the CBI's interest rates?
Case C	Ruling: Interest rate on the illegal loan fixed at same level as interest rate on non-indexed loans issued by the CBI	Ruling: Decision of the District Court confirmed with regard to interest rates	The question of interest rates answered but uncertainty remains with regard to exactly which loans are illegal

Minister announces new bill

A proposed bill to reduce uncertainty and resolve the situation would turn all FX loans to individuals into ISK-denominated loans

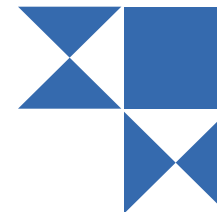
- Different financial institutions have multiple versions of FX loan agreements that could potentially be deemed illegal by the courts
- Arion Bank has no automobile loans on its Balance Sheet, but the Bank has FX mortgages to individuals and FX loans to corporations
- Without government intervention it could take years in court to determine exactly which agreements are in fact legal and which are not
- To reduce the uncertainty and resolve the situation more quickly the Minister of Economic and Business Affairs announced that he would propose a bill in the Parliament
- The bill would turn all FX loans to individuals, including mortgages, into ISK-denominated loans in compliance with the Supreme Court's rulings

Uncertainty

The proposed bill does not address FX loans to corporations which will have to be resolved on a case by case basis

The bill of law has yet to be proposed by the Minister and could change while being discussed by the Parliament or even not passed at all

The Bank will continue to meet the FME's requirements of a 16% capital ratio



- Arion Bank has worked closely with FME to assess the effects of the Supreme Court's rulings on its capital base
- The main findings of the joint assessment were disclosed in the Bank's 1H Financial Statements as six possible scenarios
- Since then there have been important developments:
 1. The capital base of the bank has strengthened
 2. Based on external legal advice, FME has agreed that the lowest risk categories of the potentially questionable FX loans can be considered legal
 3. The aforementioned rulings of the Supreme Court with regard to interest rates have ruled out the damaging contractual interest rate scenario
- The conclusion is that...
 - Despite recent rulings and the announcement from the Minister, Arion Bank will continue to meet the FME's requirement of 16% capital ratio and 20% liquidity ratio
 - Even if all those FX loans to corporations which could potentially be deemed illegal were also converted into ISK-denominated loans, the capital ratio of Arion Bank would still be at least 15%

Uncertainty

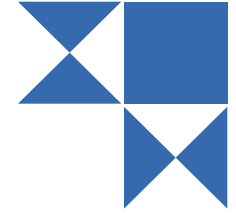
As the Minister's bill does not address FX loans to corporations there still remains some uncertainty

