Asset Management Company

Financial Statements 2018

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 to operate UCITS, investment funds and institutional investors' funds. The company also manages the assets of several partnerships limited by shares that have been established for private equity investments. Stefnir is Iceland's largest fund management company with assets of approximately ISK 331 billion under active management. Stefnir is a subsidiary of Arion Bank hf. The A-part 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. The Financial Statements have been prepared according to the same accounting methods as last year. The Financial Statements have been prepared in accordance with the Annuals Account Act, the Financial Undertakings Act and the rules on the accounts of UCITS management companies.

Operations during the year

The company reported earnings of ISK 897.1 million in the period according to the income statement. The company's equity at the end of the period was approximately ISK 2.8 billion according to the balance sheet. The capital ratio, calculated according to the Financial Undertakings Act, is 74.2%, the minimum allowed by law being 8.0%.

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

Highlights of 2018

Stefnir's annual general meeting was held on 14 March 2018 and a decision was taken to pay a dividend of ISK 1,350 million to the shareholders. The board of directors of Stefnir was elected at the meeting and comprises the following members: Hrund Rudolfsdóttir, chairman, Kristján Jóhannsson, vice chairman, and Jökull Heiddal Úlfsson, Ragnhildur Sophusdóttir and Thórdur Sverrisson. The board of directors of Stefnir has two sub-committees: the audit and risk committee, and the remuneration committee.

Assets under management decreased by approximately ISK 16 billion, from approximately ISK 347 billion to ISK 331 billion. The main reason for this was payments from alternative investments in connection with the completion of investment projects, and redemptions in the investment funds Stefnir ÍS-15 and Stefnir Liquidity Fund. Asset distribution is good and the company's revenue structure is in line with the board's objectives

In 2018 the company was named by World Finance Magazine as Iceland's best investment management company in fixed income for the second year in a row. The award is given to asset management companies which have achieved excellent results despite the challenges presented by a volatile operating environment. In Stefnir's case, the key factors cited were its long-term results, risk management and internal corporate governance. Stefnir's inflation-indexed products proved most attractive to investors in 2018. This was demonstrated most clearly by the investment fund Stefnir Fixed Income Opportunities, which invests in bonds issued by a diverse group of issuers, such as public authorities, companies and financial institutions, which grew from ISK 2.2 billon to ISK 7 billion during 2018. At year-end 83% of the fund's assets were inflation-indexed. Returns on Stefnir's fixed income funds were good and clearly vindicate World Finance Magazine's nomination of Stefnir as Iceland's best investment management company in fixed income. Stefnir's government bond index gained almost 7% in 2018.

Domestic equities indices ended the year almost unchanged when taking into account dividends. The international stock markets started the year strongly but then suffered the weakest fourth quarter since 2009 and the MSCI World Index in EUR ended the year down over 11%. Investment returns on Stefnir funds reflected these global trends. Consequently Stefnir mixed funds, with proportionally more fixed income, particularly inflation-indexed assets, performed better than funds with a higher ratio of equities.

Investment returns must always be considered with respect to the risk associated with investing in the securities markets. Stefnir published the long-term results of the funds twice during the year, plus information on asset allocation and investment returns on its website, www.stefnir.is.

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

In recent years Stefnir has placed a strong focus on private equity investments and alternative investments. There is a clear appetite for a diverse range of investment options and Stefnir has met this demand with a variety of products suited to institutional investors' portfolios. Stefnir operates and manages both Icelandic and international private equity funds and the major fund owners are pension funds, insurance companies and other financial institutions. During the year Festi was sold to N1, bringing to a conclusion the successful association between SFV, a company managed by Stefnir, and Festi. The transaction was paid for with cash and shares in N1. SÍA III acquired an interest in the machining company Hamar and the pharmacy Lyfja. Stefnir's new real estate fund, SRL, which acquired the property development company Landey, will in the next few years focus on building and developing Landey's property portfolio.

