



Asset Management Company

Financial Statements 2013

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

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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 around enterprise investment schemes. Stefir is Iceland's largest fund management company with assets of approximately ISK 414 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. They have been prepared according to the same accounting methods as last year. The Financial Statements have been prepared in accordance with the Annual Accounts 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 1,046 million in the year according to the income statement. The company's equity at the end of the year was ISK 2,570 million according to the balance sheet. The capital ratio, calculated according to the Act on Financial Undertakings, is 65.2%, the minimum being 8.0% according to the Act.

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

## Highlights of 2013

The company's annual general meeting was held on 20 March 2013 and a decision was taken to pay a dividend of ISK 900 million to the shareholders of Stefir. The board of directors of Stefir was elected at the meeting and comprises the following members: Hrunn Rudolfsson, chairman, Snjólfur Ólafsson, vice chairman, Jökull Heiddal Úlfsson, Kristján Jóhannsson and Svava Bjarnadóttir are board members.

In 2012 Stefir was recognized as the first Icelandic company to be "A model company in good corporate governance." This honour was granted by the Center for Corporate Governance at the University of Iceland and is awarded on the basis of a number of factors, including a survey conducted by the auditing company KPMG ehf. In July 2013 Stefir was given the same award for 2013. The company is constantly working on maintaining and developing corporate governance and the board's decision to formally establish a remuneration committee during the spring is part of this effort. The board therefore now has two sub-committees; an audit committee was already functioning.

In March 2013 Stefir hf. became a member of the Icelandic Financial Services Association (SFF). By becoming a member of the SFF the company will help protect the interests of the Icelandic financial sector and will also become a member of the Confederation of Icelandic Employers (SA).

Assets under management increased from approximately ISK 386 billion to more than ISK 414 billion during the year, an increase of 7.2% year on year. At the same time the company has diversified its income base due to a broader range of funds in its fund offerings.

Over the year there was a substantial difference between different asset classes in terms of returns. Bond funds yielded significantly lower nominal returns than last year, with the exception of non-indexed government bonds. The main reasons for this are the appreciation of the Icelandic króna at the beginning of the year, falling inflation and rising yields on indexed bonds. Non-indexed bonds made gains during the early part of the year. Numerous other external factors, such as uncertainty over union wage agreements, the government's proposals on debt relief and the government budget also affected the bond market. Equities funds managed by Stefir and mixed funds with a focus on equities had an excellent year. There was a strong flow of capital into the funds and returns were outstanding. Stefir – ÍS 15 yielded over 43% nominal return in 2013 and Stefir Managed Balanced Fund yielded over 21% nominal return. International funds managed by the company also had a good year, mirroring the strong performance of international markets generally. The MSCI world index in euros yielded more than 21% in 2013. Emerging markets struggled during the year as can be seen by the performance of international funds which invested in these markets. The capital controls place significant restrictions on investments by individuals and institutional investors, and international funds run and managed by Stefir have limited growth potential in this environment.

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

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In order to sharpen the focus of the available funds it was decided at the end of the year to merge the investment funds Stefñir – Verðbréfaal 1, Stefñir – Verðbréfaal 2 and Stefñir – Balanced Fund under the name of the latter. The merged fund has AuM of more than ISK 5 billion and approximately 4000 unit holders.

Alternative investments have increased in recent quarters, particularly investments in Icelandic private equity and real estate. Stefñir hf. completed the funding of a ISK 7.5 billion private equity fund, SÍA II, at the beginning of 2013. The fund has 30 shareholders that include pension funds, financial institutions and institutional investors. Stefñir and its co-investors have been leading investors in private equity and have invested more than ISK 16 billion in the Icelandic business sector. SÍA II has worked on the acquisition of the domestic operations of Norvik since last spring. It includes the retail businesses of Kaupás, Elko, and Intersport as well as the warehouse hotel Bakkinn and the advertising agency Expo. Towards the end of 2013, a deal was finalized on the acquisition of all the share capital in Skeljungur and the Faroese oil company P/F Magn, and the deal was led by the SÍA II. Stefñir's real estate fund team, on behalf of SRE II slhf., acquired Fiskislód 2, which houses the self-storage center Geymslur.is, and an 85% share in Hótel Borg. The team also completed bond financing of the premises of Nýherji and Advania for ISK 2,750 million. Stefñir's bond team issued two bonds during the year. Firstly, ISK 5.7 billion asset-backed bond to finance the real estate portfolio of Klasi Fasteignir ehf., and secondly, almost ISK 700 million bond linked to returns on the KMS Bric fund managed by Stefñir.

