Stefnir Asset Management Company

Financial Statements 2012

Stefnir hf.
Borgartun 19
105 Reykjavík

Reg. no. 700996-2479

Contents

Report and endorsement of the Board of Directors and the Managing Director

The purpose of Stefnir hf. is the day-to-day operation of undertakings for collective investments in transferable securities (UCITS), investment funds and institutional investors' funds. Stefnir is Iceland's largest fund manager with assets of approximately ISK 386 billion under active management. The company manages the assets of several partnerships limited by shares that have been established around enterprise investment schemes. Stefnir is a subsidiary of Arion Bank hf. and Part A of the Financial Statements is part of the Consolidated Financial Statements of the Bank and its subsidiaries.

The Financial Statements of the company are divided in two: part A which includes the Financial Statements of Stefnir hf and part B which includes the Financial Statements of UCITS, investment funds and institutional investors' funds. They have been prepared according to the same accounting methods as last year. The Financial Statements have been prepared in accordance with law on Financial Statements, the Financial Undertakings Act and rules on the Financial Statements of management companies of UCITS set by the Icelandic Financial Supervisory Authority.

Operations during the year

The company returned a profit of ISK 736 million during the year according to the income statement. The company's equity at the end of the year was ISK 2,424 million according to the balance sheet. The capital ratio, calculated according to the Financial Undertakings Act, is 59.0%; the minimum ratio permitted by the Act is 8.0%.

At the beginning and end of the year, the company's share capital was ISK 43.5 million and was entirely owned by Arion Bank hf. and related companies.

Highlights of the year

The company's annual general meeting was held on 20 March 2012 and a decision was taken to pay a dividend of ISK 700 million to the shareholders of Stefnir. The board of directors of Stefnir remains unchanged from the last annual general meeting; Hrund Rudolfsdóttir is chairman, Snjólfur Ólafsson is vice chairman, Eggert Teitsson, Kristján Jóhannsson and Svava Bjarnadóttir are board members. Stefnir was recognized as the first Icelandic company to be "A model company in good corporate governance." This honour is granted by the Center for Corporate Governance at the University of Iceland and is awarded on the basis of a number of factors, including a survey conducted by the auditing company KPMG ehf.

In 2012 Stefnir succeeded in substantially increasing assets under management. Assets under management increased from approximately ISK 300 billion to more than ISK 386 billion, an increase of just under 27%. At the same time the company has diversified its income base by achieving a broader spread of asset classes in its asset portfolio. New funds were launched and certain asset classes, such as Icelandic equities, grew considerably. The company generally performed very well and the board proposes that a dividend of ISK 900 million be paid out to shareholders for 2012.

Returns on the main markets were either good or acceptable during the year. The investment environment continues to be shaped by the restrictions imposed by the capital controls on foreign investment. The assets of Icelandic pension funds continued to grow and it has been a priority to develop fund products suited to pension funds, insurance companies and other institutional investors.

Stefnir has endeavoured to offer a wide selection of UCITS and investment funds, including six government bond funds, in order to cater to the needs of private investors, companies and institutional investors. In early 2012 the fund Stefnir – Liquidity Fund changed from being a UCITS into an investment fund. Bond funds grew by more than 13% and returns were most satisfactory even though they were generally below last year's levels. Returns on equities funds, both Icelandic and international, have been good. There was a substantial inflow of new capital to equities funds and this, combined with returns, led to the 60% growth of equities funds managed by Stefnir in 2012. The Icelandic equities funds Icelandic Growth Fund and ÍS-5 more than doubled in size during the year.

