



Asset Management Company

Financial Statements 2016

Stefnir hf.
Borgartun 19
105 Reykjavík

Reg. no. 700996-2479

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

The purpose of Stefir 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. Stefir is Iceland's largest fund manager with assets of approximately ISK 408 billion under active management. Stefir is a subsidiary of Arion Bank hf. and 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 Stefir 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 of the Financial Supervisory Authority on the accounts of UCITS management companies.

Operations during the year

The company reported earnings of ISK 741,3 million in the period according to the income statement. The company's equity at the end of the period was approximately ISK 2,5 billion according to the balance sheet. The capital ratio, calculated according to the Financial Undertakings Act, is 75,0 %, 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 related companies.

Highlights of 2016

The company's annual general meeting was held on 10 March 2016 and a decision was taken at the AGM to pay a dividend of ISK 1 billion to the shareholders of Stefir. The board of directors of Stefir 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 who are board directors. Svava Bjarnadóttir, a director at Stefir since 2009, left the board.

In 2012 Stefir was the first Icelandic company to be named "A model company in good corporate governance." The company is constantly working on maintaining and developing corporate governance. The board and employees of Stefir took several steps during the year to raise awareness and highlight the importance of corporate governance. The board of Stefir has supported research in the university community into good corporate governance, has sponsored a conference on good corporate governance in small and medium-sized enterprises in Iceland and two of the company's directors, Hrund Rudolfsdóttir and Kristján Jóhannsson, are lecturers on the course "Good corporate governance – qualified board members" at the Center for Corporate Governance.

Stefir has been recognized by Creditinfo as one of Iceland's most outstanding companies every year since 2011. We are proud that Stefir is considered to be one of the companies contributing to the development of the Icelandic business sector.

Assets under management increased by approximately ISK 8 billion during the year, from ISK 400 billion to ISK 408 billion. This change is chiefly related to an increase in alternative investments and bonds, while equities funds and funds focusing on equities decreased slightly during the year. Stefir – Liquidity Fund has attracted investment from individual and corporate investors, and the fund has grown just under 70% over the year. Assets under management are well distributed between asset classes and the company's revenue structure is consistent with the board's objectives.

Stefir has pioneered the development of new products for its clients. The changeable investment environment requires the company's experts to be ready to respond to investors' shifting focuses by offering new investment options or when managing funds. A new institutional investor fund ST1 was established in 2016. It invests in a diverse portfolio of bonds or loan agreements with collateral in real estate issued by individuals or legal entities. Reviewing the product offering is also part of the process of adapting the company to our clients' changing focuses. Stefir – Treasury Bill Fund was merged with Stefir – Treasury Note Fund and two international funds managed by Stefir, i.e. KMS – Emerging Markets and KMS – Global Equity merged.

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

Many of Stefmir's funds have a long history of generating positive returns for their investors. One of these is the investment fund Stefmir - Balanced Fund which celebrated its 20th year in business during 2016. Despite the fluctuations on the financial markets the fund has performed well in the long term and short term. The fund is one of the most popular in Iceland, with around 4,000 fund members. Many of these investors have been making regular savings in Stefmir funds for years.

Icelandic equities funds have been popular investment options in recent years as Stefmir has participated in the regeneration of the Icelandic stock market. Private equity funds managed by Stefmir have been a powerful driving force on the Icelandic corporate market. The year ended with a successful stock offering in Skeljungur hf. in which SF IV slhf, a company managed by Stefmir, sold its stake. Asset allocation funds managed by Stefmir have also benefited from alternative investments and have gained better access to investment options not generally available to smaller investors.

Stefmir has been a leader in private equity investments and alternative investments in Iceland for many years. There is an obvious appetite for a diverse range of investment options and Stefmir has met this demand with a variety of products suited to institutional investors' portfolios. Stefmir operates and manages both Icelandic and international private equity funds and the major owners of the funds are pension funds, insurance companies and other financial institutions. The year 2016 saw the completion of funding a ISK 12.8 billion institutional investors' fund, SÍA III slhf, which will invest in private equity with the aim of contributing to the growth and development of these businesses. The fund's first investment was in a company which will become the owner of the property and business of Marriott EDITION hotel by Reykjavík harbour.

Stefmir occupies a strong position as a manager of international equity funds in Iceland. The company employs an experienced team of experts to monitor economic developments and listed international companies and their approach to fund management has long attracted attention. Now that rules on investing in international financial instruments have been relaxed, there is a great opportunity for individual and corporate investors to spread risk by investing in international financial instruments. International funds managed by Stefmir are an attractive option for diversifying risk for Icelandic investors and savers.

The board of directors of Stefmir proposes to the company's shareholders that a dividend of ISK 890 million be paid out for 2016.