However, in all instances the capital ratio of Arion Bank will remain above 15%



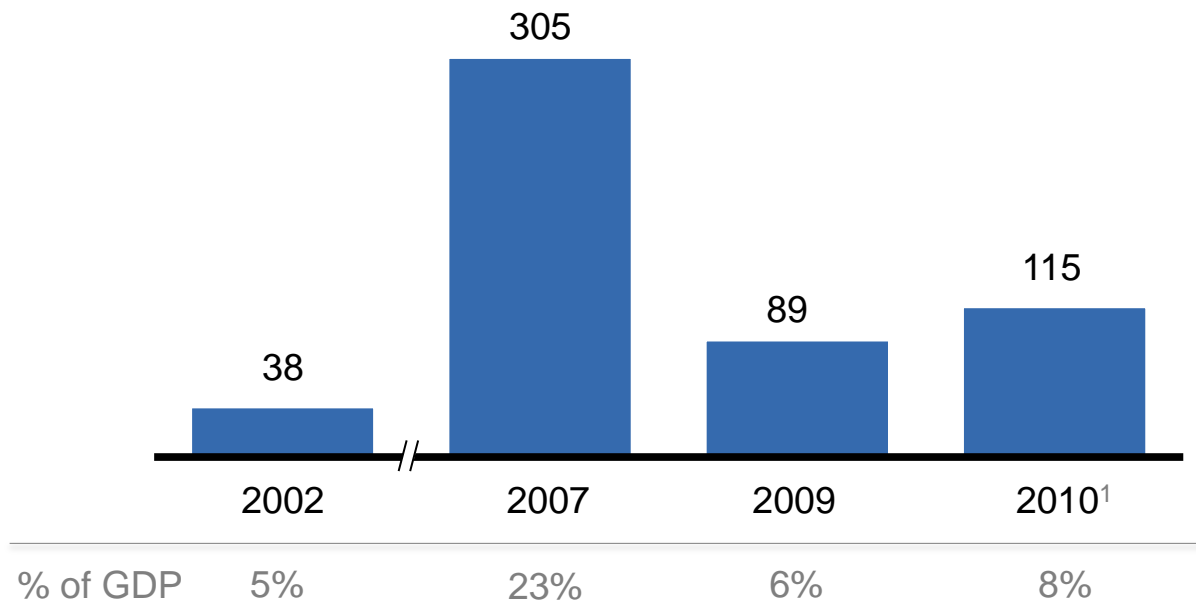
The *strategic direction*

The Icelandic financial services market is only around 1/3 of what it was at its peak



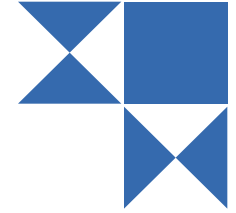
Revenues of the Icelandic financial sector

Interest and commission income, ISK billions



¹ Estimated

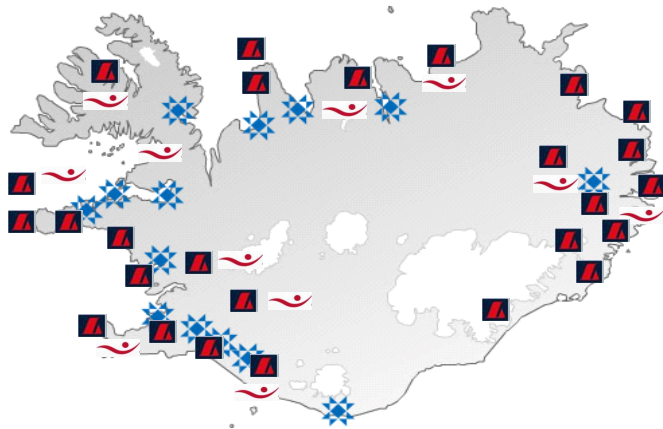
The most efficient branch network



Arion Bank is leading the way in regards to efficiency in the domestic financial sector

