Risk Management Report

Eik Banki P/F

1.1.2012 – 31.12.2012

Contents

1 Introduction

Risk and risk management are an integral part of banking. The purpose of Eik Banki's risk management is to conduct operations 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 should support the Bank's business model.

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

Credit risk, defined as the risk of financial loss arising when customers are unable to meet their financial obligations to Eik Banki.

Market risk, 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 conditions. Eik Banki's market risk consists of interest rate risk, equity risk, foreign exchange risk and other price risks.

Liquidity risk, defined as the risk that arises from differences in scheduled outgoing and incoming cash flow in the Bank.

Operational risk, defined as the risk arising from inadequate and inefficient internal processes, human errors, IT-failures and external factors.

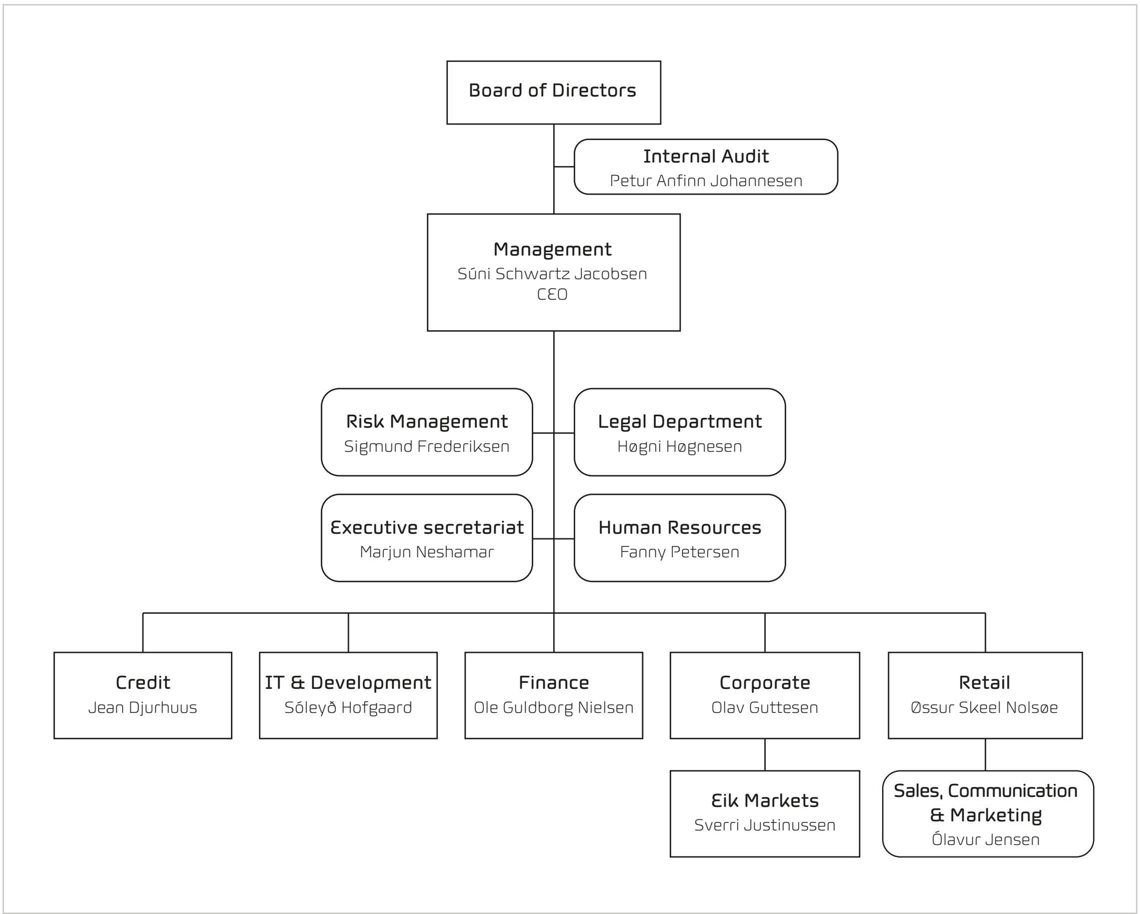
In the risk report an assessment is made of solvency and individual solvency requirement. The difference between the two is as follows:

Solvency is calculated in accordance with the Executive Order No. 510 of 25 May 2011 on Capital Adequacy, where all assets are assessed according to risk in separate risk groups.