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 Stefmir 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 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 Stefmir's employees. The board of directors of Stefmir has approved a risk management strategy established 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 Stefmir is committed to good corporate governance and endeavours to promote responsible behaviour and corporate culture within Stefmir for the benefit of all the company's stakeholders.

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 2016 by signing below.

Reykjavik, 2. February 2017

The Board of Directors:

Steindur Rindalpetur
John S. Malmus
Kjartan Jónsson
Dagm. Jóns.

Managing Director:

Felxi Hauðmann

Independent Auditor's Report

To the Board of Directors Shareholders of Stefir hf

Opinion

We have audited the financial statements of Stefir hf. for the year ended December 31, 2016 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 Stefir hf. as at December 31, 2016, 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 Stefir 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 Stefir 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 Stefir 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 Stefmir 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.

Reykjavik, 2nd of February 2017


Deloitte ehf.
Páll Grétar Steingrímsson
State Authorized Public Accountant


Pétur Hansson
State Authorized Public Accountant

Statement of Income

for the year 2016

	Note	2016	2015
Operating income			
Management and performance based fees	4	2.051.521	2.306.048
Net financial income	10	(49.560)	239.935
Other income		0	0
Net operating income		<u>2.001.961</u>	<u>2.545.983</u>
Operating expense			
Salaries and related expense	11	600.590	612.531
Safe keeping commission		189.000	185.239
Other expense		293.579	279.198
Operating expense		<u>1.083.169</u>	<u>1.076.968</u>
Earnings before tax		918.792	1.469.015
Income tax	12	(177.473)	(298.702)
Net earnings	16	<u>741.319</u>	<u>1.170.313</u>

Statement of Financial Position

as at 31 December 2016

	Note	2016	2015
Assets			
Securities with variable income		2.025.457	2.379.807
Securities with fixed income		182.075	119.232
Total Securities	5, 13	<u>2.207.532</u>	<u>2.499.039</u>
Receivable from Arion Bank hf.		60.524	53.105
Accounts receivables	7	845.976	947.067
Total Receivables		<u>906.500</u>	<u>1.000.172</u>
Tax assets	9, 17	40.360	28.696
Other assets		51.491	35.254
Cash and cash equivalents	8	29.650	82.232
Total Other Assets		<u>121.501</u>	<u>146.182</u>
Total Assets		<u><u>3.235.533</u></u>	<u><u>3.645.393</u></u>
Equity			
Share capital		43.500	43.500
Statutory reserve		10.875	10.875
Fair value equity reserve		33.818	0
Retained earnings		2.360.390	2.652.889
Total Equity	16	<u>2.448.583</u>	<u>2.707.264</u>
Liabilities			
Payable to Arion Bank hf.		289.880	334.898
Accounts payable		5.151	5.948
Other liabilities		302.782	320.891
Tax liabilities	17	189.137	276.392
Total liabilities		<u>786.950</u>	<u>938.129</u>
Total Equity and Liabilities		<u><u>3.235.533</u></u>	<u><u>3.645.393</u></u>

Statement of Cash Flows

for the year 2016

	Note	2016	2015
Cash flows from operating activities			
Net earnings	16	741.319	1.170.313
Non-cash items included in net earnings:			
Valuation changes of securities		241.819	(260.047)
Income tax recognised in profit or loss		177.473	298.702
		<u>1.160.611</u>	<u>1.208.968</u>
Changes in operating assets and liabilities		13.511	(302.419)
Income tax paid	17	(276.392)	(210.105)
Net cash from operating activities		<u>897.730</u>	<u>696.444</u>
Investing activities			
Change in Securities with variable income		98.631	(28.168)
Change in Securities with fixed income		(48.943)	6.505
Investing activities		<u>49.688</u>	<u>(21.663)</u>
Finance activities			
Dividend paid	16	(1.000.000)	(900.000)
Finance activities		<u>(1.000.000)</u>	<u>(900.000)</u>
Net change in cash and cash equivalents		(52.582)	(225.219)
Cash and cash equivalents at the beginning of the year		82.232	307.451
Cash and cash equivalents at the end of the year.....	8	<u>29.650</u>	<u>82.232</u>

Notes to the Financial Statements

Accounting policies

1. General information

Stefnir hf. is a limited liability entity and operates in accordance with Act. 2/1995 on Limited Liability 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. Accounting principles for refunded fee to Arion bank was changed in 2015 and is now presented as other expense in the statement of income. Comparison figures have been changed accordingly. 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. The Consolidated Financial Statements for Arion Bank is available on the Bank's website, www.arionbank.com.

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 entities 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 year end. Listed fund units are measured at market value at 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 end of the year.

