RISK MANAGEMENT REPORT

2010

BOARD OF DIRECTORS AND EXECUTIVE BOARD

GROUP OBJECTIVES OF RISK MANAGEMENT REPORT

To keep our shareholders and other stakeholders informed of the group’s risk and capital management policies, including risk management methodologies and practices, both short term and long term.

CONTENTS

1. Introduction

The purpose of BankNordik's Risk Management Report is to ensure transparency in the BankNordik Group and to make available information on how the Group manages the risks it encounters.

BankNordik's Risk Management Report is published annually on the Group's website, www.banknordik.fo, simultaneously with the release of the Group's Annual Report. The Risk Management Report is a separate unaudited document. There are no audit requirements for the Risk Management Report, but much of the information in the Risk Report Management Report will also be provided in the audited Annual Report.

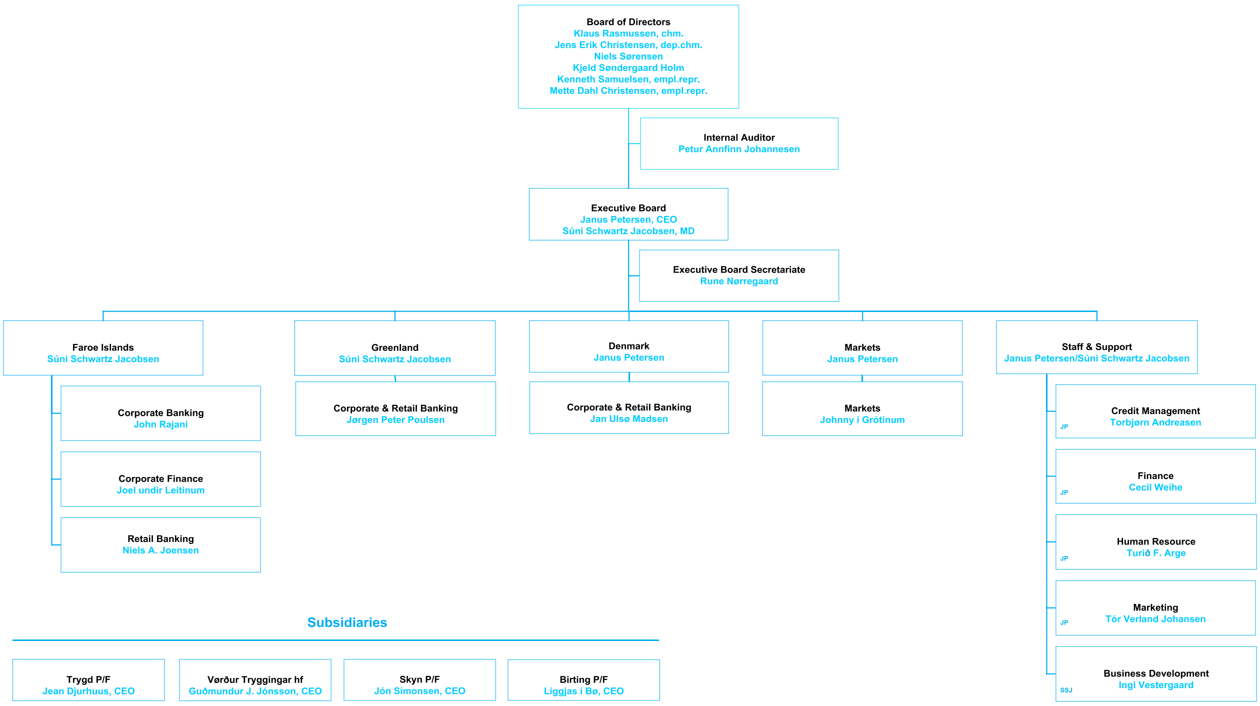
2. Organisation

2.1. Introduction

Understanding and ensuring transparency in risk taking are key elements of the BankNordik Group's business strategy. The Group's ambition is to set high standards in risk management. Our risk organisation supports this ambition, and it has developed in-depth risk management expertise.