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

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

2 Organisation



Eik Banki's official organisational structure is illustrated above.

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 carried out in different business units in the Bank.

Risk Management monitors credit risk, market risk, liquidity risk, operational risk and IT- risk on behalf of the CEO. Risk monitoring is performed in accordance with the tasks of the Risk Management function as stipulated in the Danish Financial Business Act, section 71, and Executive Order No. 336 of 12 April 2012 for the Faroes on the governance and management of financial institutions etc.

3 Base capital

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

3.1 Policy

The base capital is calculated in accordance with the Danish Financial Business Act in addition to guidelines on adequate base capital and solvency requirement for financial institutions (Vejledning om tilstrækkelig basiskapital og solvensbehov for kreditinstitutter) issued by the Danish Financial Supervisory Authority.

3.2 Base Capital Statement

The table below shows the base capital statement as of 31 December 2012.

Table 1: Base capital statement as of 31 December 2012 (DKK 1,000).

Capital requirement	
Core capital before deductions	1,206,829
Proposed dividend	122,031
Intangible assets	1,408
Tax assets	12,935
Core capital after deductions	**1,070,455**
Share capital, not included in core capital	**100,000**
Capital base	**1,170,455**

4 Solvency

This section describes how the solvency statement and sufficient capital are determined, in addition to the individual solvency requirement.

The solvency is determined in accordance with the Executive Order on Capital Adequacy, where all assets are risk assessed in the separate risk categories.

In addition to the solvency, the Bank is also required to determine the individual solvency requirement. This is to ensure that the Bank has sufficient capital to weather difficult periods and in order to meet the demands by the Danish Financial Supervisory Authority. The individual solvency requirement is calculated 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.

4.1 Objective and Policy

4.1.1 Solvency Statement

Solvency is calculated as core capital as a percentage of the risk-weighted assets. Core capital is determined in accordance with the requirements in chapter 10 of 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 divided into three main categories: credit risk, market risk and operational risk.

The table below shows the Bank's solvency statement.

Table 2: Solvency statement as of 31 December 2012 (DKK 1,000).

Capital requirement	
Core capital before deductions	1,206,829
Proposed dividend	122,031
Intangible assets	1,408
Tax assets	12,935
Core capital after deductions	**1,070,455**
Share capital, not included in core capital	**100,000**
Capital base	**1,170,455**
Weighted assets	
Weighted assets not included in the trading portfolio including off balance-sheet items	3,997,954
Weighted items with market risk	449,7
Operational risk	577,036
Total weighted assets	**5,024,690**
Solvency ratio in accordance with FIL section 124, section 2, subsection 1	**23.3%**
Core capital after deduction in % of weighted assets	**21.3%**

4.1.2 Individual Solvency Requirement

The calculation of the Bank's individual solvency requirement is based on a model developed by "Lokale Pengeinstitutter" and on guidelines on adequate base capital and solvency requirement for financial institutions issued by the Danish Financial Supervisory Authority.

Through the use of the abovementioned model and the guidelines issued by the Danish Financial Supervisory Authority, the Management considers the Bank's calculated individual solvency requirement to be fair.

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

The main purpose of calculating the individual solvency requirement is to determine the size of the base capital necessary to continue operations in the event of adverse developments in the Bank's operations.

The variables and stress levels, which are to be tested, are determined on the basis of the Bank's current situation, the requirements specified in the Executive Order on Capital Adequacy and the guidelines on adequate base capital and solvency requirement for financial institutions. The purpose of the stress tests is to determine the Bank's strength by using the Bank's accounting figures and simulating the effects of a variety of negative events.