Branch networks of the big three

Number of branches and outlets



Branches

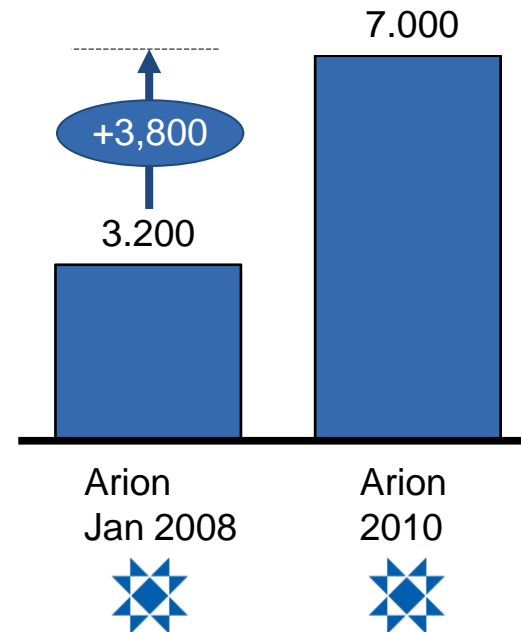
	20
	34
	19

Outlets

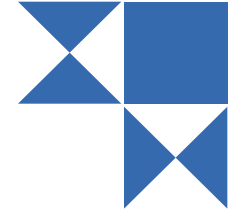
	6
	2
	2

Efficiency of branches in the capital area

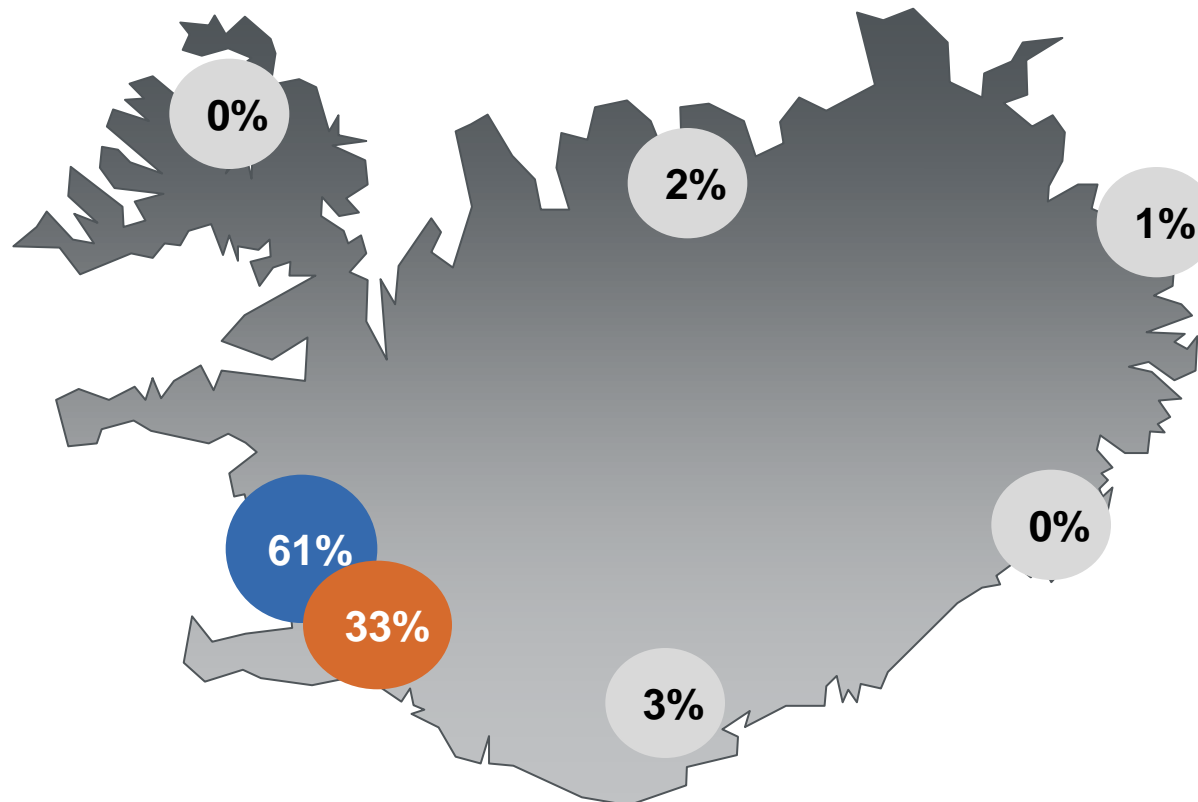
Number of customers per branch



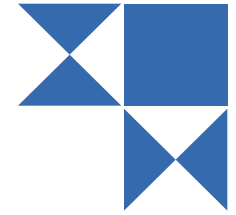
A concentrated market around the capital area