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

The board of directors of Stefñir is committed to good corporate governance and endeavours to promote responsible behaviour and corporate culture within Stefñir for the benefit of all the company's stakeholders. Further information about corporate governance can be found in Stefñir's corporate governance statement for 2014.

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

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

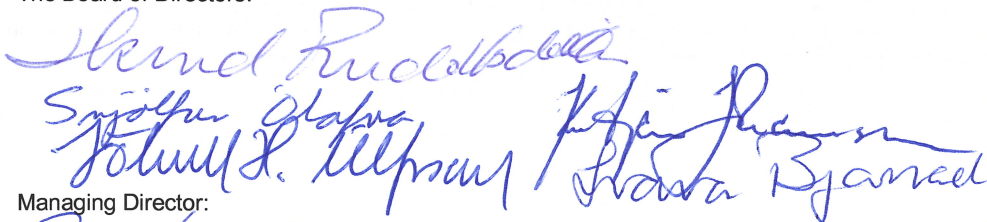
Following a judgment by the Supreme Court of Iceland on 16 January 2014 Stefñir hf. was cleared of the charges brought by LBI hf. in respect of transactions made by funds under the company's management with Landsbanki Íslands, before and the around the time of the collapse of the bank. The management company has met the litigation costs and the effect on the operations and the price of the UCITS involved is zero.

## Endorsement of the board of directors and the Managing Director

The Board of Directors and Managing Director of Stefñir hf. hereby confirm the company's Financial Statements for the year 2013 by means of their signatures.

Reykjavík, 11 March 2014

The Board of Directors:



Handwritten signatures of the Board of Directors and the Managing Director in blue ink.

Managing Director:



Handwritten signature of the Managing Director in blue ink.



# Independent Auditor's Report

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## **To the Board of Directors and Shareholders of Stefnr hf.**

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

## **Management's Responsibility for the Financial Statements**

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

## **Auditor's Responsibility**

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

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

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

## **Opinion**

In our opinion, the financial statements give a true and fair view of the financial position of Stefnr hf. as at 31 December 2013, and of its financial performance and cash flows for the year then ended in accordance with the Icelandic Financial Statements Act, the Financial Undertakings Act and Rules on the Financial Statements of management companies of UCITS.

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

Pursuant to the requirement of Paragraph 2 of Article 104 of the Icelandic Financial Statements Act No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the Managing Director includes all information required by the Icelandic Financial Statements Act that is not disclosed elsewhere in the Financial Statements.

Reykjavik, 11 March 2014

Margrét Pétursdóttir

State Authorized Public Accountant

Ernst & Young ehf.

Borgartúni 30

105 Reykjavík

# Statement of Income

## for the year 2013

	Note	2013	2012
<b>Operating income</b>			
Management and performance based fees .....	4	1.531.977	2.022.294
Net financial income .....	10	157.093	206.317
Net operating income		<u>1.689.071</u>	<u>2.228.611</u>
<b>Operating expense</b>			
Salaries and related expense .....	11	463.095	420.837
Safe keeping commission .....		210.232	172.915
Service fee to Arion bank hf. ....		26.942	27.648
Other expense .....		188.828	175.569
Provision for court case .....	18	( 500.000)	500.000
Operating expense		<u>389.096</u>	<u>1.296.969</u>
<b>Earnings before tax.....</b>		1.299.974	931.642
Income tax .....	12	( 254.053)	( 195.606)
<b>Net earnings.....</b>	16	<u><u>1.045.921</u></u>	<u><u>736.037</u></u>

# Statement of Financial Position

## as at 31 December 2013

	Note	2013	2012
<b>Assets</b>			
Securities with variable income .....		1.907.043	2.073.946
Securities with fixed income .....		59.476	64.020
Total Securities	5, 13	1.966.519	2.137.966
Receivable from Arion Bank hf. ....		2.391	0
Accounts receivables .....	7	472.077	428.431
Total Receivables		474.468	428.431
Tax assets .....	9, 17	47.046	128.863
Other assets .....		151.464	24.334
Cash and cash equivalents .....	8	597.587	755.688
Total Other Assets		796.098	908.885
<b>Total Assets</b>		<b>3.237.085</b>	<b>3.475.282</b>
<b>Equity</b>			
Share capital .....		43.500	43.500
Statutory reserve .....		10.875	10.875
Retained earnings .....		2.515.503	2.369.581
Total Equity	16	2.569.878	2.423.956
<b>Liabilities</b>			
Payable to Arion Bank hf. ....		277.113	238.838
Accounts payable .....		4.901	7.759
Other liabilities .....		211.678	699.422
Tax liabilities .....	17	173.515	105.308
Total liabilities		667.207	1.051.326
<b>Total Equity and Liabilities</b>		<b>3.237.085</b>	<b>3.475.282</b>

