Risk Management Report

Eik Banki Føroya P/F
12.10.2010 – 31.12.2011

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2 Introduction

The purpose of Eik Banki Føroya's Risk Management is to monitor the operation in such a manner that it ensures that the Bank does not take on more risks than stipulated by the Board of Directors. The risk profile must in a profitable way support the Bank's business model.

In the daily operations Eik Banki Føroya is exposed to the following risks:

Credit risk, defined as the risk that the customers become unable to meet their financial obligations with Eik Banki Føroya, either because they lack the will or ability to pay on time.

Market risk, defined as the risk that the value of assets and liabilities will be affected, as well as off-balance sheet effects as a result of changes in the market value. Eik Banki Føroya's market risk contains interest rate risk, security risk, currency risk and other price risks including raw material risk.

Liquidity risk, defined as the risk of loss arising, when lack of funding prevents Eik Banki Føroya from meeting its obligations with current liquidity and liquidity contingency.

Operational risk, defined as the risk of financial losses due to inadequate or failed internal processes, human factors, IT-failures or external factors, including legal risk.

In the risk report solvency and individual solvency requirement are mentioned. The difference between the two is as follows:

Solvency is calculated according to the Capital Adequacy Regulations, where all assets are assessed according to risk in separate risk groups.

Individual solvency requirement is calculated using Eik Banki Føroya's risk profile, external factors and budget assumptions for the coming year, in addition to other circumstances, such as increased provisions for poor and non-performing exposures.

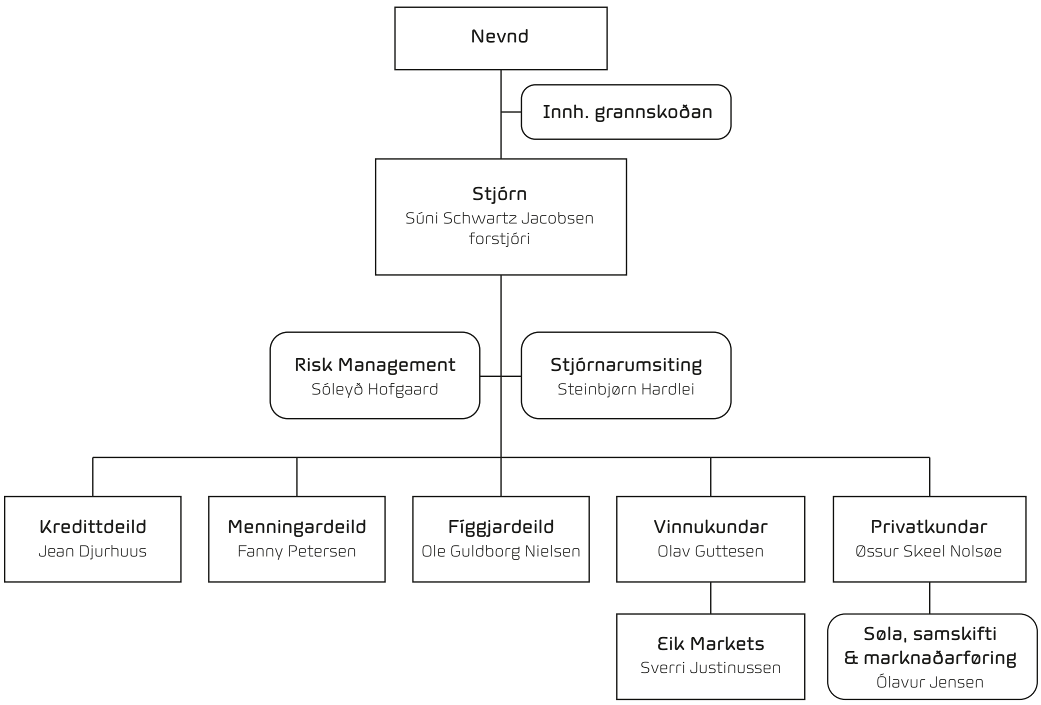
Each risk group will be defined in the following sections in terms of objective, risk policy and actual risk exposure.

3 Organisation

Eik Banki Føroya organisational structure is illustrated below for which the reporting duty applies.

General management and control of the above mentioned risks is centralised with organised reporting to the CEO and Board of Directors. Daily management, control and reporting are divided and performed in different business units in the Bank.

Risk Management controls credit risk, market risk, liquidity risk, operational risk and IT- risk on behalf of the CEO. The control is performed in accordance with the tasks of the Risk Management entity as stipulated in The Financial Business Act, Article 71, Executive order 1325, Executive Order regarding Management of Financial Institutions etc. 01/12/2010.



4 Base capital

This section describes the base capital including objective, policy and statement of base capital.

4.1 Policy

Base capital is calculated in accordance with "The Danish Financial Business Act" in addition to Guidelines for Statement of Solvency, Base Capital and Risk-weighted entries for Financial Institutions prepared by the Danish Financial Supervisory Authority.