Notes, continued

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 amount to ISK 598 millions and are specified as follows:

	EUR	USD	GBP	Other
Assets	563.211	5.890	28.555	145
Liabilities	0	0	0	0
Net balance 31.12.2016	563.211	5.890	28.555	145
Net balance 31.12.2015	628.787	18.184	15.745	180
Exchange rate of ISK 31.12.2016	119,18	112,90	139,38	
Exchange rate of ISK 31.12.2015	141,28	130,08	191,84	

7. Receivables

Receivables are measured at nominal value deducted by impairment.

8. Cash

Cash consists of cash and deposits with credit institutions.

9. Tax assets

The calculation of deferred tax asset 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 securities 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:

	2016	2015
Valuation change in securities assets	(150.742)	300.904
Dividend received	190.951	3.968
Foreign exchange gain (loss)	(104.315)	(75.585)
Interest income	14.592	10.870
Interest expense	(46)	(222)
Net financial income	(49.560)	239.935

11. Salaries and related expenses and personnel

Salaries and related expenses are specified as follows:

Salaries	465.020	474.757
Salary related expenses	135.570	137.774
Salaries and related expenses	600.590	612.531
Number of employees at the end of the year	21	23
Average number of employees during the year	21	23

Notes, continued

11. Salaries and related expenses and personnel, cont.	2016	2015
Compensation of the key management personnel:		
Flóki Halldórsson, Managing Director	35.228	30.330
Hrund Rudolfsdóttir, Chairman of the Board	6.665	6.138
Kristján Jóhannsson, Vice-Chairman of the Board	3.585	2.640
Svava Bjarnadóttir, Board-member	1.089	4.356
Jökull H. Úlfsson, Board-member	3.585	2.640
Þórður Sverrisson, Board-member	5.163	2.640
Snjólfur Ólafsson, Former Vice-Chairman of the Board	2.450	0
Total remuneration	<u>57.765</u>	<u>48.744</u>

Remuneration to four managers was total ISK 96.9 million (ISK 89.7 million in 2015). Remuneration to two non-Board members of the Board Audit and Risk Committee was total ISK 1.1 million (ISK 1.7 million in 2015).

The Board of Stefnir has set rules for bonus payments in accordance with rules set by the Financial Supervisory Authority no. 700/2011 which have been confirmed by the FSA. In 2015 the company made a provision of ISK 63.9 million for performance plan payment, including salary related expense (ISK 98.9 million in 2014). Forty percent of the payment is deferred for three years 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 145,9 million (ISK 154,8 million in the end of 2015).

12. Income tax expense	2016	2015
Current tax expense	189.137	276.392
Deferred tax expense	(11.664)	22.310
Total Income tax expense	<u>177.473</u>	<u>298.702</u>

13. Securities

Securities with variable income are specified as follows:

Fund units issued by funds operated by Stefnir hf.	1.918.168	2.091.003
Shares in investment companies	107.245	283.901
Shares in companies	44	4.903
	<u>2.025.457</u>	<u>2.379.807</u>

Securities with fixed income are specified as follows:

Listed on NASDAQ OMX Iceland:

Issued by public entities	7.065	8.414
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Unlisted:

Issued by public entities	2.626	3.127
Issued by others	172.384	107.691

	<u>182.075</u>	<u>119.232</u>
Securities total	<u>2.207.532</u>	<u>2.499.039</u>

Notes, continued

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 2016:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	186.961	430.291	112.690	289.880
Funds in operation	2.196.371	0	276.069	0
	<u>2.383.332</u>	<u>430.291</u>	<u>388.760</u>	<u>289.880</u>

Transactions with related parties 2015:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	185.565	312.519	145.554	334.898
Funds in operation	2.218.961	0	285.170	0
	<u>2.404.526</u>	<u>312.519</u>	<u>430.724</u>	<u>334.898</u>

15. Assets under Management

Assets under Management in funds in operation by Stefnir at the end of the year amount to ISK 408 billions compared to ISK 400 billions at year end 2015.

16. Equity

a. Share capital amounts to ISK 43.5 million at year end, unchanged from year end 2015, with par value of ISK 1 per share.

b. Changes in equity are specified as follows:

	Statutory Share capital	Fair value reserve	Fair value equity reserve	Retained earnings	Total
Equity 1.1.2015	43.500	10.875	0	2.382.576	2.436.951
Dividend paid	0	0	0	(900.000)	(900.000)
Net earnings	0	0	0	1.170.313	1.170.313
Equity 31.12.2015	<u>43.500</u>	<u>10.875</u>	<u>0</u>	<u>2.652.889</u>	<u>2.707.264</u>
Equity 1.1.2016	43.500	10.875	0	2.652.889	2.707.264
Dividend paid	0	0	0	(1.000.000)	(1.000.000)
Net earnings	0	0	0	741.319	741.319
Fair value equity reserve ...	0	0	33.818	(33.818)	0
Equity 31.12.2016	<u>43.500</u>	<u>10.875</u>	<u>33.818</u>	<u>2.360.390</u>	<u>2.448.583</u>

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.