The Board of Directors sets out the overall risk policies for all types of material risk while the Executive Board is responsible for the day-to-day management of the Group, including implementation of the risk policies.

Figure 1 Group Organisation



The Group allocates considerable resources to managing and monitoring risk and to ensuring ongoing compliance with approved risk limits. The Group has a firm reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Board, are kept informed of developments in risk measures at all times.

The Group's risk policies as well as limits and organisational framework for risk management are described in greater detail in the following sections. First, however, the Group has provided a presentation of how it has organised the banking activities acquired in Denmark and Greenland in 2010.

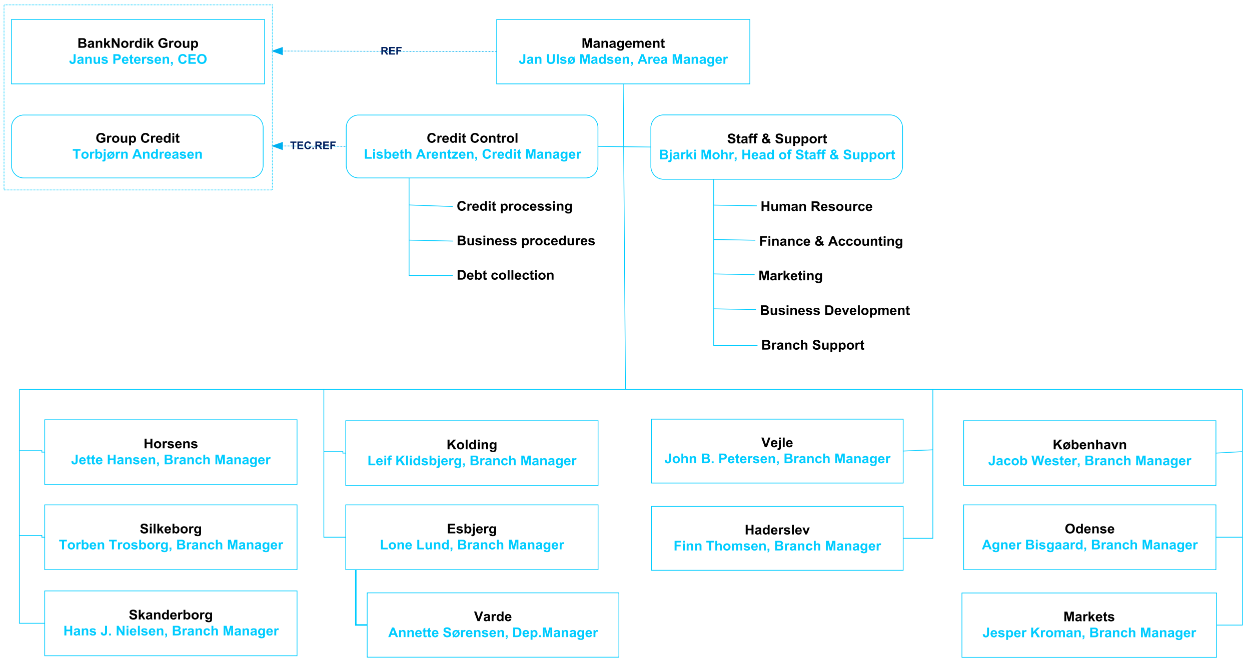
2.2. New banking activities in 2010 – Denmark and Greenland

The Danish activities have been organised as outlined below. The Danish headquarters, located in Kolding, report to the group CEO, Janus Petersen. The Executive Board has appointed Jan Ulsø Madsen as Country Manager.

Management has hired people with high credit competence, led by Credit Manager Lisbeth Arentzen who carries out the daily processing of credit matters in Denmark in cooperation with Group Credit.

In addition Bjarki Mohr has been appointed manager of the Staff & Support functions of the Danish branches and to ensure coordination with and integration of the branches into the Group.