The first part of the individual solvency requirement model is comprised of stress tests, where certain variables are used to stress the separate accounting entries from the latest financial statement.

Table 3: Stress tests in relation to determining the individual solvency requirement

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

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

In addition to the risk areas included in the stress tests, there are other risk areas which Eik Banki finds relevant to include in its assessment of the solvency requirement. These risks are listed in table 4.

Table 4: Other risks in relation to determining the individual solvency requirement

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

The Management considers the risk factors included in the model as adequate to cover all 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 Board and Management must assess whether the base capital is adequate to support future activities. In Eik Banki, this assessment is part of the general determination of the individual solvency requirement. An annual assessment is made to determine how expected growth affects the calculation of the solvency requirement. Stress factors are chosen based on Lokale Pengeinstitutter's model in addition to guidelines on adequate base capital and solvency requirement for financial institutions issued by the Danish Financial Supervisory Authority.

The conditions that have to be present for using the model are based on sector information, development overview and conditions in the coming year's budget.

The guidelines in the Danish Financial Supervisory Authority's probability model are used when calculating credit risk. These guidelines are outlined in the Danish Financial Supervisory Authority's guidelines on adequate base capital and solvency requirement for financial institutions. For customers with impairments the unsecured exposure is fully reserved. In addition, the unsecured exposure in rating category 2c is reserved by 50%.

Market risk is calculated using the stress factors in the guidelines from the Danish Financial Supervisory Authority on adequate base capital and solvency requirement.

The Bank uses the base indicator method for calculating operational risk. As mentioned in the section on operational risk, the solvency requirement for operational risk is DKK 47.9 million, and this is included in the individual solvency requirement.

For determining other risks the Bank mainly uses the Danish Financial Supervisory Authority's guidelines for sufficient base capital and individual solvency requirement.

Table 5: Individual solvency requirement (DKK 1,000).

Risk area	Adequate base capital DKK	% of weighted items
Credit risk	384,170	7.65%
Market risk	155,925	3.10%
Operational risk	47,914	0.95%
Other risk	42,220	0.84%
Total	**630,229**	**12.54%**

At the end of 2012, Eik Banki's solvency ratio was 23.3% (DKK 1,170 million) and the individual solvency requirement was 12.54%.

4.1.3 Counterparty Risk

Eik Banki uses the market value method for counterparty risk, when calculating the size of the exposure and risk-weight for derivatives covered by the Executive Order on Capital Adequacy, Appendix 17.

Determination of the value of the exposure by using 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 establish the potential future credit exposure.

3. The counterparty exposure value is calculated as the sum of the positive market value and the potential future credit exposures.

The Bank allocates capital equivalent to 8% of the positive market value of the derivatives. When Eik Banki enters into agreements with a counterparty regarding derivatives, credit limits must be observed. At the end of 2012 the positive fair value of derivatives was DKK 5.5 million.

5 Credit Risk

In this section Eik Banki's credit risk is described, including objectives, policy and actual credit risk exposures.

5.1 Objectives and Risk Policies
Credit risk is defined as the risk of financial loss arising when customers are unable to meet their financial obligations to Eik Banki.

Credit risk is managed according to Eik Banki's Credit Policy and instructions from the Board of Directors to the CEO, which stipulate responsibilities and granting authority. The Bank´s current Credit Policy was approved by the Board of Directors on 13 February 2013.

The Credit Policy is updated, should the Bank wish to change the credit terms in order to take into account external or internal changes that could affect the creditworthiness of specific customer groups. The Credit Policy is reviewed by the Board of Directors annually.

The Credit Policy is prepared in accordance with the Danish Financial Business Act and Executive Order No. 336 of 12 April 2012 for the Faroes on the governance and management of financial institutions etc.

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

5.1.1 Authority and division of labour
It is Eik Banki's policy to provide lending authorities according to competence and needs. The Board of Directors has provided the CEO with granting authorities, which have, in part, been delegated to the Head of Credit. The CEO also delegates lending authorities to the Head of Retail Banking and the Head of Corporate Banking – these are to some extent passed on to customer advisers. Eik Banki's credit granting is overseen by the Credit Department, which conducts regular checks to see if the lending authorities are being complied with.