The board of directors of Stefnir has proposed at its AGM that a dividend of ISK 1,070 million be paid for 2018. The board of directors is authorized to make further proposals on dividends at a shareholders' meeting and does not rule out that further dividend payments may be made later in the year.

Non-financial information, responsible investment, corporate governance and risk management

Stefnir's role is to manage its clients' assets as best serves their interest. Responsible and diverse investment options and thorough disclosure of information are central to the corporate social responsibility to which Stefnir is committed. By paying due attention to environmental and social issues and good corporate governance we believe we can have a positive influence on our society, to the benefit of fund members and other stakeholders. The board of directors of Stefnir established a policy on responsible investments for Stefnir funds in December 2018 and it will be implemented in 2019. Non-financial information as stipulated in Article 66 d of the Annual Accounts Act are presented on Group level, in accordance with the 3rd and 4th paragraph in the same Article. For further information, see Arion Bank's Annual report 2018.

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 management environment. The risks facing the company have been systematically analyzed 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 board of directors of Stefnir established a risk management strategy on the basis of Regulations No. 471/2014 and it applies to assets and portfolios of UCITS and investment funds managed by the company. The company has defined its risk appetite and the board of directors monitors the key performance indicators on a regular basis.

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.

Since 2012 Stefnir has been recognized as a company which has achieved excellence in corporate governance by the Center for Corporate Governance. The company is continuously working on maintaining and developing corporate governance and re-attaining this recognition on a regular basis is part of this effort.

Outlook

The operations of fund management companies are subject to various changes in the external environment. Looking ahead there are various positive factors in the operating environment, while others may have a more negative impact. On the positive side there is Iceland's strength in terms of the main economic criteria, the nation's demographic makeup and foreseeable growth of savings through the pension system. The company is in a constantly changing legal environment which could have a significant impact on business conditions. Various changes to legislation are imminent, most notably new legislation on institutional investor funds (AIFMD) and legislation applicable the financial markets (MIFID II). The changes heralded by this legislation are easy to predict, since it is a pan-European regulatory framework which has already been implemented in other countries following lengthy preparations.

The reduction in the number of pension funds and insourcing asset management has had an impact on the fund management market in Iceland and is expected to do so for some time, especially in traditional funds. Other imminent changes include the arrival of new competition in the form of fintech companies. Such companies will lead to more intense competition and put pressure on commissions in various financial services. Many of these changes require additional costs, employees with new expertise and changes to business processes and services. Over the last decade, Stefnir has demonstrated the ability to adapt to meet the radically changed business environment and also benefits from economies of scale in its business. The outlook is rather bright despite various uncertainties in the operating environment.

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

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 period 1 January to 31 December 2018 by signing below.

Reykjavik, 11 February 2019

The Board of Directors:

Managing Director:

Independent Auditor’s Report

To the Board of Directors Shareholders of Stefnir hf

Opinion

We have audited the financial statements of Stefnir hf. for the year ended December 31, 2018 which comprise the statement of income, the statement of financial position, the statement of cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Stefnir hf. as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with the Icelandic Financial Statement Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are independent of Stefnir hf. in accordance with the Icelandic Institute of State Authorized Public Accountants (FLE), Code of Ethics and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

Management is responsible for the other information. The other information comprises of the report of Board of Directors and Corporate governance statement.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. Except from the confirmation regarding report of the board of directors as stated below.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the financial statements.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the Icelandic Financial Statement Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS, 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.

In preparing the financial statements, management is responsible for assessing Stefnir hf.’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Stefnir hf.’s financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion.

Independent Auditor's Report, cont.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

• Obtain an understanding of internal control relevant to the audit 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 Stefnir hf.'s internal control.

• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

• Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

• Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Reykjavík, 11 February 2019

Deloitte ehf.