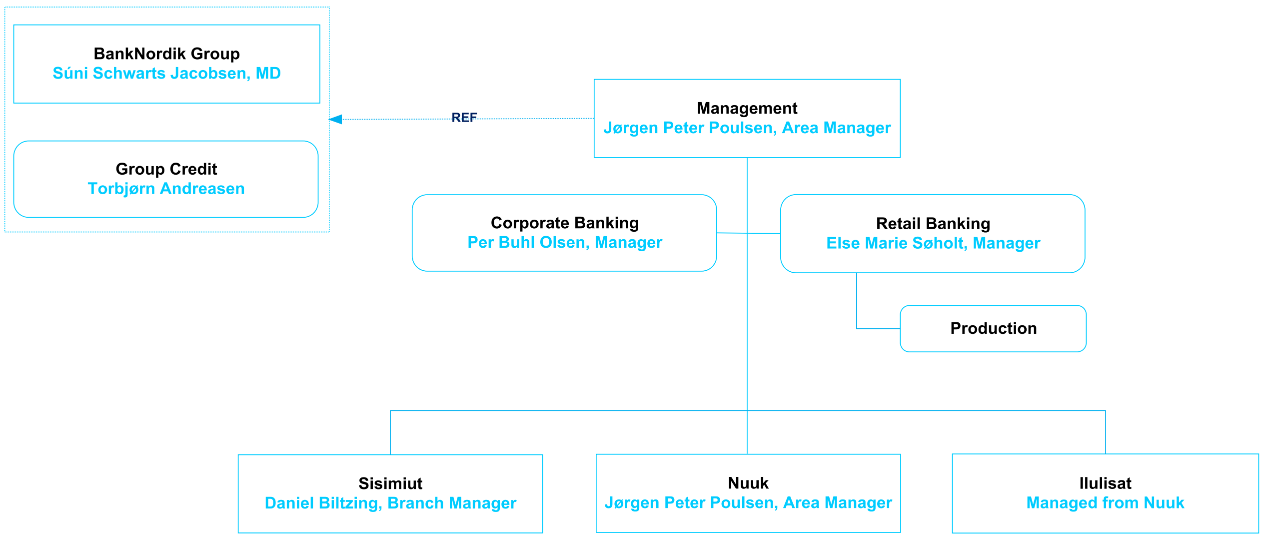
Figure 2 Organisation – Danish activities



The Greenland activities have been organised as outlined below. The Greenland headquarters, located in Nuuk, report to the group MD, Súni Schwartz Jacobsen. The Executive Board has appointed Jørgen Peter Poulsen as Acting Area Manager. Bjarti Nolsøe has been appointed Area Manager, and he will take up his position on 1 May 2011 at the latest. Biarti Nolsøe has worked as Head of Credit with GrønlandsBankin in Nuuk, and he also brings experience from the financial sector in the Faroe Islands.

Credit checks and authorizations that exceed the powers of local management are processed by the Group Credit Department.

Figure 3 Organisation – Greenlandic activities



2.3. Risk policies and limits

The Board of Directors sets out the overall risk policies and limits for all material risk types. The Board also determines the general principles for managing and monitoring risk, and it reviews the risk policies and limits annually. The Group uses risk appetite as a strategic concept to determine its risk-based limits. Risk appetite represents the maximum risk the Group is willing to assume in pursuit of its business targets. The risk appetite framework offers an overview of various risk dimensions and enables the Group to manage risk measurement across these dimensions in accordance with its overall risk policies.

The framework is based on an analysis of the Group's and the major business units' current risk profiles. It includes setting explicit targets, limits and contingency plans in accordance with the risk policies. It also includes monitoring of risk levels.

The Group implemented the risk appetite framework in its major business units in 2009. Key risk elements are identified on an ongoing basis in a dynamic process driven by new products, procedures, risk measurement applications as well as economic developments. The Group conducts risk management at the customer and industry levels as well as on the basis of geographical location and collateral type. It takes a comprehensive approach to the core risk dimensions:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Other risk dimensions are incorporated at the Group and business unit levels where appropriate. They include insurance, pension and concentration risk, financial strength, and earnings robustness. Specific risk instructions for the main business units are prepared on the basis of the overall risk policies and limits. These instructions are used to prepare business procedures and reconciliation and control procedures for the relevant units and for system development purposes.