The Credit Department is responsible for day-to-day credit granting. This includes developing credit management tools, such as ratings, drawing up credit granting processes and value assessments of collateral. The Credit Department must also ensure compliance with limits on e.g. customer concentration and industry concentration. 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 branches operate within their lending authorities and comply with the Bank's credit policy. 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 control. Customer advisers monitor the customer portfolios that have been assigned to them. Reports are made on a regular basis to determine whether customers honour their obligations and to ensure swift decision making in the event of a customer's negative financial development.

The Credit Department supervises the Bank's credit systems and credit granting processes. The Credit Department has higher lending authorities than the individual branches and is therefore involved in the granting of larger credit facilities, as well as more complicated exposures.

Credit is granted on the basis of the individual customer's financial situation with regard to ability and attitude to repay the loan, as well as collaterals. As a general rule, credit is not granted solely on the basis of collateral.

5.1.2 Credit Management and Control

Lending authorities have been granted to branch managers and customer advisers according to an assessment of competence and need. Credit applications that exceed these lending authorities must be submitted to the Credit Department, CEO or Board of Directors.

Certain conditions should be met in order for credit to be granted. For retail customers such conditions include a sufficient margin for personal disposable income and collaterals. When loans are granted with a variable interest rate, consideration is also made as to whether the borrower is able to repay the loan, should interest rates rise. Furthermore, when considered necessary, the borrower is required to take steps to cover the interest rate risk.

Eik Banki monitors the economic development of the loan portfolio. This includes submitting sizeable credit exposures to the Board of Directors for renewal annually. The credit applications must include the customer's financial situation and the conditions for the exposure to be continued by the Bank.

The Bank's Credit Department must ensure that the annual renewal is implemented timely and properly, however, the respective branches, where the customer is registered, are responsible for the exposures being renewed on time.

5.1.3 Credit granted by customer advisers and Branch Managers

When credit applications are within the lending authority of the customer adviser, the customer adviser fills in an application in the credit granting system and grants the loan.

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

5.1.4 Collaterals

Credit is granted on the basis of willingness and ability to repay. In addition to this, the Bank wants to limit risk by requiring collaterals. The types of collateral most frequently provided are real estate, ships and personal property. 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 of the collateral is calculated as the price that would be obtained in a sale.

5.1.5 Risk concentration

In order to ensure a spread in the loan portfolio, 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 distribution between retail and corporate lending and no single industry should account for more than 10% of the Bank's total gross loans.

5.1.6 Impairments

Quarterly assessments are made of the need for impairment charges, in accordance with guidelines from the Danish Financial Supervisory Authority. Impairment charges are based on individual estimations and/or collective estimations. The Bank has assembled requirements for selecting 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 selecting customers and evaluating possible impairments to ensure quality and uniform criteria in the evaluations for all customers.

If the Bank establishes an "objective indication" of negative value adjustment on a loan, an impairment charge is registered. Below is a list of incidents that can trigger 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 making repayments and interest
- The Bank has relaxed loan conditions due to the debtor experiencing financial difficulties
- High probability of the debtor going bankrupt or being in need of financial reorganisation

Impairment charges 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.

Exposures above a certain size are subjected to individual review on a quarterly basis, regardless of the customer's financial situation.

5.1.7 Rating of customers

The Bank uses a rating model to describe the credit quality of individual customers. The rating model is used for credit granting, selection of customers to be reviewed for impairments and conditions for the frequency in single customer follow-ups.

The Bank uses the following rating groups:

3	Unconditionally good customers
2a	Good customers
2b	Average customers
2c	Weak exposure
1a and b	Exposures with impairment charges
0a	Exposure leading to loss. Impairment charge is sufficient
0b	Exposure leading to loss and current impairment charge is insufficient

5.1.8 Customers

The Bank's market segment is Faroese retail, corporate and institutional customers with good repayment abilities.