Páll Grétar Steingrímsson
State Authorized Public Accountant

Pétur Hansson
State Authorized Public Accountant

Statement of Income
for the year 2018

	Note	2018	2017
Operating income			
Management and performance based fees	4	2.253.977	3.149.894
Financial income	10	61.899	162.977
Operating income		2.315.876	3.312.871
Financial expense	10	(112)	(42)
Net operating income		2.315.764	3.312.829
Operating expense			
Salaries and related expense	11	604.023	611.814
Safe keeping commission		223.200	208.200
Other expense		374.717	348.705
Operating expense		1.201.940	1.168.719
Earnings before tax		1.113.824	2.144.110
Income tax	12	(216.678)	(464.418)
Net earnings	16	897.146	1.679.692

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Statement of Financial Position
as at 31 December 2018

	Note	31.12.2018	31.12.2017
Assets			
Securities with variable income		2.031.101	2.690.922
Securities with fixed income		20.916	41.524
Total Securities	5, 13	2.052.017	2.732.446
Receivable from Arion Bank hf.		8.476	48.434
Accounts receivables	7	1.274.371	1.289.545
Total Receivables		1.282.847	1.337.979
Other assets		50.644	56.583
Cash and cash equivalents	8	160.014	34.722
Total Other Assets		210.658	91.305
Total Assets		3.545.522	4.161.730
Equity			
Share capital		43.500	43.500
Statutory reserve		10.875	10.875
Fair value equity reserve		40.697	75.476
Retained earnings		2.690.349	3.108.424
Total Equity	16	2.785.421	3.238.275
Liabilities			
Payable to Arion Bank hf.		47.752	53.558
Accounts payable		5.314	5.740
Other liabilities		487.281	425.902
Tax liabilities	17	199.708	435.178
Deferred tax liabilities..		20.046	3.077
Total liabilities		760.101	923.455
Total Equity and Liabilities		3.545.522	4.161.730

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Statement of Cash Flows
for the year 2018

	Note	2018	2017
Cash flows from operating activities			
Net earnings	16	897.146	1.679.692
Non-cash items included in net earnings:			
Valuation changes of securities		(41.535)	(97.407)
Income tax recognised in profit or loss		216.677	464.418
		1.072.288	2.046.703
Changes in operating assets and liabilities		116.218	(543.396)
Income tax paid	17	(435.178)	(174.940)
Net cash from operating activities		753.328	1.328.367
Investing activities			
Change in Securities with variable income		697.862	(502.219)
Change in Securities with fixed income		24.102	68.924
Investing activities		721.964	(433.295)
Finance activities			
Dividend paid	16	(1.350.000)	(890.000)
Finance activities		(1.350.000)	(890.000)
Net change in cash and cash equivalents		125.292	5.072
Cash and cash equivalents at the beginning of the year		34.722	29.650
Cash and cash equivalents at the end of the year	8	160.014	34.722

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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 a 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 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, 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, total assets or subscriptions 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 cost at the end of the year. Listed fund units are measured at market value at the end of the year.

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 the end of the year.

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 31 December 2018 amount to ISK 810 millions and are specified as follows:

	EUR	USD	GBP	Other
Assets	806.483	67	3.106	153
Liabilities	0	0	0	0
Net balance 31.12.2018	806.483	67	3.106	153
Net balance 31.12.2017	651.631	53	26.171	148
Exchange rate of ISK 31.12.2018	133,20	116,34	148,27	
Exchange rate of ISK 31.12.2017	124,52	103,7	140,16	

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 / liabilities

The calculation of derferred tax asset / liability 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:

	2018	2017
Valuation change in securities assets	2.012	134.203
Dividend received	580	0
Foreign exchange gain (loss)	45.220	15.690
Interest income	14.104	13.084
Interest expense	(129)	(42)
Net financial income	61.787	162.935

11. Salaries and related expenses and personnel

	2018	2017
Salaries	469.033	474.557
Salary related expenses	134.990	137.257
Salaries and related expenses	604.023	611.814
Number of employees at the end of the year.	21	18
Average number of employees during the year.	21	19

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11. Salaries and related expenses and personnel, cont.