Alternative investments have increased in recent quarters, particularly investments in Icelandic private equity and real estate. Limited partnerships run by Stefnir have undergone certain changes since the beginning of the year. In January SF III slhf. signed an agreement on acquiring an 82% stake in Jardborarnir hf. and the new owners received their shares in March. The investment fund SÍA I delivered all its shares in Hagar hf. to its fund members; the shares were originally acquired through Búvellir slhf. The fund sold all its shares in Sjóklæðagerðin hf. in March. It owned a stake in the company through SF II slhf. SF1 slhf, a company operated by Stefnir, exercised a call option on 20.6% in Sjóvá-Almennar tryggingar hf at the beginning of August. SF1 slhf. owned 73% of Sjóvá after exercising the option. The stake was sold by ESÍ hf, a company set up to administer the Central Bank of Iceland's assets. SF1 slhf. is owned by pension funds and other institutional investors, including SÍA I and the institutional investor fund Stefnir ÍS-5. Preparations for the launch of a new venture capital fund, SÍA II, were made during the year, and it is a successor to SÍA I which was set up in 2010 and is now fully invested. In January 2013 the launch of SÍA II was formally announced. The fund is ISK 7.5 billion, more than twice the size of its predecessor.

Report and endorsement of the Board of Directors and the Managing Director, cont.

At the end of June 2012 Stefnir established SRE II slhf. The objective of the company is to invest in Icelandic commercial property and it has an investment capacity of ISK 16.4 billion. Investments have been made in two properties: Borgartún 37 which houses the headquarters of Nýherji and Sætún 10 which houses Advania. The company's shareholders include some of Iceland's largest pension funds and insurance companies.

Investors were not only interested in investing in commercial property but were also keen to finance good quality real estate. Stefnir's fixed income team set up several institutional investor funds which issued asset-backed bonds to finance commercial property. The institutional investor fund lends real estate companies money with a mortgage in the financed property and other collateral to secure the lender. At the same time the funds issue bonds which are sold to institutional investors. The institutional investor funds are then given a certain time frame to list the bonds on the Icelandic stock market, NASDAQ OMX Iceland. At the end of 2012 it was announced that the bonds issued by the institutional investor funds OFAN SVÍV and OFAN VÍ had been admitted for trading on the NASDAQ OMX Iceland. New institutional investor funds were also set up in conjunction with the funding of some of Iceland's major retail and leisure properties. The combined size of these funds amounted to more than ISK 17 billion.

The number of employees at Stefnir increased from 17 to 20 by the end of the year. Despite the capital controls, the small but growing equities market and the limited issue of corporate bonds, Stefnir has nevertheless managed to adapt to a changed environment in recent years and has emerged as a leader in the development of new products to meet the demands of a diverse group of Icelandic investors.

Risk management and corporate governance

Risk management and active internal control are mainstays of the responsible operation of a fund management company. The board of directors of Stefnir has mapped the company's risk environment. The risks facing the company have been systematically analysed and measured, and the board is regularly informed of matters relating to risk management and internal control. Measures to manage and mitigate possible risk factors are vital to the operational security of the company. The outsourcing of tasks and monitoring such outsourcing are critical components of risk management and mitigation. The company has also prepared a written contingency plan concerning the risks which may disrupt or stop the company's operations temporarily and has presented it to Stefnir's employees.

The board of directors of Stefnir is committed to good corporate governance and endeavours to promote responsible behaviour and corporate culture within Stefnir for the benefit of all the company's stakeholders. Further information about corporate governance can be found in Stefnir's corporate governance statement for 2013.

Forthcoming events, risk factors and uncertainties in the company's operations

Capital controls hamper the growth of the company's international funds; new investments are not possible and the Central Bank's actions relating to lifting the capital controls have pressured the Icelandic pension funds into selling assets in international UCITS.

The board of directors of Stefnir draws attention to the fact that legal action has been brought against the company by the winding-up committee of Landsbanki Íslands hf. in respect of transactions made by funds under the company's management with Landsbanki Íslands, before and around the time of the collapse of the bank. Please refer to note 17 for further details on this case and other legal matters.

Endorsement of the board of directors and the Managing Director

The Board of Directors and Managing Director of Stefnir hf. hereby attest the company's interim financial statement for the year 2012 by signing below.

Reykjavík, 12 March 2013

The Board of Directors:

Managing Director:

Independent Auditor's Report

To the Board of Directors and Shareholders of Stefnir hf.