5.1.9 Circumstances that are considered when granting credit

The Bank considers credit applications based on an assessment of the individual customer's financial situation. This assessment must be thoroughly prepared and well documented.

Retail customers: Credit granting is based on the customer's personal income and assets, in addition to a calculation of disposable income.

Corporate customers: Credit granting is based on the company's revenues, solidity, state of collateral, in addition to the owner's experience and willingness to repay the loan.

BRF: Eik Banki collaborates with BRF-Kredit providing mortgage loans for Faroese homeowners. The agreement stipulates that Eik Banki handles all customer communication, conducts customer ratings and forwards loan applications to BRF-Kredit. BRF provides financing for up to 80% of the market value of the properties. Eik Banki guarantees repayment of the loans.

5.2 Actual Credit Risk Exposures

This section shows credit risk exposures, risk-weighted items and capital requirements as of 31.12.2012. These are broken down by industry and remaining repayment period. The Bank also analyses non-performing and depreciated assets, transfers on depreciated assets caused by value adjustments and impairment charges, and financial collaterals.

5.2.1 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, broken down by exposure groups.

Table 6: Risk-weighted exposures in relation to credit risk (DKK 1,000).

Exposure group	Risk-weighted items	Capital req. 8%
Central governments or central banks	0	0
Local authorities	0	0
Public entities	23,849	1,908
Financial institutions	63,304	5,064
Retail customers[1]	589,578	47,166
Corporate customers	1,854,741	148,379
Guaranteed by mortgage on real estate	775,756	62,060
Arrears or overdrafts	384,229	30,738
Other exposures, including assets without counterparts	363,921	29,114
Total	**4,055,379**	**324,430**

[1] Includes all exposures ≤ DKK 3 million.

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

Table 7: Risk-weighted exposures in relation to market risk (DKK 1,000).

Exposure groups	Risk-weighted items	Capital req. 8%
Bonds	286,223	22,898
Shares	92,951	7,436
Currency risk	70,527	5,642

5.2.2 Credit Risk and Risk of Dilution

The Bank adheres to the Executive Order on Financial Reports for Credit Institutions etc. and uses the accounting definition of non-performing and impaired debts as defined in sections 51-54.

Individual impairment charges for all loans are made in accordance with section 52 of the Executive Order on Financial Reports for Credit Institutions etc. Group impairment charges are made in accordance with section 53 of the Executive Order on Financial Reports for Credit Institutions etc.; this applies to loans without individual impairment charges.

Total value of the exposures after value adjustments and before considering credit risk decrease was DKK 7,113 million as of 31.12.2012.

The table below shows the exposures after value adjustments before credit risk decrease is analysed.

Table 8: Exposures after value adjustment before credit risk decrease (DKK 1,000).

Exposure group	Exposure after value adjustment	Average exposure during the year after value adjustment
Governments or central banks	419,243	364,496
Local authorities	336,297	330,789
Public entities	120,951	110,265
Financial institutions	290,350	327,760
Retail customers[1]	896,156	1,114,645
Commercial customers	2,110,366	2,079,192
Exposures secured by mortgage in real estate	2,213,146	2,082,638
Exposures with arrears or overdrafts	304,340	329,232
Exposures in other items, including assets without counterparties	422,183	503,524
Total	**7,113,030**	**7,242,542**

[1] Includes all exposures ≤ DKK 3 million.

As more than 95% of the Bank's credit exposure is to the Faroese market, the Bank has chosen not to provide information on the geographical spread of the loan portfolio.

Table 9: Exposures broken down by industry (DKK 1,000).

The table below shows the exposures in accordance to the Executive order on Capital Adequacy, Appendix 3, broken down by industry. The table also shows the breakdown between retail customers and corporate customers.