Compensation of the key management personnel:

	2018	2017
Flóki Halldórsson, Managing Director	40.177	36.001
Hrund Rudolfsdóttir, Chairman of the Board	7.855	7.290
Kristján Jóhannsson, Vice-Chairman of the Board	4.405	4.150
Jökull H. Úlfsson, Board-member	2.243	4.150
Ragnhildur Sophusdóttir, Board-member	1.685	3.140
Þórður Sverrisson, Board-member	5.600	5.160
Total renumeration	61.965	59.891

Renumeration to five managers was total ISK 134.2 million (ISK 112.6 million to five managers in 2017). Renumeration to one non-Board member of the Board Audit and Risk Committe was total ISK 1.0 million (ISK 1.0 million to two non-Board members in 2017).

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. In 2018 the company made a provision of ISK 64.4 million for performance plan payment, including salary related expense (ISK 84.4 million in 2017). Forty percent of the payment is deferred for three years if it exceeds 10% of the employee's annual salary without any bonus payments in accordance with FME rules on remuneration policy for financial undertakings. At the end of the year the company's accrual for performance plan payments amounts to ISK 155.6 million (ISK 160.4 million in the end of 2017).

12. Income tax expense

	2018	2017
Current tax expense	199.708	435.178
Prior year correction	0	(14.197)
Deferred tax expense	16.970	43.437
Total Income tax expense	216.678	464.418

13. Securities

Securities with variable income are specified as follows:

	31.12.2018	31.12.2017
Fund units issued by funds operated by Stefnir hf.	1.921.062	2.559.453
Shares in investment companies	110.035	115.801
Shares in companies	4	15.668
	2.031.101	2.690.922

Securities with fixed income are specified as follows:

	31.12.2018	31.12.2017
Listed on NASDAQ OMX Iceland:		
Issued by public entities	4.505	5.802
Unlisted:		
Issued by public entities	1.705	2.159
Isued by others	14.706	33.563
	20.916	41.524
Securities total	2.052.017	2.732.446

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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 during the year. Transaction with related parties have been conducted on an arm's length basis.

Transactions with related parties 2018.

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	165.171	540.209	220.418	47.752
Funds in operation	1.639.780	0	331.377	0
	1.804.951	540.209	551.795	47.752

Transactions with related parties 2017.

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	165.773	500.762	139.061	53.558
Funds in operation	1.939.948	0	355.349	0
	2.105.721	500.762	494.410	53.558

15. Assets under Management

Assets under Management in funds in operation by Stefnir at the end of the year amount to ISK 331 billions compared to ISK 347 billions at year end 2017.

16. Equity

a. Share capital amounts to ISK 43,5 million at year end, unchanged from year end 2017, with par value of ISK 1 per share.

b. Changes in eqity are specified as follows:

	Share capital	Statutory reserve	Fair value equity reserve	Retained earnings	Total
Equity 1.1.2017	43.500	10.875	33.818	2.360.390	2.448.583
Dividend paid	0	0	0	(890.000)	(890.000)
Net earnings	0	0	0	1.679.692	1.679.692
Fair value equity reserve ...	0	0	41.658	(41.658)	0
Equity 31.12.2017	43.500	10.875	75.476	3.108.424	3.238.275
Equity 1.1.2018	43.500	10.875	75.476	3.108.424	3.238.275
Dividend paid	0	0	0	(1.350.000)	(1.350.000)
Net earnings	0	0	0	897.146	897.146
Fair value equity reserve ...	0	0	(34.779)	34.779	0
Equity 31.12.2018	43.500	10.875	40.697	2.690.349	2.785.421

According to the Financial Statements Act No. 3/2006 fair value changes of financial assets from the initial reporting, shall be transferred from retained earnings to a fair value equity reserve, net of tax. The fair value equity reserve is not subject to dividend payments. The fair value equity reserve shall be released in accordance with fair value changes recognized when financial asset is sold or redeemed or the assumptions for the fair value change is no longer in force.

c. Return on assets, presented as the ratio between net earnings and the average balance of assets according to the Balance Sheet, was 23,3% in 2018. Return on assets in 2017 was 45,4%.