2.4. Risk Organisation

BankNordik's "Rules of procedure" for the Board of Directors and the "Board of Directors' Instructions to the Executive Board" specifies the responsibilities of the Board of Directors and the Executive Board and the division of responsibilities between them. This two-tier management structure has been developed in accordance with Faroese and Danish legislation, and the "Rules of procedure" and "Board of Directors' Instructions to the Executive Board" are key documents in the Group's management structure, including the organisation of risk management and authorisations.

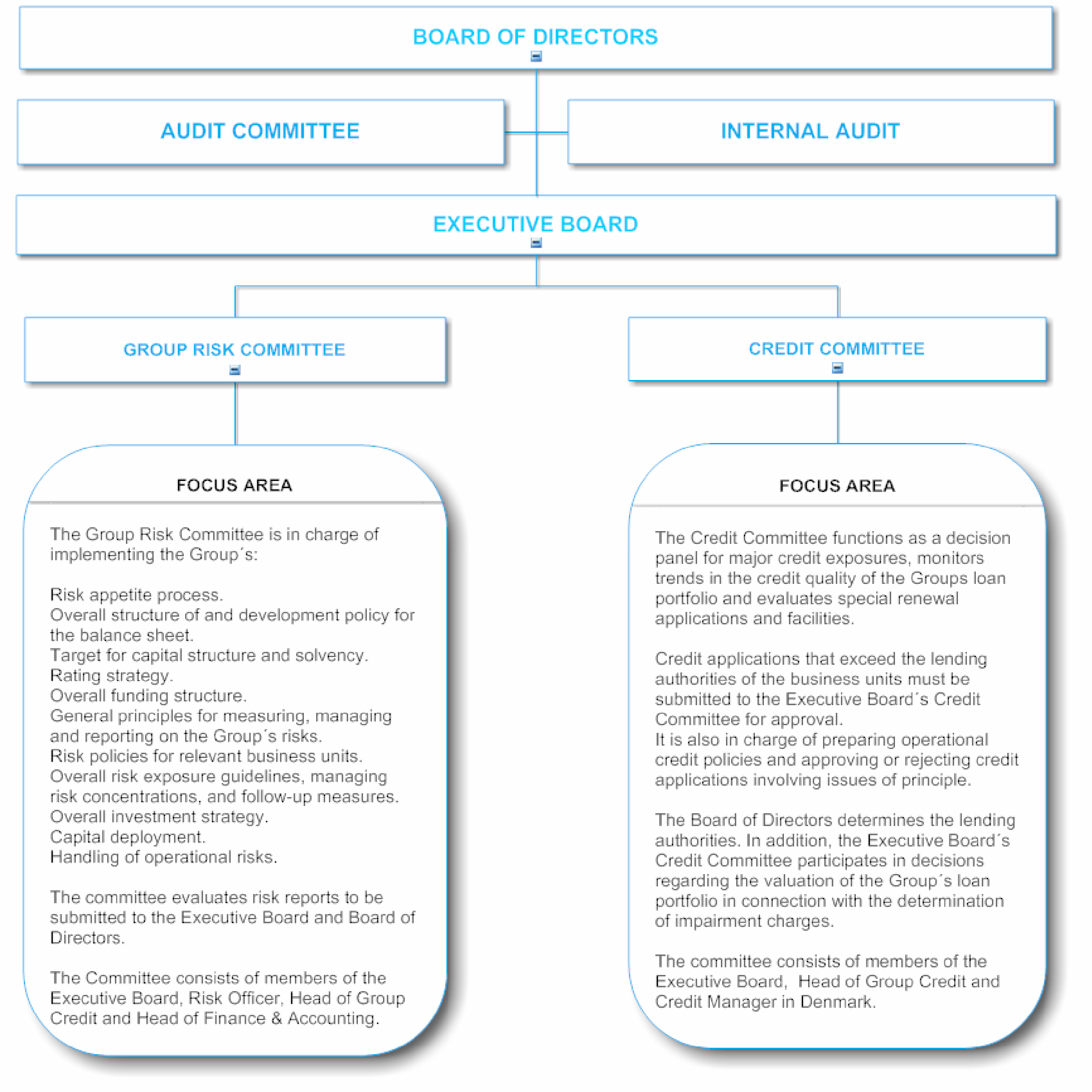
The Board of Directors lays down overall policies, while the Executive Board is in charge of the Group's day-to-day management and reports to the Board of Directors. None of the Group's executive managers serve on the Board of Directors of the parent company. The risk and capital management functions are separate from the credit assessment and credit-granting functions, as shown in figure 4.