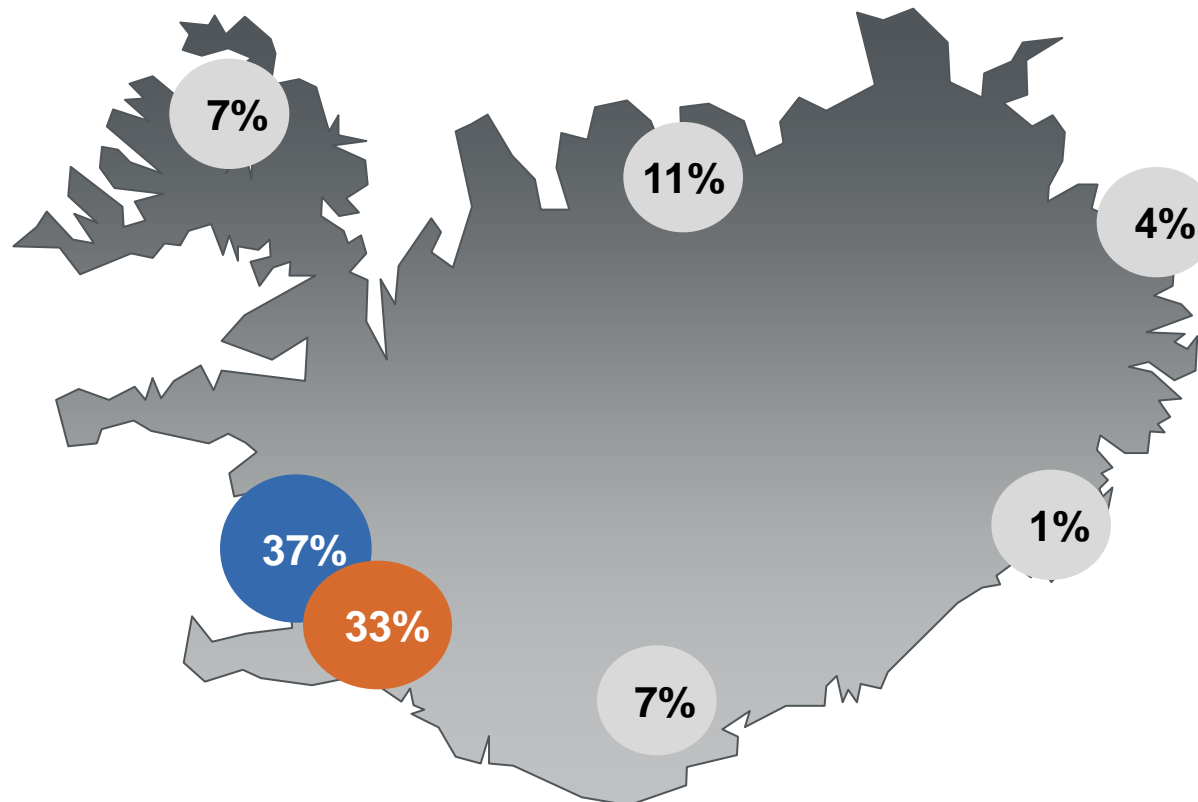
Distribution of the 360 largest corporations



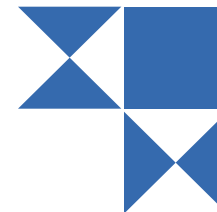
Around 70% of the population is located in the capital area



Geographical distribution of the population



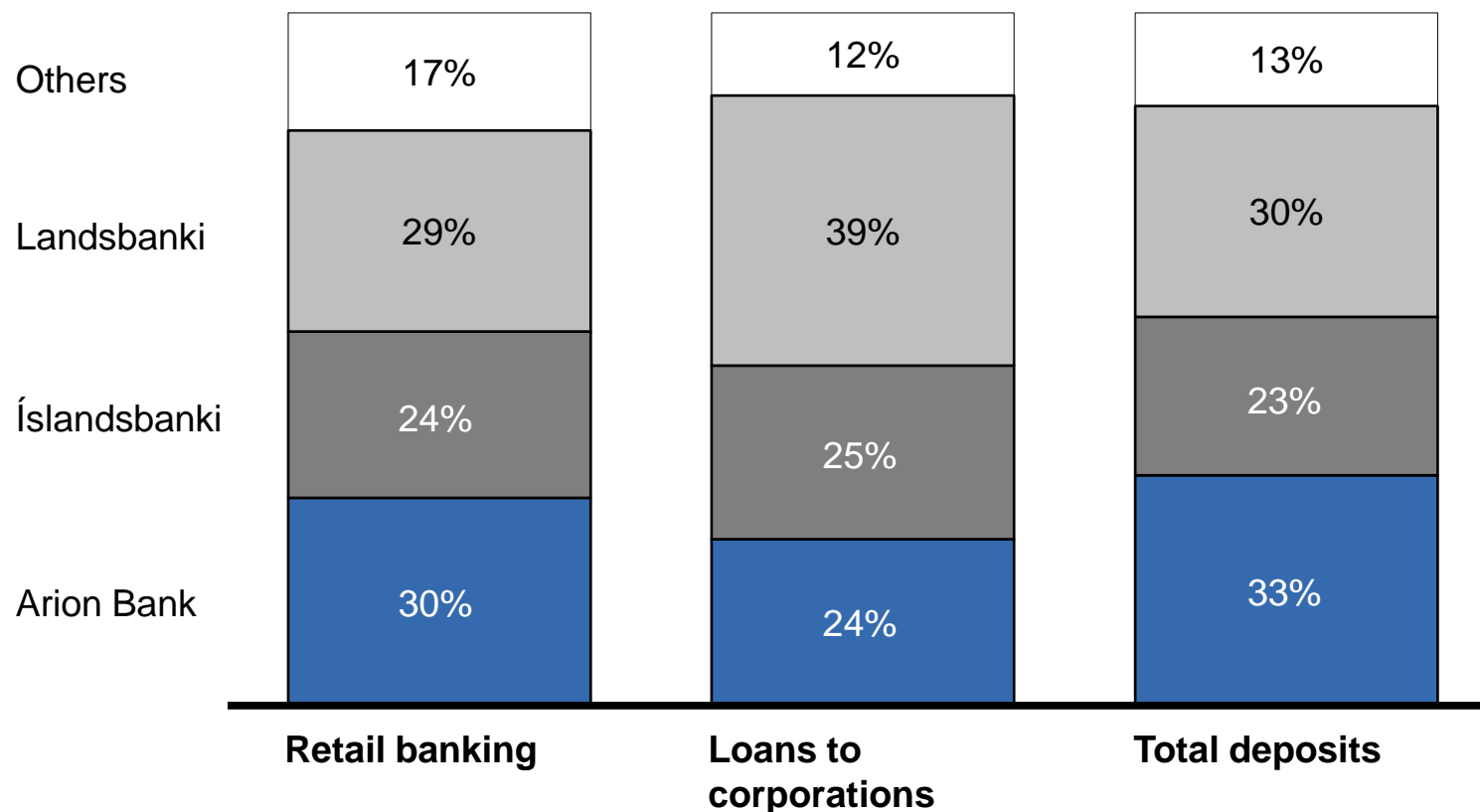
Three strong players in the domestic market