We have audited the accompanying financial statements of Stefnir hf. The financial statement includes part A, which is the management company and includes the statements of income, balance sheet, statement of cash flows and explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Icelandic Annual Financial Statements Act, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Stefnir hf. as at 31 December 2012, and of its financial performance and cash flows for the year then ended in accordance with the Icelandic Financial Statements Act, the Financial Undertakings Act and Rules on the Financial Statements of management companies of UCITS.

Confirmation of Endorsement and Statement by the Board of Directors and the Managing Director

Pursuant to the requirement of Item 5, Paragraph 1 of Article 106 of the Icelandic Financial Statements Act No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the Managing Director includes all information required by the Icelandic Financial Statements Act that is not disclosed elsewhere in the Financial Statements.

Reykjavik, 12 March 2013

Margrét Pétursdóttir

Margrét Pétursdóttir
State Authorized Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Statement of Income
for the year 2012

	Note	2012	2011
Operating income			
Management and performance based fees	4	2.022.294	1.493.432
Net financial income	10	206.317	(11.311)
Net operating income		2.228.611	1.482.121
Operating expense			
Salaries and related expense	11	420.837	295.873
Safe keeping commission		172.915	165.022
Service fee to Arion bank hf.		27.648	55.151
Other expense	18	675.569	237.125
Operating expense		1.296.969	753.171
Earnings before tax...		931.642	728.950
Income tax	12	(195.606)	(55.343)
Net earnings…………………………………………………………..	16	736.037	673.608

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

Statement of Financial Position
as at 31 December 2012

	Note	31.12.2012	31.12.2011
Assets			
Securities with variable income		2.073.946	1.035.038
Securities with fixed income		64.020	76.884
Total Securities	5, 13	2.137.966	1.111.922
Receivable from Arion Bank hf.		0	108.953
Accounts receivables	7	428.431	273.833
Total Receivables		428.431	382.786
Tax assets	9, 17	128.863	209.888
Other assets		24.334	9.749
Cash and cash equivalents	8	755.688	1.039.777
Total Other Assets		908.885	1.259.414
Total Assets		3.475.282	2.754.121
Equity			
Share capital		43.500	43.500
Statutory reserve		10.875	10.875
Retained earnings		2.369.581	2.333.545
Total Equity	16	2.423.956	2.387.920
Liabilities			
Payable to Arion Bank hf.		238.838	204.116
Accounts payable		7.759	21.640
Other liabilities		699.422	140.446
Tax liabilities	17	105.308	0
Total liabilities		1.051.326	366.202
Total Liabilities and Equity		3.475.282	2.754.121

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

Statement of Cash Flows

for the year 2012

	Note	2012	2011
Cash flows from operating activities:			
Net earnings	16	736.037	673.608
Non-cash items included in net earnings:			
Valuation changes of securities		(140.776)	73.996
Expensed tax		195.606	54.534
Changes in operating assets and liabilities		519.587	311.672
Net cash from operating activities before taxes		1.310.453	1.113.810
Income tax paid	17	(9.273)	(236.279)
Net cash from operating activities		1.301.179	877.530
Investing activities			
Change in Securities with variable income		(898.830)	(138.940)
Change in Securities with fixed income		13.561	(46.561)
Investing activities		(885.269)	(185.501)
Finance activities			
Dividend paid	16	(700.000)	(500.000)
Finance activities		(700.000)	(500.000)
Net change in cash and cash equivalents		(284.089)	192.030
Cash and cash equivalents at the beginning of the year		1.039.777	847.747
Cash and cash equivalents at the end of the year	8	755.688	1.039.777

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

Notes to the Financial Statements

Accounting policies

1. General information

Stefnir hf. is a limited liabilty entity and operates in accordance with Act. 2/1995 on Limited Liabilty Companies and Act. 161/2002 on Financial Undertakings. The address of Stefnir's registered office is at Borgartún 19, Reykjavík and its ID no. is 700996-2479.