Industries	Central governments or central bank	Local authorities	Public entities	Financial institutions	Retail customers[1]	Commercial customers	Exposures secured by mortgage in real estate	Exposures with arrears or overdrafts	Exposures in other items, including assets without counterparties	Total
Public authorities	**36,737**	**333,247**	**119,339**	**0**	**0**	**1,378**	**1,473**	**0**	**0**	**492,174**
Agriculture, hunting, forestry and fishing	0	0	0	0	16,336	360,474	4,721	31,104	0	412,636
Industry and raw materials extraction	0	0	0	0	13,416	478,796	7,377	10,462	0	510,051
Energy supply	0	0	0	0	0	26,262	0	0	0	26,262
Building and construction	0	0	0	0	31,764	52,539	13,431	34,442	0	132,176
Trade	0	0	0	0	48,170	364,274	29,465	32,772	0	474,682
Transport, hotels and restaurants	0	0	0	0	18,091	199,096	4,287	54,453	0	275,927
Information and communication	0	0	0	0	3,041	62,871	0	0	0	65,912
Credit and insurance institutions	382,505	0	0	290,350	-35,367	52,955	22,180	276	422,183	1,135,083
Real estate	0	0	0	0	20,547	312,257	36,204	12,581	0	381,589
Other industries	0	3,050	1,612	0	35,953	190,620	31,923	4,981	0	268,139
Total corporate	**382,505**	**3,050**	**1,612**	**290,350**	**151,952**	**2,100,145**	**149,589**	**181,072**	**422,183**	**3,682,458**
Retail	**0**	**0**	**0**	**0**	**744,204**	**8,842**	**2,062,084**	**123,268**	**0**	**2,938,398**
Total	**419,243**	**336,297**	**120,951**	**290,350**	**896,156**	**2,110,366**	**2,213,146**	**304,340**	**422,183**	**7,113,030**

[1] Includes all exposures ≤ DKK 3 million.

The table below shows the maturity of credit exposures divided into short and long maturities.

Table 10: Credit exposure broken down by maturity (DKK 1,000).

Exposure group	On demand	0-3 months	3 months – 1 year	1-5 years	Over 5 years	Total
Central governments or central banks	373,662	0	0	21,095	24,485	419,243
Local authorities	73,721	0	17,727	38,882	205,966	336,297
Public entities	1,301	404	481	9,429	109,335	120,951
Financial institutions	271,274	0	9,355	0	9,722	290,350
Retail customers[1]	84,928	41,631	20,098	140,573	608,926	896,156
Commercial customers	245,346	15,919	300,265	220,443	1,328,394	2,110,366
Exposures secured by mortgage in real estate	8,917	12,637	9,551	139,770	2,042,270	2,213,146
Exposures with arrears or overdrafts	50,837	4,407	10,145	38,896	200,056	304,340
Exposures in other items, including assets without counterparties	30,773	0	0	252,683	138,727	422,183
Total	**1,140,759**	**74,997**	**367,623**	**861,770**	**4,667,881**	**7,113,030**

[1] Includes all exposures ≤ DKK 3 million.

5.2.3 Defaulted and depreciated claims

This section shows defaulted and depreciated claims.

The table below shows exposures that have defaulted and reduce the value of the Bank's claims. The exposures are broken down by industry. The table also shows the breakdown between retail customers and corporate customers.

Table 11: Defaulted and depreciated claims broken down by industries (DKK 1,000).

	Bad debts exposure	Depreciated claims exposure	End-of-year impairments and provisions	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	77,851	91,079	57,354	16,762
Industry and raw materials extraction	32,283	120,664	62,709	15,739
Energy supply	0	0	0	-5,764
Building and construction	58,311	57,208	29,418	4,095
Trade	45,187	44,674	25,911	5,876
Transport, hotels and restaurants	61,881	127,846	61,101	12,185
Information and communication	0	0	0	1,238
Credit and insurance institutions	543	265	265	-14,727
Real estate	13,314	34,148	11,541	14,181
Other industries	19,501	48,818	36,72	8,401
Total corporate	**308,869**	**524,702**	**285,021**	**57,986**
Retail	**160,051**	**132,158**	**61,29**	**3,203**
Total	**468,921**	**656,86**	**346,311**	**61,189**

Amounts booked as costs are calculated as: impairments/provisions at end of 2012 less impairments/provisions at start of 2012 including total annual loss.