4.2 Base Capital Statement

The table below shows the base capital statement as of 31.12.11.

Table 1: Base capital statement as of 31.12.2011 in DKK thousand.

	Amount
Core capital	1,485,921
Profit/loss	(255,921)
Deductions from core capita	
Intangible assets	(25,421)
Tax asses	(30,186)
Base capital after deduction	1,174,393

5 Solvency

This section describes the procedure regarding solvency statement and sufficient capital in addition to the individual solvency requirement.

The solvency is determined in accordance with The Executive Order on Capital Adequacy, which risk-weighs all assets in each risk category separately.

In addition to the solvency, the Bank is also required to determine the individual solvency requirement. This will ensure that the Bank has sufficient solvency, should the course turn negative and in order to meet the demands placed by the Danish Supervisory Authority. Individual solvency requirement is determined using the Bank's risk profile, social conditions and budget conditions for the coming year, in addition to other circumstances such as increased provisions for poor and non-performing exposures.

5.1 Objective and Policy

5.1.1 Solvency Statement

Solvency is calculated as core capital in relation to the risk-weighted assets. Core capital is determined in accordance with the conditions of chapter 10 in The Danish Financial Business Act, while the weighted assets are calculated in accordance with The Executive Order on Capital Adequacy. The risk-weighted assets are determined into three main categories: credit risk, market risk and operational risk.

The table below shows the Bank's solvency statement.

Table 2: Solvency statement in DKK thousand

Capital requirement	
Core capital before deduction	1,230,000
Intangible assets	(25,421)
Tax assets	(30,186)
Core capital after deduction	1,174,393
Subordinated debt	0
Core capital	**1,174,393**
Weighted assets	
Weighted assets outside of the trading assets, including figures not included in the balance	4,360,895
Weighted items with market risk	458,174
Operational risk	480,651
Total weighted assets	**5,299,720**
Solvency ratio in accordance with FIL Article 124, section 2, subsection 1	**22.2%**
Core capital after deduction in % of weighted assets	**22.2%**

5.1.2 Individual Solvency Requirement

The Bank's Management has chosen to base its calculation of the Bank's individual solvency requirement on a template developed by "Lokale Pengeinstitutter" and on Guidelines on Adequate Base Capital and Solvency Requirement for Financial Institutions (Vejledning om tilstrækkelig basiskapital og solvensbehov for pengeinstitutter) (Base Capital) issued by the Danish Financial Supervisory Authority.

The Management has estimated that on the basis of this model and the guidelines published by the Financial Supervisory Authority, the Bank's calculated individual solvency requirement is fair.

The method applied by Eik Banki Føroya for its calculation of the individual solvency requirement reserves capital within four risk areas, credit risk, market risk, operational risk and other matters.

The main purpose of the determination of the individual solvency requirement is to determine the size of the base capital necessary to withstand in the event of adverse development in the Bank's operations.

The variables and stress levels, which Eik Banki Føroya should use for tests are determined on the basis of the Bank's current situation, the requirements specified in the Capital Adequacy Regulation and the Guidelines on adequate Base Capital and Solvency Requirement for Financial Institutions. The stress tests are generally an attempt to expose the Bank's accounting figures to a number of negative events.

Stress tests are found in the first part of the individual solvency requirement model. The separate accounting entries, from the most current annual report, are "stressed" using certain variables.

Table 3: Stress tests in relation to the determination of solvency requirement

Stress variables	Influence on variables
Credit risk:	• Increase in impairments and provisions
Market risk:	• Increase in interest rate • Drop in share price • Drop in exchange rate • Counterpart risk on derivatives
Real estate risk:	• Drop in real estate prices
Other risks:	• Drop in income

The Management decides what risks the Bank should be able to overcome and thereby which variables to stress test. The total influence of the stress test on the individual solvency requirement is calculated by comparing the total influence of the result to the weighted accounting entries.

In addition to the risk areas included via stress tests, there are other risk areas which Eik Banki Føroya has found relevant to include in its assessment of the solvency requirement.

Table 4: Other risk areas assessed in relation to the determination of solvency requirement

Additional capital to cover credit risk	Including: • Customers with financial problems • Concentration risk of single commitments • Geographic concentration • Commercial concentration risk • Concentration of guarantees
Additional capital to cover market risk	
Additional capital to cover operational risk	
Additional capital to cover other matters	Including: • Strategic risk • Reputational risk • Property risk • Risk in relation to the size of the Bank • Funding • Liquidity risk • Group risk • Settlement risk • Other circumstances

In the Management's opinion, the risk factors included in the model are adequate to cover all of the risk areas, which the Bank's management is required by law to take into account in determining the individual solvency requirement as well as the risks, which the Management finds that the Bank has assumed.