Stefnir is að subsidiary of Arion Bank hf., ID no. 581008-0150, Borgartún 19, Reykjavík.

2. Basis of preparation

The Financial Statements of Stefnir hf., A-part, are prepared in accordance with law on Financial Statements, law on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS. The Financial Statements are prepared on the historical cost basis except for Securities that are valued at fair value. The Financial Statements are presented in Icelandic króna (ISK), rounded to the nearest thousand unless otherwise stated. The company is a subsidiary of Arion bank hf. The Financial Statements of Stefnir hf. are part of the Consolidated Financial Statements for the parent company with information on operations and financial position of the Consolidated company.

3. Use of estimates and judgements

The preparation of 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 be material to the Financial Statements.

4. Management and performance based fees

The company earns asset management fees for the operations of Stefnir's Securities Funds, Investment Funds and Professional Investors' Funds. The fee is a fixed percentage of the net assets of each fund and includes the following operating expenses of the funds; salaries of the employees of the operating company, marketing and management. Fees are also earned from the operation of special purpose entites that have been established for enterprise investments. Additionally the company earns fees for the asset management of foreign funds that are in custody of foreign entities. Performance fees are earned if certain conditions are met.

5. Securities

a. Securities with variable income

Securities owned by the company are trading assets. Fund units and shares in special purpose entities are measured at buy price at year end. Listed fund units are measured at market value at year end.

b. Securities with fixed income

Bonds that are listed on regulated securities market which is active and price generating are measured at market price at each time. The expression “active and price generating” means that the closing price of a bond is not based on old trades, trading with an insignificant portion of the total issuance or does not reflect the fair value of the bond as valued by specialists. If the issuer of a bond is expected to default, the bond is valued at the expected recoverable amount taking into account priority order of claims.

A bond where the issuer is deemed viable but is not listed on an active and price generating securities market is measured at present value of future cash flow. The choice of yield curve used for each bond is based on general risk and the circumstances on the market at the end of the year.

For a bond where the issuer is not deemed viable the methods described above are deviated from and the bond is measured at expected recovery value and no interest income is realised. The estimate of expected recovery value takes into account the experience of the recovery from similar issuers, the financial statements of the issuer and statements issued by it. If the issuer is in administration, has defaulted or stated that payments of the bond will not be made the expected recovery is measured 0-1% and the bond entered into a collection process. If new information is received from issuers that have previously been fully provisioned for, the bond is re-valued, which might change the valuation of the bond to higher value. Due to significant uncertainty about the valuation of bonds the final recovery might vary considerably from the valuation at year end.

6. Foreign currency transactions

Transactions in foreign currencies are translated to Icelandic króna at exchange rates at the dates of transactions, according to Reuter. Assets and liabilities denominated in foreign currency are translated at exchange rate at the end of the year. Net foreign assets at December 31st amount to ISK 1.146 millions and are specified as follows:

	EUR	USD	GBP	SEK
Assets	1.062.255	45.581	37.944	225
Liabilities	(117)	0	0	0
Net balance 31.12.2012	1.062.138	45.581	37.944	225
Net balance 31.12.2011	901.884	65.171	111.248	200

7. Receivables

Recivables are measured at nominal value deducted by impairment.

8. Cash

Cash consists of cash and deposits whth credit institutions.

9. Tax assets

The deferred income tax asset has been calculated and entered in the Statement of Financial Position. The calculation is based on the difference between Statement of Financial Position items as presented in the tax return on the one hand, and in the Financial Statements on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because of time difference in impairment of securites and foreign exchange gain and loss are distributed over three years in the tax return.