Notes, continued

16. Equity, cont.

- c. Return on assets, presented as the ratio between net earnings and the average balance of assets during the year according to the Balance Sheet, was 22.4% in 2016. Return on assets in 2015 was 34.2%.
- d. Equity at end of the year is ISK 2.449 million or 75.7% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 75,0%, exceeding the minimum legal requirement of 8%. Comparison figures have been changed accordingly. The ratio is calculated as follows:

	2016	2015
Total equity	2.448.583	2.707.264
Tax asset	(40.360)	(28.696)
Total own funds for solvency purposes	<u>2.408.223</u>	<u>2.678.568</u>
Total capital requirements are specified as follows:		
Credit risk	209.162	243.573
Market risk	47.824	53.032
Capital requirement	<u>256.986</u>	<u>296.605</u>
Capital adequacy ratio	75,0%	72,2%

17. Tax assets (liabilities)

Changes in tax assets and liabilities are specified as follows:

Tax assets at the beginning of the year	(247.696)	(159.099)
Income tax recognised in Statement of Income	(177.473)	(281.073)
Additional 6% tax recognised in Statement of Income	0	(17.629)
Income tax paid	276.392	210.105
Net tax assets (liabilities) at the end of the year	<u>(148.777)</u>	<u>(247.696)</u>

Specified as follows:

Current tax	(189.137)	(258.763)
Additional 6% tax on financial institution	0	(17.629)
Deferred tax asset	40.360	28.696
Net tax assets (liabilities) at the end of the year	<u>(148.777)</u>	<u>(247.696)</u>

Deferred tax assets are attributable to the following:

Securities	25.646	25.646
Deferred foreign exchange gain and loss	18.948	11.579
Provision	(9.228)	(10.079)
Other items	4.994	1.550
Deferred tax asset at the end of the year	<u>40.360</u>	<u>28.696</u>

Tax liabilities are attributable to the following:

Income tax using the Icelandic corporation tax rate	189.137	258.763
Additional 6% tax on financial institutions	0	17.629
Tax liabilities at the end of the year	<u>189.137</u>	<u>276.392</u>

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.

Corporate Governance Statement of Stefnr hf. 2017

By issuing this corporate governance statement Stefnr hf. (Stefnr) 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 Stefnr hf.'s corporate governance statement was written. The Guidelines on Corporate Governance and the Principles of Corporate Governance can be viewed on Stefnr's website.

In 2012 Stefnr 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 ehf. Stefnr 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 Stefnr believes that good corporate governance is a key factor behind Stefnr'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.

Stefnr 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. Stefnr is Iceland's largest fund management company with assets of approximately ISK 408 billion under active management. Stefnr has 21 employees with extensive experience of work in financial markets.

Stefnr 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 Stefnr, parties that service and participate in the operations of Stefnr, 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. Stefnr 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 devised a risk strategy for the company:

"Stefnr'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 Stefnr 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 Stefnr's operations is identified and assessed on a regular basis. The company has established processes to monitor and report this risk. Stefnr operates a strong control environment which utilizes policies, processes and systems to appropriate internal controls and risk mitigation. Stefnr 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 was defined during the year and this work was based on international models which were adapted to Icelandic conditions and the company. The company's audit and risk committee played a crucial role in the work defining the risk appetite and tolerance limits. The board of directors of Stefnr will review 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 Stefmir 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 Stefmir 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 Stefmir hf. and the price calculations of funds managed by Stefmir 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 Stefmir and the funds managed by Stefmir. 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 ehf.

Stefmir'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 company's core values reflect the ethical standards 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. Responsible and diverse investment options and thorough disclosure of information are central to the corporate social responsibility that the company aspires to demonstrate.

Stefmir 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 Stefmir, 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 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. Stefnir's attorney is the secretary to the board and provides legal advice to the directors at board meetings. There were 13 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, attorney at 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, area 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 April 2016. The chairman of the board is Thórdur Sverrisson, director on the board of Stefnir. The other committee members are Kristján Jóhannsson, board member at Stefnir, and Sigríður Gudmundsdóttir, internal auditor at Marel hf. The audit and risk committee met seven times in 2016 and achieved a quorum on each occasion. The role of the audit and risk committee and its rules of procedure were modified in 2016 following changes to the Financial Undertakings Act No. 161/2002. 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 April 2016. 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 2016 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. 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.

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 MBA 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. At the end of July the Financial Supervisory Authority (FME) published the results of its investigation into investments by investment funds managed by Stefnir hf. The FME concluded that the company was in breach of Article 59 (4.1) of Act No. 128/2011 but no fine was imposed on the company.

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.