In addition, the Management must assess whether the base capital is adequate to support possible future activities. At Eik Banki Føroya, this assessment is a part of the general determination of the individual solvency requirement. The Management therefore makes an annual assessment of how the expectations for growth affect the calculation of the solvency requirement.

The Management will decide a course of action on its stress future scenario and the level of risk profile for other risks. Stress factors have been chosen from Lokale Pengeinstitutter's template in addition to regulation from 13 January 2012 by the Danish Financial Supervisory Authority regarding sufficient base capital and solvency requirement.

The method for determining sufficient base capital, in addition to the conditions that are present for using the model, described in the section on solvency requirement and sufficient base capital is based on sector information, development overview and conditions in the coming year's budget.

The regulations in the Danish Financial Supervisory Authority's probability model are used to determine credit risk. These regulations are described in the Danish Financial Supervisory Authority's guidelines regarding sufficient base capital and individual solvency requirement for financial institutions.

Exposures with impairments and exposures that are part of exposure groups accounting for more than 1%

of the base capital are reviewed individually to determine the size of the loss if repayment agreements are not honoured (henceforth: LDG) in relation to a cautiously determined part that is in blank: a conservatively determined loss risk, shown as a percentage of the total exposure. A total of 58% of the total exposures before impairments have been reviewed individually.

Stress factors in the guideline from the Danish Financial Supervisory Authority regarding sufficient base capital and individual solvency requirement are used as basis for determining market risk.

The Bank uses the basis indicator method for determining operational risk. As mentioned in the section regarding operational risk, the solvency requirement for determined operational risk is DKK 48.9 million, and included in the individual solvency requirement.

The Danish Financial Supervisory Authority's guidelines for sufficient base capital and individual solvency requirement are mainly used as basis for determining other risks.

Table 5: Individual solvency requirement in DKK thousand

Risk area	Adequate base capital DKK	% of weighted items
Credit risk	459,941	8.61%
Market risk	126,864	2.38%
Operational risk	48,877	0.92%
Other risk	2,019	0.04%
Total	637,702	11.94%

Eik Banki Føroya's solvency ratio was 22.2% (DKK 1.174 million) ultimo 2011 and the individual solvency requirement was 11.94%.

5.1.3 Counterparty Risk

Eik Banki Føroya uses the market value method for counterparty risk, when calculating size of the exposure and risk-weighted derivatives in the executive order on Capital Adequacy, Appendix 17.

Determination of the value of the exposure by the market value method for counterparty risk is derived from the procedure below:

1. All contracts are computed at market value and all contracts with a positive value are included.
2. The contracts' nominal principals or the underlying values are multiplied by percentages fixed by the Danish Financial Supervisory Authority to obtain a figure for the potential future credit exposure.
3. The counterparty exposure value is the sum of the current costs of re-acquisition and the potential future credit exposures.

Capital equivalent to 8% of the positive market value of the derivatives is held. When Eik Banki Føroya makes agreements with a counterparty regarding a derivative, the Bank makes sure not to exceed the credit limit. At the moment all contracts regarding interest swaps are negative, therefore it is not relevant to assess this until they again become positive.

Positive gross market value of financial contracts after netting is DKK 0 in accordance to the executive order on Capital Adequacy, Appendix 17.

6 Credit Risk

Eik Banki Føroya's credit risk described in this section includes objectives, policy and actual credit risk exposures.

6.1 Objectives and Risk Policies

The credit risk is defined as the risk of financial loss when the customer is unable to maintain his financial obligations to Eik Banki Føroya.

Processes of monitoring and control of Eik Banki Føroya's credit is described in the Banks Credit Policy as well as in guidelines from the Board of Directors and CEO, which stipulate the division of responsibility and authority. The Bank´s Credit Policy was approved by the Board of Directors on 21 September 2011.

The Credit Policy is updated, if and when, the Bank wants to change the credit terms in order to take into account external or internal changes that could affect customers' creditworthiness. Such factors may be that the Bank makes changes to terms in connection with financing specific customer groups. The Credit Policy is submitted to and approved by the Board of Directors annually.

The Credit Policy is prepared in accordance to The Financial Business Act and Executive Order 1325, Executive Order on Management and Government of Financial Institutions etc. from 01/12/2010.

The Policy determines the basic rules that apply to how the Bank handles credit risk in relation to the Bank's business organisation, operation area and within the framework set by the Danish Financial Supervisory Authority.

6.1.1 Authority and division of labour

It is Eik Banki Føroya's policy to provide authority to grant loans according to competence and needs. The Board of Directors has provided the CEO with authority, which has forwarded certain amount of authority the Head of Credit. The CEO also provides Head of Retail Banking certain amount of authority that is partly passed on to advisers. All of Eik Banki Føroya's credit activity is in general terms overseen by the Credit Department, which conducts regular checks to see if the authorisation is being complied with.