# Statement of Cash Flows

## for the year 2013

	Note	2013	2012
<b>Cash flows from operating activities</b>			
Net earnings .....	16	1.045.921	736.037
Non-cash items included in net earnings:			
Valuation changes of securities .....	(	186.528)	( 140.776)
Income tax recognised in profit or loss .....		254.053	195.606
Changes in operating assets and liabilities .....	(	625.494)	519.587
		487.953	1.310.453
Income tax paid .....	17	( 104.029)	( 9.273)
Net cash from operating activities		383.925	1.301.179
<b>Investing activities</b>			
Change in Securities with variable income .....		337.238	( 898.830)
Change in Securities with fixed income .....		20.738	13.561
Investing activities		357.975	( 885.269)
<b>Finance activities</b>			
Dividend paid .....	16	( 900.000)	( 700.000)
Finance activities		( 900.000)	( 700.000)
Net change in cash and cash equivalents .....		( 158.100)	( 284.089)
Cash and cash equivalents at the beginning of the year .....		755.688	1.039.777
Cash and cash equivalents at the end of the year.....	8	597.587	755.688



# Notes to the Financial Statements

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

### 2. Basis of preparation

The Financial Statements of Stefnir hf., A-part, are prepared in accordance with law on Financial Statements, law on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS. The Financial Statements are prepared on the historical cost basis except for Securities that are valued at fair value. The Financial Statements are presented in Icelandic króna (ISK), rounded to the nearest thousand unless otherwise stated. The 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 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 year end.

## 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 1.158 millions and are specified as follows:

	EUR	USD	GBP	Other
Assets .....	1.087.926	38.614	33.307	4.483
Liabilities .....	( 2.693)	( 498)	( 2.987)	0
Net balance 31.12.2013 .....	1.085.233	38.115	30.320	4.483
Net balance 31.12.2012 .....	1.062.138	45.581	37.944	225

### 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:

	2013	2012
Valuation change in securities assets .....	221.136	106.968
Dividend received .....	4.144	0
Foreign exchange gain (loss) .....	( 80.958)	86.683
Interest income .....	13.046	12.738
Interest expense .....	( 275)	( 71)
Net financial income .....	157.093	206.317

### 11. Personnel

Salaries and related expenses are specified as follows:

Salaries .....	357.469	323.887
Salary related expenses .....	106.076	96.949
Salaries invoiced .....	( 450)	0
Salaries and related expenses .....	463.095	420.837

Number of employees is as follows:

Employees at the end of the year .....	21	20
Average number of employees during the year .....	20	18

## Notes, continued:

<b>11. Personnel, cont.</b>	<b>2013</b>	<b>2012</b>
Compensation of the key management personnel:		
Flóki Halldórsson, Managing Director .....	26.398	24.541
Hrund Rudolfssdóttir, Chairman of the Board .....	4.900	3.600
Snjólfur Ólafsson, Vice-Chairman of the Board .....	3.035	2.400
Kristján Jóhannsson, Board-member .....	2.300	1.800
Svava Bjarnadóttir, Board-member .....	2.600	1.800
Total remuneration .....	<u>39.233</u>	<u>34.141</u>

Remuneration to six managers total ISK 92.0 million (ISK 89.4 million to five managers in 2012). Remuneration to two non-Board members of the Board Audit and Risk Committee was ISK 1.6 million (ISK 1.2 million in 2012).

The Board of Stefir 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. Estimated accrued bonus payments for 2013, partly payable in 2014 and partly after three years, amount to ISK 42 million plus salary related expense. Total amount of ISK 53 million has been posted in the Statement of Financial Position. Bonus payments in 2013 amounted to ISK 30 million plus salary related expense. The remaining balance of accrued bonus payments for the year 2012 are payable in 2015 and amount to ISK 17 million, including salary related expense.