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16. Equity, cont.

d. Equity at end of the year is ISK 2.785 million or 78,6% of total assets.

The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 74,2%, exceeding the minimum legal requirement of 8%.

Comparison figures have been changed accordingly. The ratio is calculated as follows:

	31.12.2018	31.12.2017
Total equity	2.785.421	3.238.275
Total own funds for solvency purposes	2.785.421	3.238.275
Total capital requirements are specified as follows:		
Credit risk	235.530	265.465
Market risk	64.785	54.240
Capital requirement	300.315	319.705
Capital requirement due to fixed overheads	300.485	292.180
Capital adequacy ratio	74,2%	81,0%

17. Tax assets (liabilities)

Changes in tax assets and liabilities are specified as follows:

	31.12.2018	31.12.2017
Tax assets at the beginning of the year	(438.255)	(148.777)
Income tax recognised in Statement of Income	(216.678)	(464.418)
Income tax paid	435.179	174.940
Net tax assets (liabilities) at the end of the year	(219.754)	(438.255)
Specified as follows:		
Current tax	(199.708)	(435.178)
Deferred tax assets (liabilities)	(20.046)	(3.077)
Net tax assets (liabilities) at the end of the year	(219.754)	(438.255)
Deferred tax assets are attributable to the following:		
Deferred foreign exchange gain and loss	(7.075)	4.862
Provision	(12.811)	(12.956)
Other items	(160)	5.017
Deferred tax assets (liabilities) at the end of the year	(20.046)	(3.077)
Tax liabilities are attributable to the following:		
Income tax using the Icelandic corporation tax rate	199.708	435.178
Tax liabilities at the end of the year	199.708	435.178

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18.	**Shareholders of Stefnir hf.**	**31.12.2018**	**31.12.2017**
	Shareholders of Stefnir hf. with shareholding exceeding 1% of issued share capital:		
	Arion banki hf.	99,93%	99,93%
	Shareholders of Arion banki hf.:		
	Kaupskil ehf.	*32,70%*	*55,57%*
	Taconic Capital Advisors	*10,00%*	*9,99%*
	Arion banki hf.	*9,30%*	*9,50%*
	Attestor Capital	*7,40%*	*12,44%*
	Och Ziff Capital management	*6,60%*	*6,58%*
	Goldman Sachs funds	*3,50%*	*3,37%*
	Eaton Vance funds	*3,30%*	-
	Lansdowne funds	*2,90%*	-
	Gildi lífeyrissjóður	*2,50%*	-
	Milton Asset Management funds	*1,40%*	-
	Artemis	*1,20%*	-
	MainFirstBank AG	*1,00%*	-
	Deutsche Asset & Wealth Management	*1,00%*	-
	Other	*17,20%*	*2,55%*
		100,00%	*100,00%*

In the case of any discrepancy between the English and the Icelandic texts, the Icelandic versions shall prevail and questions of interpretation will be addressed solely in the Icelandic language.

Stefnir hf. Financial Statements 2018 16 Amounts are in ISK thousands

Corporate Governance Statement of Stefnir hf. 2019

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 Act No. 161/2002. The Guidelines on Corporate Governance, 5th edition, issued by the Icelandic Chamber of Commerce, SA – Business Iceland, and Nasdaq Iceland hf. and the OECD's Principles of Corporate Governance from 2015 were used as a reference when 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 the first Icelandic company to be recognized for "Excellence 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. Stefnir has since been recognized in this way on repeated occasions and therefore remains a model company in good corporate governance in Iceland.

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 enables the board to perform its monitoring duties effectively.

Stefnir is an independent financial institution according to the Financial Undertakings Act No. 161/2002. The company manages UCITS, investment funds and institutional 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 management company with assets of approximately ISK 331 billion under active management. Stefnir has 21 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 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 supervised 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 in 2018 updated its risk policy for the company with a special emphasis on reputational risk:

"Stefnir's board of directors is aware that risk management and active internal control are some of the mainstays of a responsible fund management company. By setting out a clear risk policy the board wishes to encourage and support a corporate culture at Stefnir which is characterized by a keen sense of risk awareness. The aim is also to communicate clear messages to all the company's stakeholders.