The Credit Department has the overall responsibility for credit processes. This includes the responsibility to develop credit management tools, such as ratings, drawing up credit granting processes and value assessment of collateral. The Credit Department must also ensure that concentration limits of e.g. single customers and industry branches are being complied with. The Credit Department is responsible for the Bank's impairment procedures and credit risk management including monitoring the development in overdrafts and arrears.

The Credit Department reports to the CEO on developments in the Bank's credit risk and whether the respective departments and branches operate within their authorisation and that the Bank's credit policy is complied with. The CEO presents this report to the Board of Directors on a quarterly basis.

Customer advisers, together with their Branch Manager, are responsible for daily credit supervision. Customer advisers monitor customer portfolios that have been assigned to them. Reports are continuously made to determine whether customers are honouring their obligations and to ensure that decision is swiftly taken regarding a customer's negative financial development.

It is the Credit Department's responsibility to oversee the development of the Bank's credit systems and credit processes. The Credit Department also has higher authority than the branches and is therefore involved in the granting of larger credit facilities, as well as the more complicated exposures.

Credit is granted on the basis of the individual customer's financial situation. The specific credit risk is evaluated on the basis of circumstances, such as financial situation, ability and attitude to repay the loan, as well as collateral. As a general rule, credit is not granted solely on the basis of collateral.

6.1.2 Credit Management and Control

Credit granting is authorised to branch managers and customer advisers according to an assessment of competency and need. The Credit Department, the CEO or the Board of Directors deal with affairs that are not covered by decentralized granting authority.

Retail customers are required to meet certain conditions such as a sufficient margin for personal disposable income and collaterals. When loans are granted with a variable interest rate, it is taken into consideration, whether the borrower is able to repay the loan, should the interest rates rise. Furthermore, when considered necessary, the borrower is required to take steps to cover the interest rate risk.

Eik Banki Føroya follows the economic development of any lending exposure in the Bank. As a result, at least once a year all credit facilities larger than a certain amount must be put forward to the Board for renewal. The credit recommendation must summarize the status of the respective customer's financial situation and the conditions for the exposure to be continued by the Bank.

The Bank's Credit Department shall ensure that the annual renewal is implemented timely and properly, but the respective branch has the responsibility for the exposures being renewed on time.

6.1.3 Credit granted by customer adviser and Branch Manager

When a loan application is within the authority of customer adviser, the customer adviser himself fills in an application in the credit granting system and grants it himself.

In cases where the loan application is outside the customer adviser's authority, the customer adviser prepares the application and places it in the credit granting system. The loan application is then reviewed and granted/denied by Branch Manager. In cases where the affair is outside the Branch Manager's authorisation, the application is reviewed by the Credit Department and if necessary also presented to the CEO or Board of Directors.

6.1.4 Collaterals

Credit is granted on the basis of willingness and ability to repay the credit extended. In addition to this, the Bank wants to limit risk by taking collaterals. The types of collateral most frequently provided are real estate, ships and movables. The value of the collateral is estimated using set procedures, thus ensuring uniform estimations. The Bank regularly assesses the value of the collateral provided. The value is calculated as the price that would be obtained in a forced sale.

6.1.5 Risk concentration

In order to ensure a spread of loans, the Credit Policy stipulates that no single exposure, with deduction of certain guaranteed claims and collaterals received, must generally be higher than 10% of the Bank's base capital. Additionally it is the Bank's aim that the total amount of these exposures does not exceed 125% of the base capital.

In addition to these limits, the Bank aims for an even division between retail and corporate lending and that no single branch accounts for more than 10% of the Bank's total gross loans.

6.1.6 Impairments

The need for impairments is assessed on a quarterly basis in accordance with guidelines from the Danish Financial Supervisory Authority. Impairments are partly done using individual estimations and partly using collective estimations. The Bank has assembled requirements for choosing customers to be subject to impairments. The Credit Department is responsible for making impairment evaluations together with the branches. Clear procedures have been adopted for choosing customers and evaluating possible impairments to ensure quality of work and that all customers are evaluated using the same criteria.

If the Bank establishes an "objective indication" of negative value adjustment on loans, impairment is registered. The incidents listed below give an objective indication, which can cause a negative value adjustment:

- Debtor has encountered serious financial difficulties
- Breach of contract on the side of debtor, e.g. not paying due loan payments and interests, or being in large deficit
- The Bank has eased loan conditions for debtor, which had not taken place had debtor not been in financial difficulties
- High probability of bankruptcy of debtor or in some other way financial reorganisation

Impairments are calculated as the difference between the book value of the loan and the present value of calculated future payments. Calculated future payments include income from the potential sale of collaterals. The present value is calculated using the effective interest rate on the loan.