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 impairment charges (DKK 1,000).

	Individual impairments/provisions		Collective impairments
	Loans	Guarantees	Loans
Accumulated impairments/provisions on loans and guarantees, at the beginning of the year	321,992	2,017	40,031
Impairments/provisions during the year	81,854	1,013	14,528
Reversal of impairments/provisions from previous year, where there is no longer an objective indication of depreciation	28,741	379	0
Other changes	28,685	0	2,866
Value adjustment of acquired assets	7,014	0	
Impairments, previously individually impaired/set aside for provisions	52,965	152	
Total impairments/provisions on loans and guarantees at year end	**343,811**	**2,500**	**57,425**
Total impairments on loans and guarantees, where there have been made individual impairments/provisions (calculated before impairments/provisions)	**656,854**	**5,911**	**1,773,132**

5.2.4 Financial collateral

The table below shows financial collaterals broken down by exposure group.

Table 13: Financial collateral (DKK 1,000).

Exposure group	Collateral with sub-stitution	Financial collateral expanded
Governments or central banks	0	0
Local authorities	0	0
Public entities	0	404
Financial institutions	0	0
Retail customers[1]	278	39,120
Commercial customers	3	54,994
Exposures secured by mortgage in real estate	0	0
Exposures with arrears or overdrafts	525	3,675
Exposures in other items, including assets without counterparties	0	0
Total	**805**	**98,192**

[1] Includes all exposures ≤ DKK 3 million.

6 Market Risk

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

6.1 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 conditions.

Taking on market risk is an integral part of banking.

The market risk in Eik Banki is divided into interest rate risk, equity risk, foreign exchange risk and other price risks.

The Board of Directors of Eik Banki has approved a market risk policy, which defines and sets limits for the market risk that the Bank is willing to accept for each market risk area.

The Board of Directors and CEO receive regular reports on the market risk and compliance with the limits defined in the policy and instructions from the Board to the CEO.

6.1.1 Interest Rate Risk

Interest rate risk is the risk of loss caused by changes in market rates. Interest rate risk or the modified duration is measured as the expected capital loss, when the interest curve is displaced in parallel by one percentage point up.

As a rule, interest rate risk on fixed interest loans is hedged. The largest interest rate risk is in the portfolio of fixed interest rate bonds. This risk is adjusted within certain limits in relation to the interest rate outlook.

6.1.2 Equity Market Risk

Equity market risk is the risk of loss caused by changes in share prices. Equity market risk is managed by managing and monitoring the portfolio of shares closely.

6.1.3 Foreign Exchange Risk

Foreign Exchange risk is the risk of loss caused by fluctuating exchange rates.

As a main rule Eik Banki hedges foreign exchange risk. The exception is foreign exchange risk between Danish kroner and Euros, which is only hedged under special circumstances.

Foreign exchange risk is calculated as the higher figure of foreign exchange assets or debt and is determined as a percentage of the core capital corresponding to the Danish Financial Supervisory Authority's currency indicator 1.

6.1.4 Other price risks including Commodity Risk
Other price risks is the risk of loss caused by fluctuating market prices on other assets than those mentioned in 6.1.1 – 6.1.3, e.g. change in commodity prices.

At year end 2012 Eik Banki had no other price risks.

6.1.5 Reporting and Division of Responsibility
The market risk policy stipulates the division of responsibility concerning risk taking, monitoring and reporting to the CEO and Board of Directors.

The Board of Directors receives reports regularly about the current market risk as compared to the limits defined in the market risk policy and the Board's authorisation to the CEO. The Finance Department is responsible for these reports.

6.1.6 Responsibility and monitoring
Eik Markets has day-to-day responsibility for the Bank's liquidity, securities portfolio and foreign exchange deposits on behalf of the CEO. Thus, Eik Markets is also responsible for ensuring that the market risk is within the limits for market risk that are specified in the instructions from the Board of Directors to the CEO.