10. Net financial income

Net financial income is specified as follows:

	2012	2011
Valuation change in securities assets	106.968	(96.531)
Dividend received	0	45.603
Foreign exchange gain (loss)	86.683	32.848
Interest income	12.738	12.915
Interest expense	(71)	(6.146)
Net financial income	206.317	(11.311)

11. Personnel

Salaries and related expenses are specified as follows:

	2012	2011
Salaries	323.887	240.410
Salary related expenses	96.949	55.463
Salaries and related expenses	420.837	295.873

Number of employees is as follows:

	2012	2011
Employees at the end of the year	20	17
Average number of employees during the year	18	16

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

11. Personnel, cont.

Compensation of the key management personnel:

	2012	2011
Flóki Halldórsson, Manging Director	24.541	18.986
Hrund Rudolfsdóttir, Chairman of the Board	3.600	3.400
Snjólfur Ólafsson, Vice-Chairman of the Board	2.400	2.150
Kristján Jóhannsson, Board-member	1.800	1.050
Svava Bjarnadóttir, Board-member	1.800	1.700
Total renumeration	34.141	27.286

Renumeration to five managers total ISK 89.4 million (ISK 66.2 million to four managers in 2011). Renumeration to two non-Board members of the Board Audit and Risk Committe was ISK 1.2 million (ISK 900 thousand in 2011).

The Board of Stefnir has set rules for bonus payments in accordance with rules set by the Financial Supervicory Authority no. 700/2011 which have been confirmed by the FSA. Estimated accrued bonus payments for 2012 are payable in 2013 and amount to ISK 52 million plus salary related cost. Total amount of ISK 72.2 million has been posted in the Statement of Financial Position.

12. Income tax

	2012	2011
Current year	186.332	145.794
Prior year correction	9.273	(90.451)
Total Income tax expense	195.606	55.343

13. Securities

	31.12.2012	31.12.2011
Securities with variable income are specified as follows:		
Fund units issued by funds operated by Stefnir hf.	1.925.480	852.108
Fund units issued by others	76.779	147.868
Shares in investment companies	71.687	35.063
	2.073.946	1.035.038
Securities with fixed income are specified as follows:		
Listed on NASDAQ OMX Iceland:		
Issued by public entities	11.862	13.920
Unlisted:		
Issued by public entities	4.664	5.521
Isued by others	47.494	57.442
	64.020	76.884
Securities total	2.137.966	1.111.922

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

14. Related parties

Stefnir hf. has a related party relationship with the parent company, Arion Bank hf. and its subsidiaries and associates, funds under management, The Board of Directors and key management personnel at Stefnir.

No unusual transaction took place with related parties in the reporting period. Transaction with related parties have been conducted on an arm's length basis.

Transactions with related parties 2012:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	1.023.255	105.212	774.037	242.838
Funds in operation	786.754		284.060	64.796
	1.810.010	105.212	1.058.097	307.634

15. Assets under Management

Assets under Management in funds in operation by Stefnir at year end 2012 amount to ISK 383 billions compared to ISK 304 billions in 2011.

16. Equity

a. Total share capital amounts to ISK 43.5 million at year end. One vote is associated with every one króna share.

b. Changes in eqity are specified as follows:

	Share capital	Statutory reserve	Retained earnings	Total
Equity 1.1.2011	43.500	10.875	2.159.937	2.214.312
Dividend paid			(500.000)	(500.000)
Net earnings			673.608	673.608
Equity 31.12.2011	43.500	10.875	2.333.545	2.387.920
Equity 1.1.2012	43.500	10.875	2.333.545	2.387.920
Dividend paid			(700.000)	(700.000)
Net earnings			736.037	736.037
Equity 31.12.2012	43.500	10.875	2.369.581	2.423.956

c. Equity at year end is ISK 2,424 thousands or 69.7% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 59.0%, exceeding the minimum legal requirement of 8%. The ratio is calculated as follows:

	31.12.2012	31.12.2011
Total equity	2.423.956	2.387.920
Tax assets	(128.863)	(209.888)
Total own funds for solvency purposes	2.295.093	2.178.032
Total capital requirements are specified as follows:		
Credit risk	219.350	130.020
Market risk	91.671	78.424
Capital requirement	311.021	208.444
Capital adequacy ratio	59,0%	83,6%