Customers above a certain size of exposure are subjected to individual review every quarter, based on size, regardless of how the financial development has been.

6.1.7 Rating Customers

The Bank uses rating to describe the credit quality of individual exposures. The rating is e.g. used in connection with authorisation, selection of customers to be reviewed for impairments and conditions for frequency in single customer follow-up.

The following rating groups are used:

3	Unconditional good customers
2a	Good customers
2b	Average good customers
2c	Reduced exposure
1a and b	Exposures with impairments
0a	Exposure leading to losses. Impairment is sufficient
0b	Exposure leading to losses and current impairment is insufficient

The above rating is not completely comparable to the rating, which is used in connection with the individual solvency requirement in chapter 6. The above rating is an internal tool in Eik Banki Føroya.

6.1.8 Customers

The Bank's market segment is Faroese retail, corporate and institutional customers with high ability to repay loans.

6.1.9 Circumstances that are considered when granting credit

The Bank's decision making processes regarding granting of loan are prepared on an assessment of the individual customer's financial situation on the basis of a thoroughly prepared and well documented foundation for making a decision.

Retail: Customer's personal income and property, in addition to calculated cash at disposal are all the basis of decision making for lending to retail customers.

Corporate: When granting corporate exposures the Bank examines the company's revenues, solidity, state of collateral, in addition to the owner's experience and will to repay the loan.

BRF: Eik Banki Føroya collaborates with BRF-Credit on providing mortgage loans for Faroese house owners. The agreement stipulates that Eik Banki Føroya handles all customer communication, conducts customer ratings and forwards loan applications to BRF-Credit. BRF provides financing for up to 80% of the market value of the houses. Eik Banki Føroya guarantees the financing and receives a fee for this service.

6.2 Actual Credit Risk Exposures

In the tables below, credit risk exposures, risk-weighted items and capital requirements at 31.12.11 are analysed. These are divided into branches of industry and remaining period of repayment. Non-performing and depreciated assets, transfers on depreciated assets caused by value adjustment and impairment and financial collateral are also analysed.

6.2.1 Risk-weighted exposures and Capital Requirements

This section shows risk-weighted items and capital requirements.

The table below shows risk-weighted items and capital requirements for credit risk, divided on exposure groups.

Table 6: Risk-weighted exposures in relation to credit risk in DKK thousand

Exposure group	Risk-weighted items	Capital req. 8%
Central governments or central banks	30,265	2,421
Local authorities	0	0
Public units	1,250	100
Financial institutions	78,854	6,308
Retail customers	690,802	55,264
Business enterprises etc.	1,920,257	153,621
Guaranteed by mortgage on real estate	760,973	60,878
Arrears or overdraft	366,249	29,300
Other items, including assets without counterparts	512,154	40,972
Total	**4,360,803**	**348,864**

The table below shows risk-weighted items and capital requirements for market risk in DKK thousand.

Table 7: Risk-weighted exposures in relation to market risk in DKK thousand

Exposure group	Risk-weighted items	Capital req. 8%
Debt instruments	269,754	21,580
Shares	114,668	9,173
Currency risk	73,789	5,903

6.2.2 Credit Risk and Risk of Dilution

The Bank adheres to the regulation on financial reports for credit institutions etc. and utilises the accounting definition of non-performing and claims with decreased value stipulated in the Regulation on Financial Reports for Credit Institutions etc. Article 51-54.

Individual impairments are conducted in accordance with Article 52 of the Regulation on Financial Reports for Credit Institutions for all Loans. Group impairments are conducted in accordance with Article 53 of the Regulation on Financial Reports for Credit Institutions for all Loans where individual impairments have not been made.

Total value of exposures after value adjustments and before consideration for credit risk decrease is DKK 7,190 million at 31.12.2011.

The table below shows the exposure after value adjustment before credit risk decrease is analysed.

Table 8: Exposure after value adjustment before credit risk decrease in DKK thousand

Exposure group	Exposure after value adjustment	Average exposure after value adjustment
Governments or central banks	176,564	689,000
Local authorities	315,069	291,897
Public entities	14,318	23,640
Financial institutions	400,633	345,861
Retail customers	1,043,802	2,293,753
Commercial enterprises etc.	2,191,079	1,482,974
Exposures secured by mortgage in real estate	2,175,168	2,154,183
Exposures with arrears or overdrafts	324,898	508,642
Exposures in other items, including assets without counterparties	548,831	527,987
Total	**7,190,361**	**8,317,937**

As more than 95% of the Bank lending is to the Faroese market, the Bank has chosen not to provide information on geographical spread of total loans.

Table 9: Exposures divided on industries in DKK thousand

The table below shows division of exposures in accordance to the executive order on capital adequacy, Appendix 3 divided on industries. The table also shows the division between private sector and corporate sector exposures.