<b>12. Income tax</b>	<b>2013</b>	<b>2012</b>
Current year .....	254.053	186.332
Prior year correction .....	0	9.273
Total Income tax expense .....	<u>254.053</u>	<u>195.606</u>

## **13. Securities**

Securities with variable income are specified as follows:

Fund units issued by funds operated by Stefir hf. ....	1.700.015	1.925.480
Fund units issued by others .....	69.368	76.779
Shares in investment companies .....	<u>137.660</u>	<u>71.687</u>
	<u>1.907.043</u>	<u>2.073.946</u>

Securities with fixed income are specified as follows:

Listed on NASDAQ OMX Iceland:

Issued by public entities .....	10.614	11.862
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Unlisted:

Issued by public entities .....	4.151	4.664
Issued by others .....	<u>44.712</u>	<u>47.494</u>
	<u>59.476</u>	<u>64.020</u>
Securities total .....	<u>1.966.519</u>	<u>2.137.966</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 in the reporting period. Transaction with related parties have been conducted on an arm's length basis.

Transactions with related parties 2013:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated .....	185.935	229.197	613.499	277.113
Funds in operation .....	1.359.087	0	213.689	70.276
	<u>1.545.022</u>	<u>229.197</u>	<u>827.188</u>	<u>347.389</u>

### 15. Assets under Management

Assets under Management in funds in operation by Stefnir at the end of the year amount to ISK 414 billions compared to ISK 386 billions at year end 2012.

### 16. Equity

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

b. Changes in equity are specified as follows:

	Share capital	Statutory reserve	Retained earnings	Total
Equity 1.1.2012 .....	43.500	10.875	2.333.545	2.387.920
Dividend paid .....			( 700.000)	( 700.000)
Net earnings .....			736.037	736.037
Equity 31.12.2012 .....	<u>43.500</u>	<u>10.875</u>	<u>2.369.581</u>	<u>2.423.956</u>
Equity 1.1.2013 .....	43.500	10.875	2.369.581	2.423.956
Dividend paid .....			( 900.000)	( 900.000)
Net earnings .....			1.045.921	1.045.921
Equity 31.12.2013 .....	<u>43.500</u>	<u>10.875</u>	<u>2.515.503</u>	<u>2.569.878</u>

c. Equity at year end is ISK 2,570 thousands or 79.4% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 65.2%, exceeding the minimum legal requirement of 8%. The ratio is calculated as follows:

	2013	2012
Total equity .....	2.569.878	2.423.956
Tax asset .....	( 47.046)	( 128.863)
Total own funds for solvency purposes .....	<u>2.522.831</u>	<u>2.295.093</u>

Total capital requirements are specified as follows:

Credit risk .....	216.792	219.350
Market risk .....	92.652	91.671
Capital requirement .....	<u>309.445</u>	<u>311.021</u>
Capital adequacy ratio .....	65,2%	59,0%

## Notes, continued:

<b>17. Tax assets (liabilities)</b>	<b>2013</b>	<b>2012</b>
Changes in tax assets and liabilities are specified as follows:		
Tax assets at the beginning of the year .....	23.556	209.888
Income tax recognised in profit or loss .....	( 254.053)	( 186.332)
Income tax paid .....	104.029	0
Net tax assets (liabilities) at the end of the year .....	( 126.468)	23.556
Specified as follows:		
Current taxes .....	( 173.515)	( 105.308)
Deferred tax asset .....	47.046	128.863
Net tax assets (liabilities) at the end of the year .....	( 126.468)	23.556
Deferred tax asset es attributable to the following:		
Securities .....	39.057	39.057
Deferred foreign exchange gain and loss .....	5.043	( 13.693)
Provision .....	0	100.000
Other items .....	2.946	3.499
Deferred tax asset at the end of the year .....	47.046	128.863

## 18. Other information

In October 2011 the winding-up committee of Landsbanki Íslands brought legal action against the company demanding the annulment and repayment of payments made by Landsbanki Íslands of money market deposits which matured in early October 2008 to two funds managed by Stefnir. The amount involved was ISK 450 million plus interest. As a result of judgment by Reykjavík District Court, Stefnir, on behalf of the two funds, was ordered to repay the amounts. The company made provision in respect of this case in 2012. The case was appealed to the Supreme Court of Iceland where Stefnir was acquitted on 16 January 2014.