Stefnir hf. Financial statements 2012 Amounts are in ISK thousands

17. Tax asset

Changes in deferred tax assets are specified as follows:

	31.12.2012	31.12.2011
Tax assets at the beginning of the year	209.888	28.143
Reassessment of taxes for the years 2009-2011	0	326.731
Income tax recognised in profit or loss	(186.332)	(145.794)
Other changes	0	808
Net tax asset at the end of the year	23.556	209.888

Specified as follows:

	31.12.2012	31.12.2011
Current taxes	(105.308)	0
Deferred t axes	128.863	28.143
Net tax asset at the end of the year	23.556	28.143

Tax assets are attributable to the following:

	31.12.2012	31.12.2011
Tax loss carried forward	0	165.714
Securities	39.057	39.057
Deferred foreign exchange gain and loss	(13.693)	3.185
Provision	100.000	0
Other items	3.499	1.932
Deferred tax asset at the end of the year	128.863	209.888

In 2011 tax authorities made amendments to Stefnir's 2009 Tax form for operations in 2008. The amendment concerned impairment of securities assets that was deemd unauthorised at that time. The amendment does not have material impact on the amount of the impairment, but postpones it to the years 2009 and 2011. The tax asset at the beginning of 2011 is affected by the amendment as explained in the above table. Amended income tax assesment for the year 2009 was paid 2011.

18. Other information

The winding-up committee of Landsbanki Íslands has brought legal action against Stefnir 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. The amount involved is ISK 450 million plus interest. Stefnir 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 it is now considered appropriate to provision for these cases. Court hearings are expected to take palace in Q1.

A legal entity has brought legal action against Stefnir and Arion Bank and is claiming damages for alleged illegal handling by Kaupthing Bank hf. of financial assets which Kaupthing Bank hf. was instructed to manage for the legal entitiy. Stefnir and the bank are defending this case and reject the claims of the legal entity.

In July the EFTA Surveillance Authority (ESA) concluded its formal investigation into the purchases of the assets of money market funds in the autumn of 2008. The investigation aimed to clarify whether the purchase by Arion Bank hf. of assets in the funds could be interpreted as state aid. The ESA concluded that it did constitute state aid but that it complied with Article 61(3)(b) of the EEA agreement. The board of directors is pleased that a definitive conclusion has been reached and that all uncertainty relating to the investigation has been eliminated.

Stefnir hf. Financial statements 2012 | Amounts are in ISK thousands

Corporate Governance Statement of Stefnir hf. 2013

By issuing this corporate governance statement Stefnir hf. (Stefnir) is fulfilling the requirements set out in recognized guidelines current at the time this Financial Statement is approved by the company's board of directors and the provisions of Article 19 of Act No. 161/2002, cf. Article 12 of Act no. 75/2010. Guidelines on Corporate Governance, 4th edition, issued by the Icelandic Chamber of Commerce, the Confederation of Icelandic Employers and NASDAQ OMX Iceland hf. and OECD Principles of Corporate Governance were taken into special consideration when the Stefnir hf.'s corporate governance statement was written. The Guidelines on Corporate Governance and the Principles of Corporate Governance can be viewed on Stefnir's website.

In 2012 Stefnir was recognized as the first Icelandic company to be "A model company in good corporate governance." This honour was granted by the Center for Corporate Governance at the University of Iceland and is based on a survey conducted by the auditing company KPMG ehf. This recognition is granted for one year. Stefnir aims to win such recognition again next year and KMPG is currently conducting a review in this respect.

The board of directors of Stefnir believes that good corporate governance is a key factor behind Stefnir's success as a leading fund management company in Iceland. Corporate governance provides companies with a framework in which objectives are defined, which tools should be used to achieve these objectives and how the success of these objectives is measured. Good corporate governance is designed to provide the right incentives to the board of directors and management to exploit the opportunities which serve the interests of the company, the shareholders and general public. Good corporate governance also makes it easier for the board to perform its monitoring duties effectively.