Industries	Central governments or central bank	Local authorities	Public entities	Financial institutions	Commercial enterprises etc.	Retail customers	Exposures secured by mortgage in real estate	Exposures with arrears or overdrafts	Exposures in other items, including assets without counterparties	Total
Public authorities	0	311,819	2	0	1,681	3,128	2,974	0	0	319,605
Agriculture, hunting, forestry and fishing	0	0	1	0	379,945	20,501	3,432	48,380	0	452,259
Industry and raw materials extraction	0	0	495	0	498,740	15,957	9,621	47,912	0	572,725
Energy supply	0	0	3,000	0	28,052	0	0	5	0	31,057
Building and construction	0	0	0	0	50,006	32,687	16,581	46,181	0	145,455
Trade	0	0	0	0	367,621	41,045	37,786	21,875	0	468,328
Transport, hotels and restaurants	0	0	10,027	0	225,901	13,849	5,212	3,575	0	258,565
Information and communication	0	0	0	0	72,504	3,194	0	0	0	75,698
Credit and insurance institutions	176,564	0	0	400,633	82,670	-36,641	1,100	159	548,831	1,173,316
Real estate	0	0	0	0	363,127	23,608	41,789	13,706	0	442,230
Other industries	0	3,212	793	0	114,455	53,298	31,766	21,849	0	225,372
Total corporate	176,564	3,212	14,315	400,633	2,183,021	167,497	147,287	203,643	548,831	3,845,004
Private	0	0	0	0	6,126	873,464	2,024,907	121,255	0	3.025.752
Total	176,564	315,032	14,318	400,633	2,190,829	1,044,089	2,175,168	324,898	548,831	7.190.361

The table below shows the terms to maturity for credit exposures divided into short and long periods.

Table 10: Maturity terms to credit exposures in DKK thousand

Exposure group	On demand	0-3 months	3 months – 1 years	1-5 years	Over 5 years	Total
Central governments or central banks	146,299	0	0	30,265	0	176,564
Local authorities	72,128	0	0	42,757	200,184	315,069
Public entities	7,647	0	0	724	5,947	14,318
Financial institutions	212,538	170,000	18,090	0	5	400,633
Retail customers	68,980	29,785	31,174	149,321	764,541	1,043,802
Commercial enterprises etc.	165,083	49,114	85,674	480,181	1,411,027	2,191,079
Exposures secured by mortgage in real estate	181	6,084	487,483	152,538	1,528,882	2,175,168
Exposures with arrears or overdrafts	33,194	232	10,437	91,798	189,238	324,898
Exposures in other items, including assets without counterparties	0	0	0	376,623	172,208	548,831
Total	**706,051**	**255,215**	**632,858**	**1,324,205**	**4,272,032**	**7,190,361**

6.2.3 Defaulted and depreciated claims

This section shows violated and depreciated claims.

The table below shows exposures that have been defaulted and reduce the value of the Bank's claims. The exposures are divided on industries. The table also shows the division between retail sector and corporate sector exposures.

Amounts booked as costs calculated as: impairments/provisions end of 2011 less impairments/provisions start of 2011 included total annual loss.

Table 11: Defaulted and depreciated claims divided on industries in DKK thousand

	Bad debts exposure	Depreciated claims exposure	Impairments/ provisions ultimo and provision	Impairments/ provisions ultimo amounts carried to the debit side regarding value adjustments and impairments in the period
Public authorities	0	0	0	0
Agriculture, hunting, forestry and fishing	81,853	100,117	47,007	83,365
Industry and raw materials extraction	61,781	154,571	59,144	62,044
Energy supply	5	0	0	323
Building and construction	75,334	68,795	29,687	40,455
Trade	41,418	62,685	30,992	59,605
Transport, hotels and restaurants	14,848	132,620	60,863	63,819
Information and communication	0	0	0	844
Credit and insurance institutions	1,007	2,368	2,308	9,728
Real estate	28,507	40,300	10,166	11,136
Other industries	56,034	61,479	37,314	45,147
Total corporate	360,786	622,935	277,481	376,468
Retail	174,442	109,422	46,528	51,087
Total	**535,228**	**732,358**	**324,009**	**427,554**

The table below shows movements on claims with reduced value caused by value adjustments and impairments. These are divided into individual and group impairments.

Table 12: Movements on claims with reduced value caused by value adjustments and impairments in DKK thousand

	Individual impairments/ provisions		Collective impairments/ provisions	
	Loans	Guarantees	Loans	Guarantees
Accumulated impairments/provisions on loans and guarantees, at the beginning of the year	0	54,209	0	0
Impairments/provisions during the year	380,100	2,342	39,937	0
Reversal of impairments/provisions from previous year, where there is no longer an objective indication of depreciation	0	-110	0	0
Interest on impairments	-19,645	0	92	0
Value adjustment of acquired assets	-13,313	0	0	0
Other changes	32,958	0	0	0
Impairments, previously individually impaired/set aside for provisions	-58,107	-54,424	0	0
Total impairments ultimo on loans and guarantees	**321,993**	**2,017**	**40,029**	**0**
Total impairments on loans and guarantees, where there have been made individual impairments/provisions (calculated before impairments/ provisions)	**720,992**	**11,364**	**1,561,203**	**0**

6.2.4 Financial collateral

Financial collaterals are divided on exposure groups below.