**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. 2014

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This corporate governance statement by Stefnr hf. is in compliance with the requirements set forth in recognized guidelines at the time these financial statements are approved by the board of the company and the provisions Article 19 of Act No. 161/2002. Guidelines on Corporate Governance, 4th edition, issued by the Icelandic Chamber of Commerce, the Confederation of Icelandic Employers and NASDAQ OMX Iceland hf. and OECD Principles of Corporate Governance were taken into special consideration when the Stefnr hf.'s corporate governance statement was written. Both the Guidelines on Corporate Governance and the Principles of Corporate Governance can be viewed on Stefnr's website.

In 2012 Stefnr was recognized as the first Icelandic company to be "A model company in good corporate governance." This honour was granted by the Center for Corporate Governance at the University of Iceland and is based on a survey conducted by the auditing company KPMG ehf. In 2013 Stefnr was granted the same recognition 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 hf. is an independent financial institution according to the Financial Undertakings Act No. 161/2002. The company manages UCITS, investment funds and professional investor funds under Act No. 128/2011. In addition to this, the company is licensed to operate asset management services, investment advisory and to manage financial instruments for collective investments, cf. sub-paragraphs 1-3 of paragraph 1 of Article 27 of Act No. 161/2002. Stefnr is Iceland's largest fund manager with assets of approximately ISK 414 billion under active management. Stefnr has 21 employees with average experience on the financial markets of 10 years.

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 monitored by the FME under Act No. 87/1998.

Risk management and active internal control are mainstays of the responsible operation of a fund management company. The board of directors of Stefnr 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 formulating a clear risk policy the board continues to encourage the existing strong risk management culture within Stefnr and simultaneously informs its policy to its stakeholders.

All risk within Stefnr's operations is identified and assessed regularly and a process to monitor and report this risk is in place. 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 corporate governance the board of directors ensures that the policies, processes and systems are implemented at all decision levels."

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

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



## Corporate Governance Statement, cont.:

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

The board of directors of Stefnir comprises the independent board members Hrunn Rudolfsdóttir, Chairman, CEO of Veritas, Snjólfur Ólafsson, Vice Chairman, professor in the faculty of business administration at the University of Iceland, Kristján Jóhannsson, chairman of Icepharma hf. and Svava Bjarnadóttir, partner and consultant at Strategía. The dependent board member is Jökull H. Úlfsson, head of A Plus at Arion Bank hf. The majority of board members have served on the board since 2009. Kristján Jóhannsson was elected to the board in June 2011 and Jökull H. Úlfsson in March 2013. Further information on the board members of Stefnir can be seen on the company's website.

The alternate board members are Ásgerður Hrönn Sveinsdóttir, area and branch manager at Arion Bank hf, Gunnar Ingi Jóhannsson, attorney at Lögmenn Höfðabakka, Kristbjörg Edda Jóhannsdóttir, head of marketing at Síminn, Þórhallur Örn Guðlaugsson, lecturer in the faculty of business administration at the University of Iceland, and Hördur Kvaran, specialist in Arion Bank's finance division.

The audit committee, elected by the board, was re-elected from the previous year. The chairman of the committee is Snjólfur Ólafsson. The other committee members are Guðlaug Sigurdardóttir and Sturla Jónsson. The audit committee met five times in 2013 and achieved a quorum on each occasion. The committee members are independent of the company and their broad expertise in business administration, auditing and management was put to good use in the course of the committee's business. The committee submits its annual report to the board of directors in the first quarter of every year. Stefnir's remuneration committee was founded during the year. Its members are Hrunn Rudolfsdóttir and Svava Bjarnadóttir. The main roles of the committee are to establish a remuneration policy for the company and to make proposals on salaries and other remuneration to the managing director, other management and board of Stefnir. The company's remuneration policy can be read on its website.

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

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

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

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

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

## Corporate Governance Statement, cont.:

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

New rules of procedure for the board were approved in January 2014. The rules were established with reference to Article 54 (2) of the Financial Undertakings Act and Article 70 (5) of the Public Limited Companies Act. The rules of procedure are largely based on guidelines No. 1/2010 of the Financial Supervisory Authority (FME) and the company's articles of association. The work undertaken in relation to the company's recognition as a model company in good corporate governance has been important in this respect. The rules of procedure can be viewed on Stefnr's website.

Stefnr has been at the forefront in offering its clients competitive and responsible investment options in virtually all asset classes. It is vital that the company is able to pass on information accurately and simply to investors. The company's website performs an important role in this respect by displaying detailed information on all the Stefnr funds available to the public.

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 Stefnr hf. Information on court cases relating to Stefnr can be found in the notes to the company's annual financial statement.