The Group's management structure also reflects the statutory requirements governing listed Faroese companies in general and financial services institutions in particular. The BankNordik Group applies the comply-or-explain principle in respect of the recommendations on Corporate Governance issued by the Icelandic Chamber of Commerce. These recommendations apply to companies listed on NASDAQ OMX Iceland.

The Audit Committee examines accounting, auditing and security issues that the Board of Directors, the Audit Committee, the internal auditor and the external auditors believe deserve attention. The committee also reviews the internal control and risk management system.

The Audit Committee consists of members of the Board of Directors.

Figure 4 Risk Organisation of the BankNordik Group



2.4.1. Board of Directors

The Board of Directors must ensure that the Group is appropriately organised. As part of this duty, it appoints the members of the Executive Board and the Group's Chief Internal Auditor.

The largest credit facilities are submitted to the Board of Directors for approval, and the Board defines overall limits for market risk and liquidity risk. Regular reporting enables the Board of Directors to monitor whether the overall risk policies and systems are being complied with and whether they meet the Group's needs. In addition, the Board of Directors reviews reports analysing the Group's portfolio, particularly information about industry concentrations, large exposures and weak portfolios.

Internal Audit examines accounting, auditing and security issues. These are issues that the Board of Directors or the external auditors believe deserve day-to-day attention. The Internal Audit also reviews the internal control and risk management systems.

Due to the size and complexity of the BankNordik Group, the Board of Directors have not established other risk committees.

2.4.2. Executive Board

The Executive Board is responsible for the day-to-day management of the Group as stated in the “Rules of procedure” for the Board of Directors and the “Board of Directors’ Instructions to the Executive Board.

The Executive Board sets forth specific risk instructions and supervises the Group’s risk management practices. It reports to the Board of Directors on the Group’s risk exposures and approves material business transactions, including credit applications up to a defined limit.

The Executive Board has established two committees to be in charge of ongoing risk management, the Group Risk Committee and the Credit Committee. The Group has also organised various subcommittees/functions for specific risk management areas such as asset and liability management and the management of risk parameters and models affecting the Group’s capital and risk-weighted assets. The subcommittees consist mostly of members of the management team.

2.4.3. Group Risk Committee

The Group Risk Committee consists of :

- the Executive Board
- the Risk Officer
- the Head of Credit and
- the Head of Finance & Accounting

The Group Risk Committee is in charge of implementing the Group’s

- risk appetite process
- overall structure of the balance sheet
- targets for capital structure and solvency
- rating strategy
- overall funding structure
- general principles for measuring, managing and reporting on the Group’s risks
- risk policies for relevant business units
- overall risk exposure guidelines
- investment strategy
- capital deployment.

In addition, the Committee evaluates the risk report to be submitted to the Board of Directors. The Committee also assists the Executive Board in its functions and processes related to operational risk management, including

- implementing a programme that addresses and manages the Group’s current and potential risk
- processing reports from operational risk management functions
- monitoring the development and mitigation of the group’s key operational risks
- handling “critical risks”
- processing management information on issues such as IT security, physical security, business continuity and compliance.
- Processing recommendations on about Credit risk to the Credit Committee

2.4.4. Credit Committee

The Credit Committee consists of members of the Executive Board, the Head of the Credit Department and the Credit Manager in Denmark.

Credit applications that exceed the lending authorities of the business units must be submitted to the Credit Committee for approval. The local business units review these applications before the respective department heads submit them to the Credit Committee for approval.