All risk within Stefnir's operations is identified and assessed on a regular basis. The company has established processes to monitor and report this risk. A special emphasis is on limiting reputational risk for the benefit of all stakeholders. 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 meticulous corporate governance the board of directors ensures that the policies, processes and systems are implemented at all decision levels."

The company's risk appetite has been defined and this work was based on international models which were adapted to Icelandic conditions and the company. The company's audit and risk committee participated in the preparation of the work defining the risk appetite and tolerance limits. The board of directors of Stefnir reviews the company's risk appetite on an annual basis to take into account changes in the company's internal and external environment.

Corporate Governance Statement, cont.:

Compliance, internal auditing and risk management are partly outsourced to Arion Bank with the permission of the FME. The heads of the relevant divisions regularly report the results of their assessments to the board of directors of Stefnir and the audit and risk committee. Internal control and risk management is the responsibility of a member of risk management who is part of the company's operations team. All supervisory measures are documented and regularly assessed by the team. The audit and risk committee is informed of the progress of these measures.

The structure and organization of internal corporate governance are vital tools for the effective management of the company, the separation of different business units and the prevention of conflicts of interest. Internal corporate governance at Stefnir has been assessed with respect to the FME Guidelines No. 1/2016 and the board of directors is of the opinion that the company operates in accordance with the standards set out there concerning best practice in internal corporate governance.

The company’s accounting is outsourced to 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 price calculations of funds managed by Stefnir are the responsibility of the Bank. The audit and risk committee examines the company’s 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 Deloitte.

Stefnir’s core values have been an important guideline for employees and the board of directors, who devised them together, in their day-to-day work.

The first core value is “success through knowledge” which implies that our strengths are embodied in the combination of knowledge, experience, professional corporate governance and fund management. Meticulous working practices, responsibility and reliability lay the foundations for future success. By doing this we are safeguarding our clients' interests.

Our second core value is “the ambition to excel” which describes our progressive, determined and dynamic approach in which we do not hesitate to seek new ways to achieve our goals. Fertile thinking, ambition and financial clout provide a platform for us to lead the way in developing new financial products. This is how we create key opportunities to excel for the benefit of our clients.

The third and final core value is “united in a strong team" and it describes how the way we operate is characterized by clearly defined team work, mutual respect and a healthy team spirit in which we support each other in what we do. We are known for our well-considered decisions which we regularly review and re-evaluate. This is how we harness the synergy of a dynamic team in order to provide our clients with outstanding service.

The Board of Directors have established codes of ethics which the board and employees are working in accordance with, and other benchmarks on the same topic can be found in employment agreements, the conflicts of interest policy and the board of directors’ rules of procedure.

The company has not established a formal policy on corporate social responsibility but in setting out its strategy and defining its role the board of directors has underlined the importance of being guided by the interests of clients, owners, employees and society as a whole when managing funds and running the company. Stefnir is a signatory to Principles for Responsible Investment and undertakes to provide information on how it takes into account environmental, social and corporate governance issues when managing its investments. The company is also one of the founding members of Iceland SIF, which was founded in 2017. Iceland SIF is an independent forum for discussion and education on responsible and sustainable investment. Responsible and diverse investment options and thorough disclosure of information are central to the corporate social responsibility that the company aspires to demonstrate. A policy on responsible investing was set in 2018 and will be incorporated into all investment processes in 2019.

Stefnir has adopted a policy on conflicts of interest. The objective of the policy is to protect clients and fund members and to safeguard the independence and reputation of the company and its employees. The policy applies equally to directors and employees and implies that the company will take all available measures to prevent conflicts of interest from damaging the interests of clients and fund members. An extract of the policy and other rules designed to prevent conflicts of interest, e.g. rules on business dealings by employees of Stefnir, can be found on the company’s website.