This is conducted by regularly calculating the interest rate risk on the Bank's bond portfolio, a weekly statement on the currency positions and continuous monitoring of the Bank's equity portfolio. These calculations and statements are then compared to the limits for market risk that have been authorised to the CEO and the authorisation provided to Eik Markets in this area.

6.2 Actual Market Risk
This section concerns the actual market risk exposures as of 31.12.2012. These concern risks related to the trading portfolio, exposures in equities etc., which are not connected to the trading portfolio and interest rate risk.

6.2.1 Risk pertaining to the Trading Portfolio
Solvency requirements for the various risks that constitute market risk are detailed in the table below.

Table 14: Risk-weighted exposures with market risk (DKK 1,000).

	Risk-weighted items	Capital requirement 8%
Bonds	286,223	22,898
Shares	92,951	7,436
Currency position	70,527	5,642

6.2.2 Exposures in equities that are not part of the Trading Portfolio
Exposures in equities that are not part of the trading portfolio are listed below:

Table 15: Exposures in equities that are not part of the trading portfolio (DKK 1,000).

	Exposure 31.12.2012	Operating influence
Shares relating to the Bank's suppliers	17,289	-1,881
Corporations	21,012	5,902

6.2.3 Interest Rate Risk

Interest rate risk separated into various items is shown in the table below.

Table 16: Interest Rate Risk in and outside the trading portfolio (DKK 1,000).

	Interest rate risk
Interest rate risk on items outside the Trading Portfolio	
Balance (loans, deposits, receivables/ debt with financial institutions)	47,181
Total outside of trading portfolio	47,181
Interest rate risk broken down by items in the trading portfolio:	
Securities in balance (incl. spot market)	12,727
Futures, forwards etc.	0
Total in trading portfolio	12,727
Total Interest Rate Risk	**59,908**

7 Liquidity Risk

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

7.1 Objective and Policy

Eik Banki's liquidity risk can be defined as the risk that arises from differences in scheduled outgoing and incoming cash flow in the Bank.

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

Eik Banki identifies the following as liquidity risks:

- Significant increases in funding expenses
- Lack of funding preventing Eik Banki from maintaining its approved business model
- Eik Banki being unable to fulfil its payment obligations due to a lack of funding

According to the liquidity policy Eik Banki wants to maintain liquidity, which is 50 per cent above the statutory minimum requirement. At year-end 2012 the Bank's excess liquidity was 297 per cent above the statutory minimum requirement.

7.1.1 Reporting and division of responsibility

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

The Board of Directors and the CEO receive a monthly statement on the Bank's liquidity situation from the Bank's Finance Department. The statement is prepared in accordance with section 152 in the Danish 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 determined by conducting a 12 month projection of the liquidity under normal market conditions and a 12 month projection of the liquidity under stressed conditions.

7.1.2 Responsibility and monitoring

Eik Markets has been given day-to-day responsibility of liquidity by the CEO. Eik Markets is also responsible for the daily monitoring of liquidity and liquidity projections. This is done on the basis of known future cash flows.

8 Operational Risk

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

8.1 Objectives and Policy

Operational risk is defined as the risk arising from inadequate and inefficient internal processes, human errors, IT-failures and external factors.

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 20 December 2011.

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

- credit, liquidity, security, market and real estate risk
- 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.

8.1.1 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 briefs the CEO monthly, who, in turn, 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.

8.1.2 Responsibility and monitoring

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 section 71 of the Danish Financial Business Act and Executive Order No 336 of 12 April 2012 for the Faroes on the governance and management of financial institutions etc.

8.2 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 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 registering, reporting and reassessing risk, in order to increase awareness.

Eik Banki'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. This is conducted in accordance with analyses from BIR, Business Impact Assessment from ISF, International Security Forum. A risk assessment was conducted in January 2013, resulting in an estimated risk amounting to DKK 47.9 million.