Table 13: Financial collateral in DKK thousand

Exposure group	Collateral with substitution	Financial collateral expanded	Risk-weighted items
Governments or central banks	0	0	30,265
Local authorities	0	0	0
Public entities	0	115	1,250
Financial institutions	0	0	78,854
Retail customers	290	39,707	690,802
Commercial enterprises etc.	3	85,564	1,920,257
Exposures secured by mortgage in real estate	0	0	760,973
Exposures with arrears or overdrafts	525	5,870	366,249
Exposures in other items, including assets without counterparties	0	0	512,154
Total	**818**	**131,256**	**4,360,803**

7 Market Risk

Market risk is described below, including objectives, policy and actual market risk exposures.

7.1 Objective and Risk Policy

Market risk is defined as the risk that the market value of assets and liabilities, as well as off- balance items, will be affected as a result of changing market value.

The Board of Directors of Eik Banki Føroya has approved a Market Risk Policy and defined the acceptable level of market risk that the Bank is willing to take. The market risk must be as low as possible.

7.2 Interest Risk

Interest rate risk is the risk of loss caused by changes in interest rates. Interest rate risk or the modified duration is measured as the expected loss caused by a fall in the value of securities, if the interest curve is displaced in parallel by one percentage point up.

Interest rate risk on fixed interest loans is as a rule hedged. The largest interest rate risk is in the portfolio of fixed interest bonds that are adjusted within certain limits in relation to the interest rate outlook.

7.2.1 Share Risk

Share risk is the risk of loss caused by changes in share price. Share risk is controlled by controlling and monitoring the portfolio of shares closely.

7.2.2 Currency Risk

Currency risk is the risk of loss caused by fluctuating exchange rates.

Predominantly Eik Banki Føroya hedges currency risk. The exception is currency risk between Danish kroner and Euro, which are only hedged if the circumstances favourites it.

Currency risk is calculated as the higher figure of asset or currency debt and is set in percentage of core capital corresponding to currency point 1 by the Danish Financial Supervisory Authority.

7.2.3 Other price risk including Raw Material Risk

Other price risk is the risk of loss caused by fluctuating market prices on other assets than those mentioned in 7.1.1 – 7.1.3, e.g. change in raw material price.

Eik Banki Føroya has currently no risks in this area.

7.2.4 Reporting and Division of Responsibility

The Market Risk Policy stipulates the division of responsibility concerning taking the risk, execution of risk, monitoring and reporting to the CEO and Board of Directors.

The Board of Directors receives reports at every board meeting about the market risk compared to market values defined in the policy and the Board's authorisation to the CEO. The Finance Department is responsible for these reports.

7.2.5 Responsibility and monitoring

Eik Markets has daily responsibility for liquidity, securities portfolio and the Bank's currency deposits on behalf of the Bank. Thus Eik Markets is also responsible for ensuring that market risk meets requirements for market risk that are specified to the Management in the Article 70 instructions from the Board of Directors to the CEO.

This is conducted by regularly calculating the interest rate risk on the bonds deposits, determining weekly the currency situation and continuous monitoring of the Bank's share deposit. These calculations and statements are then compared to limit values for market risk that have been authorised to the CEO and the authorisation provided to Eik Markets in the area.

7.3 Actual Market Risk

Below the actual market exposures at 31.12.11 are analysed. These encompass risk that is related to the securities portfolio, shares etc. which is not connected to the securities portfolio and interest risk.

7.3.1 Risk pertaining to the Trading Portfolio

Solvency requirements for the various risks under market risk are detailed in the table below.

Table 14: Risk-weighted exposures with market risk in DKK thousand

	Risk-weighted items	Capital requirement 8%
Debt instruments	269,754	21,580
Shares	114,668	9,173
Currency situation	73,789	5,903

7.3.2 Exposures in shares that are not part of the Trading Portfolio

Exposures in shares that are not part of the trading portfolio are listed below:

Table 15: Exposures in shares that are not part of the trading portfolio, in DKK thousand

Type	Exposure 31.12.2011	Operating influence
Shares relating to the Bank's suppliers	19,113	2,034
Corporations	41,311	-35,671

7.3.3 Interest Rate Risk

Interest rate risk divided on the various items is shown in the table below.