Stefnir hf. is an independent financial company under Act No. 161/2002 on Financial Undertakings. The company manages UCITS, investment funds and professional investor funds under Act No. 128/2011. In addition to this, the company is licensed to operate asset management services, investment advisory and to manage financial instruments for collective investments, cf. sub-paragraphs 1-3 of paragraph 1 of Article 27 of Act No. 161/2002. Stefnir is Iceland's largest fund manager with assets of more than ISK 380 billion under active management. Stefnir has 20 employees with extensive experience of work in financial markets.

Stefnir is a subsidiary of Arion Bank hf. The company is fully owned by Arion Bank and related companies. The company's corporate governance statement serves to encourage open and reliable communications between the board, shareholders and other stakeholders such as unit holders in funds managed by Stefnir, parties that service and participate in the operations of Stefnir, employees and the general public.

The company's operations are subject to stringent restrictions by the legislator. The company's operations are governed by acts of law including the Financial Undertakings Act No. 161/2002 and the UCITS, Investment Funds and Institutional Investor Funds Act, no. 128/2011. Stefnir is monitored by the FME under Act No. 87/1998.

Risk management and active internal control are mainstays of the responsible operation of a fund management company. The company's board of directors has devised a risk strategy for the company.

"Stefnir's board of directors is aware of that risk management and active internal control are some of the mainstays of a responsible fund management company and by formulating a clear risk policy the board continues to encourage the existing strong risk management culture within Stefnir and simultaneously informs its policy to its stakeholders.

All risk within Stefnir's operations is identified and assessed regularly and a process to monitor and report these risks is in place. Stefnir operates a strong control environment which utilizes policies, processes and systems to appropriate internal controls and risk mitigation. Stefnir has in place a continuity plan to ensure the ability to operate despite a severe business disruption. Through corporate governance the board of directors ensures that the policies, processes and systems are implemented at all decision levels."

Compliance, internal audit and risk management are partly outsourced to Arion Bank with the permission of the FME and the board is regularly informed of issues concerning the above.

The company's accounting is the responsibility of Arion Bank's finance division. The FME has authorized the outsourcing of this task. Arion Bank is also the depositary of Stefnir hf. and the financial statements of Stefnir's funds are the responsibility of the Bank. The auditing committee examines the financial statement and obtains the opinion of an external auditor on the six-month financial results and 12-month financial results of Stefnir and the funds managed by Stefnir. Reporting to the board of directors with respect to the accounts is the responsibility of the committee; the board also meets the auditing company Ernst & Young hf.

Stefnir has five board members and five alternate members. The majority of the board is independent of Arion Bank, Stefnir's parent company, and the company itself. All board members are elected at a shareholders' meeting of the company. The managing director is hired by the board and has the mandate from the board to manage the day-to-day operations of the company. Board meetings are held regularly, on average once a month and more often if required. The operations manager of Stefnir is the secretary of the board. Stefnir's legal representative is also present and provides board members with legal advice at board meetings. There were 14 board meetings during the year and there was a quorum present at every meeting. The board's rules of procedure, work schedule and articles of association can be seen on the company's website, www.stefnir.com.

The board of directors of Stefnir comprises the independent board members Hrund Rudolfsdóttir, Chairman, corporate director of human resources at Marel, Snjólfur Ólafsson, Vice Chairman, professor in the faculty of business administration at the University of Iceland, Kristján Jóhannsson, chairman of Icepharma hf. and Svava Bjarnadóttir, an independent board member. The dependent board member is Eggert Teitsson, deputy managing director of finance at Arion Bank hf. The board members have all served on the board since 2009, with the exception of Kristján Jóhannsson who took up his position in June 2011. Further information on the board members of Stefnir can be seen on the company's website.

The alternate board members are Ásgerdur Hrönn Sveinsdóttir, operations and branches manager at Arion Bank hf, Gunnar Ingi Jóhannsson, attorney at Lögmenn Höfdabakka, Kristbjörg Edda Jóhannsdóttir, managing director of HuxHux, Thórhallur Örn Gudlaugsson, lecturer in the faculty of business administration at the University of Iceland, and Hördur Kvaran, specialist in Arion Bank's finance division.