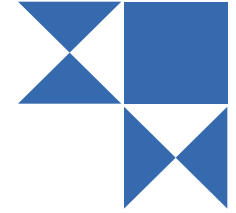
Arion Bank has a strong position within retail banking

Market share

Percentage of the total market, 2009

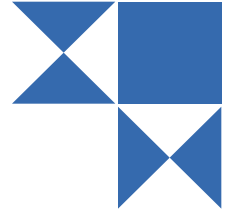


Key believes about the financial market



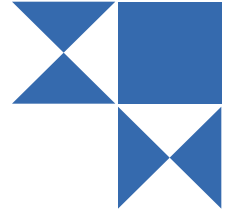
- The corporate as well as the retail market will continue to be concentrated around the *capital area*
- *Density in the corporate market* will continue to be great
- The *service level is excessive* and greater efficiency is needed
- *Competition will intensify* both from domestic and foreign banks
- The current funding of the financial sector needs to be *diversified* further

Key believes about Arion bank



- Arion Bank is a *universal bank*
- Solid core of *large customers* whom for the most part are located in and around the capital area
- Employees with *know-how and talent to* provide excellent services to large customers with demanding needs
- The necessary *broad range in service offerings* to be able to service large customers with high demands

Arion Bank's strategic direction



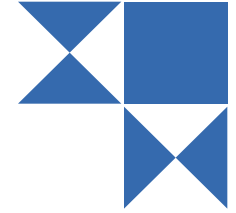
The Bank will be a relationship bank with focus on large corporations and valuable individuals

Arion Bank is a strongly capitalized bank with...

- Prime focus on *large corporations* and *valuable individuals*, delivering tailored solutions and personalized services
- Operations in the *capital area* as well as the largest urban areas around the country
- A leading position within the domestic financial market in regards to *return on equity*, *operational efficiency* and *service offerings*



With a new strategy come new operational objectives

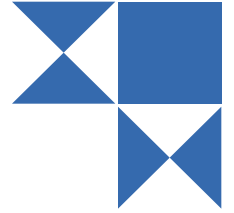


Market segmentation	<ul style="list-style-type: none">▪ Focus on service to large corporations and valuable individuals
Value proposition	<ul style="list-style-type: none">▪ Simple, standardised and effective services for all customers▪ Customised solutions and personalised services for the targeted customer groups
Sale channels	<ul style="list-style-type: none">▪ Multiple sales channels, with centralised services to larger corporations▪ Strong branches in urban areas
Marketing	<ul style="list-style-type: none">▪ The right CRM tools/software to analyse our customer base▪ Highly capable front line
Organisation	<ul style="list-style-type: none">▪ Centralised decision making with respect to service offerings
Back office	<ul style="list-style-type: none">▪ Ability to produce complicated and specialised products



Thank you

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