Table 16: Interest Rate Risk in and outside the trading portfolio in DKK thousand

	Interest rate risk
Interest rate risk on items outside the Trading Portfolio	
Balance (loans, deposits, dues/debt with financial institutions)	7,720
Total outside of trading portfolio	7,720
Interest rate risk divided on items in trading portfolio	
Securities in balance (incl. spot market)	12,995
Futures, forward deals etc.	-1
Total in trading portfolio	12,994
Total Interest Rate Risk	**20,714**

8 Liquidity Risk

Liquidity risk is shown below, including objectives, policy and actual liquidity risk exposures.

8.1 Objective and Policy

Eik Banki Føroya's liquidity risk can be defined as the risk that comes from fluctuating outgoing and incoming cash flow streams in the Bank.

The Board of Directors of Eik Banki Føroya have approved an overall risk policy for liquidity risk, which stipulates clear requirements for daily liquidity and statement of liquidity risk.

Eik Banki Føroya identifies the following as liquidity risks:

- Significant increases in funding expenses
- Lack of funding prevents Eik Banki Føroya to maintain its approved business model
- Eik Banki Føroya is unable to fulfil its conditions because of a lack of funding

It is Eik Banki Føroya's liquidity policy to maintain liquidity, which is 80% above the 10% statutory minimum requirement. At the end of 2011 the Bank had a liquidity cover of 207% in relation to the 10% statutory minimum requirement.

8.1.1 Reporting and division of responsibility

The liquidity risk policy determines the division of responsibility regarding risk taking, risk execution, control and reporting to the CEO and the Board of Directors.

The Board of Directors and the CEO receive monthly statements on the Bank's liquidity situation from the Bank's Finance Department. The statement is prepared on the basis of Article 152 in The Financial Business Act, which stipulates that the total liquidity must be at least 10% of the Bank's debt and guarantee obligations and at least 15% of the Bank's total debt, which has a term to maturity less than one month. Moreover, the monthly report contains a statement on liquidity risk. This is done by conducting a 12 month projection of the liquidity under normal market conditions and a 12 month liquidity projection of liquidity under harsh market conditions.

8.1.2 Responsibility and monitoring

Eik Markets has been given daily responsibility of liquidity by the Management. Eik Markets also is responsible for daily monitoring of liquidity and liquidity projections. This is done on the basis of known future cash flows coming in and going out of the Bank.

9 Operational Risk

Operational risk, including objectives, policy and actual operational risks is described below.

9.1 Objectives and Policy

Operational risk is the risk of financial loss due to inadequate and inefficient internal processes, human factors, IT-failures, or external factors including legal risks.

The Board of Directors approves the risk policy for operational risk, decides on procedures and how monitoring and follow-up on the risks is to be organised. These are reviewed annually, latest on 21 December 2011.

Eik Banki Føroya identifies the following as possible operational risks. Financial loss on the basis of:

- credit, liquidity, security, market and real estate risk
- in relation to advising retail, corporate and public customers
- operational risks in staff functions and management
- manual procedures, guidelines and/or quality of these
- ineffective internal controls
- insufficient, integration, stability, and usability of IT-systems
- operational risks of hosted services
- inadequate insurance
- insufficient employee competences in relation to diversity of tasks
- inadequate security in premises

Increased risk may also be a result of new services, products as well as influence from outside factors.

9.1.1 Reporting and division of responsibility

The operational policy stipulates procedures, registration and reporting. Employees are responsible for reporting all risk events to their nearest manager and Risk Management. Risk Management registers the events and notifies the CEO monthly, which notifies the Board of Directors at the next board meeting.

Risk Management is also required to advise internally and inform about risks, in order to ensure that laws and regulations are followed.

9.1.2 Monitor and management

As stated in Section 3, Risk Management is authorised by the Management to monitor operational risks. The monitoring is conducted in accordance with the functions of the Risk Management entity defined in The Financial Business Act Article 71, Executive Order 1325, Executive Order regarding Management of Financial Institutions etc. 01/12/2010.

9.2 Actual Operational Risk

Operational risk can be limited but not eliminated. Regular processes are in place to determine if risk that may have a negative impact on Eik Banki Føroya appears. The Bank continuously focuses on developing and improving the management of risks, e.g. by strengthening and reviewing procedures and controls, ensuring documentation, controlling changes and register, reporting and reassessing risk, in order to increase awareness.

Eik Banki Føroya's IT-systems are hosted by Skandinavisk Data Center (SDC). The Board of Directors has prepared an overall framework in the IT-security policy to ensure the safety of material and sensitive information. The IT-contingency plan supports this procedure and objectives.

A risk analysis of all IT-systems is conducted annually in order to determine what business impact the risk has on Eik Banki Føroya. This is conducted in accordance with analyses from BIR, Business Impact Assessment from ISF, International Security Forum. A risk assessment was conducted in December 2011 resulting in an estimated risk amounting to DKK 48.9 million, cf. Table 6.