Corporate Governance Statement, cont.:

Stefnir has five board members and two 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 the 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. Stefnir's attorney is the secretary to the board and provides legal advice to the directors 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.is

The board of directors of Stefnir comprises the independent board members Hrund Rudolfsdóttir, Chairman, CEO of Veritas, Kristján Jóhannsson, Vice Chairman, chairman of Icepharma hf, and Thórdur Sverrisson, self-employed. Dependent board members are Jökull H. Úlfsson, head of human resources at Arion Bank hf, and Ragnhildur Sophusdóttir, head of Recovery and Litigation within the Legal Department of Arion Bank hf. Hrund Rudolfsdóttir has served on the board since 2009, Kristján Jóhannsson was elected to the board in June 2011, Jökull H. Úlfsson in March 2013, Thórdur Sverrisson in March 2014 and Ragnhildur Sophusdóttir in March 2016. Further information on the board members of Stefnir can be seen on the company's website.

The alternate board members are Ásgerdur Hrönn Sveinsdóttir, dept. manager at Arion Bank hf., and Thórhallur Örn Gudlaugsson, lecturer in the faculty of business administration at the University of Iceland. The audit and risk committee was appointed by the board of directors in March 2018. The chairman of the commitee is Thórdur Sverrisson, director on the board of Stefnir. The other committee members are Kristján Jóhannsson, board member at Stefnir, and Sigrídur Gudmundsdóttir, internal auditor at Marel hf. The audit and risk committee met eight times in 2018 and achieved a quorum on each occasion. Sigrídur Gudmundsdóttir resigned from the committee in December due changes in her work commitment. 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 submits its annual report to the board of directors in the first quarter of every year. The committee's rules of procedure can be found on the company's website.

The board of directors of Stefnir appointed Hrund Rudolfsdóttir, Jökull H. Úlfsson and Thórdur Sverrisson to the remuneration committee in March 2018. The main roles of the committee are to prepare a proposal for a remuneration policy for the company and to make proposals on salaries and other remuneration to the managing director, other management and the board of Stefnir. The committee also deals with a range of monitoring functions related to remuneration and human resources. The remuneration committee met six times in 2018 and achieved a quorum on each occasion. The committee works in accordance with its rules of procedure and has established a work schedule for its operating year. The rules of procedure of the remuneration committee are not publically available. The committee submits its annual report to the board of directors in the first quarter of every year. The company's remuneration policy can be viewed on its website.

No nomination committee has been appointed with Stefnir.

The board of directors 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. For the assessment the board uses an anonymous, electronic questionnaire. The results of the assessment are then discussed at a board meeting and the board's proposals for improvements are assigned to people for completion.

Corporate Governance Statement, cont.:

The company's managing director since 1 July 2009 has been Flóki Halldórsson (born 1973), who has a BA in economics from the University of Iceland and an EMBA from the Copenhagen Business School. Flóki has extensive experience of the financial markets and management. Flóki is a board director of companies which are connected to Stefnir's business. He or related parties have no shareholdings or call options in the company. 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 carry out limited aspects of their duties.

The managing director is responsible for analyzing, 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 and discharges them. The board's rules of procedure 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.

The board of directors' rules of procedure cover in detail the protocol for communications between shareholders and the board. The rules basically state that the chairman of the board is responsible for communications between the board and shareholders. The chairman shall ensure that the board is informed of all communications with shareholders and that at every board meeting a report, verbal or in writing, shall be given on communications with shareholders between meetings. The rules of procedure can be viewed on Stefnir's website.

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. In May the Financial Supervisory Authority (FME) published the results of its survey of specific parts of risk management within Stefnir. Following the conclusion of the FME Stefnir's internal editor was to inform the FME of amendments made in a report in June 2018.

Stefnir has been a leader in many areas and has placed great importance on 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. The company's website performs an important role in this respect by displaying detailed information on all the Stefnir funds available to the public.