The Committee is in charge of preparing operational credit policies and approving or rejecting credit applications involving issues of principle.

The Board of Directors determines the lending authorities. In addition, the Credit Committee participates in decisions regarding the valuation of the Group’s loan portfolio in connection with the determination of impairment charges.

2.4.5. Staff Departments

The Group’s overall risk issues including credit, market, liquidity and operational risks are monitored by The Group Risk Committee, in co-operation with managers of business units and subsidiaries, reporting directly to the Executive Board.

The Finance and Accounting department oversees the Group’s financial reporting, budgeting, liquidity and capital structure, and the performance and analytical tools used by the business units. It also has overall responsibility for the Group’s compliance with the Capital Requirements Directive and for the internal capital adequacy assessment process.

The Group has established a functional separation between units that enter into business transactions with customers or otherwise expose the Group to risk on the one hand and units in charge of overall risk management on the other.

The Group’s Risk Management unit is a separate function of the Group’s Credit Department. Risk Management has overall responsibility for monitoring the Group’s risk portfolio and reporting on overall risk measures. In addition, Risk Management is responsible for the implementation of risk models and risk analysis. Risk Management also handles relations with rating agencies.

The Credit Department has the overall responsibility for the credit process in all of the Group’s business units. This includes responsibility for developing credit classification and valuation models and for seeing that they are used in day-to-day credit processing in the local units.

The Credit Department is in charge of determining the utilisation of portfolio limits for industries and countries and of the quarterly process of calculating the impairment of exposures. It also keeps track of the credit quality of the Group’s loan portfolio by monitoring trends in unauthorised overdrafts and overdue payments, new approvals to weak customers and other factors.

In addition, the Credit Department reports to the Group management and to business units on developments in the Group’s credit risk. Finally, the department is in charge of providing management information about credits, of monitoring credit approvals in the business units, and of determining the Group’s requirements relating to its credit systems and processes.

HR and the Executive Board Secretariat are in charge of analysing and monitoring the strategic business risk and corporate governance. The Group’s investor relations are handled by the Executive Board Secretariat. The Business Development unit is responsible for monitoring the Group’s operational risk.

2.4.6. Business units

Core risk dimensions such as market risk and liquidity risk are managed centrally in the organisation. For credit risk, however, lending authority for specific customer segments and products has been granted to the individual business units. The business units carry out the fundamental tasks required for optimal risk management. This includes updating the necessary registrations about customers that are used in risk management tools and models, as well as maintaining and following up on customer relationships.

Each business unit is responsible for preparing carefully drafted documentation before business transactions are undertaken and for properly recording the transactions. Each business unit is also required to update information on customer relations and other issues as may be necessary.

The business units must ensure that all risk exposures comply with specific risk instructions as well as the Group's other guidelines. Loan and credit approvals to retail customers and small business customers are given according to the lending authorities delegated to the individual branches (see Figure 5).

Customer advisers are responsible for the basic credit assessment of customers. Their lending authority depends on customer classification, and they can approve credits up to certain amounts. Advisers must forward applications for credit facilities beyond their lending authority to the branch management, which may decide to submit applications to the Credit Department.

2.5. Reporting

The Group has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Board, are kept informed of among other things developments in risk measures, the credit portfolio, non-performing loans, market risk, strategic and operational risk.

The Board of Directors receives the principal risk reports annually (see Table 1) and interim reports quarterly. The report is updated quarterly in a condensed format, and once a year the full report is submitted to the Board of Directors for approval.

Table 1 Annual Reporting to the Board Of Directors

Risk appetite	Strategic determination of risk-based limits, representing the maximum risk that the Group is willing to assume in pursuit of business targets and in accordance with its overall risk policies.
Risk policy	Review of the Group's overall risk policy to determine whether revisions are required.
Models and parameters	Update on the use of risk models and risk parameters.
Quality of credit portfolio	Analysis of impairment charges and losses by business unit and portfolio break-downs by category, size, business unit, etc.