The audit committee, elected by the board, was re-elected from the previous year. The chairman of the committee is Snjólfur Ólafsson. The other committee members are Gudlaug Sigurdardóttir and Sturla Jónsson. The audit committee met six times in 2012 and achieved a quorum on each occasion. The committee members are independent of the company and their broad expertise in business administration, auditing and management was put to good use in the course of the committee's business. The committee submitted its report to the board of directors of Stefnir in January 2013. The committee's rules of procedure can be found on the website of Stefnir. There are no subcommittees. The board members perform the role of a remuneration committee and the company's remuneration policy can be found on the company's website.

The board members of Stefnir jointly devised the following mission statement for the board:

The board's key role is to establish a corporate strategy and ensure that it is implemented. The core of the strategy is for the company to be a leading fund management company and to ensure that the interests of clients, owners, employees and the community at large are prime considerations. The focus is on running a solid and profitable business and minimizing risk. The board places a strong emphasis on good corporate governance and ensuring that the board and company operate at all times in compliance with the law, rules and good business practices.

The role of the board is defined in more detail in the rules of procedures and the company's articles of association.

The board assesses its work annually and proposes ways to make improvements. The managing director is not present during the assessment and the chairman leaves the meeting when the board members assessed her work. The assessment is then compiled, the board's proposals for improvements are sent out the relevant parties and a time frame is set for completion.

The company's managing director since 1 July 2009 is Flóki Halldórsson (born 1973), an economics graduate from the University of Iceland. Flóki has extensive experience of the financial markets and management. The managing director is responsible for ensuring that the day-to-day operations of the company are conducted according to the strategy and instructions given by the board of directors; cf. Paragraph 2, Article 68 of the Public Limited Companies Act. He is responsible for reporting to internal and external supervisory bodies. The managing director is authorized, upon approval by the board, to grant other employees of the company the power to handle limited authorizations of his/her duties.

The managing director is responsible for analysing, measuring, monitoring and supervising risks associated with the operations of the company. The managing director shall maintain an organizational chart that clearly specifies areas of responsibility, employees' authorizations and channels of communications. The managing director shall formalize objectives for internal control in consultation with the board and ensure that the follow-up is efficient. The managing director hires and dismisses the employees of the company, other than those discussed in Article 16 of Act No. 161/2002.

This year the board has undertaken extensive work on strategy. The board has established and defined in detail benchmarks for the company's operations. These benchmarks are based on objective values and they will be checked at least quarterly. The board has also defined the role of the company. Stefnir's role is to manage its clients' assets as best serves their interests. In order to support this role the board has defined focuses in operations which concern service and future developments, relationships with clients, finances, security, risk management and human resources. The board has also taken a position on its position in the community and its corporate social responsibility. The board and the company's employees have jointly prepared and published a set of values based on the company's role and focus.

New rules of procedure for the board were approved during the year. The rules have been under preparation for several years. The rules were established with reference to Article 54 (2) of the Financial Undertakings Act and Article 70 (5) of the Public Limited Companies Act. The rules of procedure are largely based on guidelines No. 1/2010 of the Financial Supervisory Authority (FME) and the company's articles of association. The work undertaken in relation to the company's recognition as a model company in good corporate governance has been important in this respect.

Stefnir has been at the forefront in offering its clients competitive and responsible investment options in virtually all asset classes. It is vital that the company is able to pass on information accurately and simply to investors. This year a new website was launched which made comparing different investment options even more straightforward.

No judgements for punishable acts according to the Criminal Code, the competition law, the act on financial undertakings or laws on public limited companies, private limited companies, book-keeping, annual accounts, bankruptcy or taxation, nor under special legislation applicable to parties subject to public supervision of financial activities, have been passed on Stefnir hf. Information on court cases relating to Stefnir can be found in the notes to the