Table 2 Quarterly reporting to the Board Of Directors

BankNordik Group Methodology	Evaluation of the preferred risk and the level of capital in relation to the internal Group methodology. The report contains the conclusions drawn from stress testing and the effect on expected losses and capital requirements.
Key figures for the credit portfolio	An overview of credit-quality indicators, classifications and trends in lending volumes.
Market risk	Analysis of the Group´s current equity, fixed income and currency positions and report on the utilisation of Board approved limits since the preceding report.
Large exposures	An overview of exposures equal to or exceeding 10% of the Group´s capital base and the sum of these exposures, including the percentage of the Group´s capital base it represents.

The Group Risk Committee evaluates risk reports to be submitted to the Executive Board and the Board of Directors. It also reviews annual reports identifying all of the Group's risks and providing information on risk trends. The Committee regularly receives reports on the Group's risks and reviews trends in the regional business units.

The Group Risk Committee regularly reviews trends in the Group's key operational risks and the progress on concrete action plans regarding these risks. The committee receives reports and acts on key risk indicators.

3. Capital Management

BankNordik is well capitalised with a high solvency ratio and excess capital relative to the regulatory requirements. The Board of Directors is focused on maintaining the necessary capital base to fulfil its strategic goals and sustain the Bank's continued business development.

In February 2009, the Danish parliament passed a bill allowing Danish credit institutions that meet the regulatory solvency requirement to apply for hybrid core capital. In September, BankNordik received DKK 204m in hybrid core capital, which brought the core capital ratio to 25 per cent.

A constant monitoring and valuation of the Group solvency ratio forms an integral part of the Group's capital management.

3.1. Framework of the Group's capital management

The basis of the BankNordik Group's capital management is the regulatory framework in BASEL II, which consists of three pillars.

- Pillar I contains a set of rules for a mathematical calculation of the capital requirement based on risk weighted assets (RWA).
- Pillar II describes the supervisory review and evaluation process and contains the framework for the internal capital adequacy assessment process.
- Pillar III deals with market discipline and sets forth disclosure requirements for risk and capital management.

3.2. Pillar I

In accordance with the Basel II requirements, the total RWA is calculated as the sum of RWA for operational, market and credit risk.

3.2.1. Approach to capital adequacy statement

The Bank's capital adequacy statement was completed in accordance with the executive order on capital adequacy for the Faroe Islands of 21 May 2008. This executive order came into force on 1 January 2009, replacing executive order of 16 November 2001 as amended.

As a result of the change in the regulatory framework, the Bank has applied the Basel II rules effective from 1 January 2009. These rules generally require that the capital adequacy statement divides the Bank's risks into credit risk, market risk and operational risk.

Table 3 sets out the Bank's capital adequacy statement as of 31 December 2010, including the basis for calculating risk-weighted items, core capital, the core capital after deductions, the capital base, the capital base after deductions and equity.

Table 3 Statement of capital – P/F BankNordik

Solvency		
DKK 1,000	**Des. 31 2010**	**Des. 31 2009**
Core capital	1.734.785	1.768.845
Base capital	1.713.710	1.743.017
Risk-weighted items not included in the trading portfolio	7.974.767	6.029.519
Risk-weighted items with market risk etc.	1.394.961	618.176
Risk-weighted items with operational risk	710.588	0
Total risk-weighted items	10.080.316	6.647.695
Core capital ratio	17,2%	26,6%
Solvency ratio	17,0%	26,2%
Core Capital and Shareholders' eguity		
Share capital	200.000	200.000
Reserves	36.649	0
Net profit	334.176	110.661
Retained earnings, previous years	1.429.267	1.308.584
Shareholders' equity	2.000.091	1.619.245
Deduction of Foreign currency translation reserve	17.501	0
Deduction of intangible assets	429.968	27.857
Deduction of deferred tax assets	4	0
Deduction of insurance subsidiaries	21.074	25.827
Core capital exclusive of hybrid core capital	1.531.545	1.565.560
Hybrid core capital	203.240	203.285
Core capital	1.734.785	1.768.845
Base capital		
Core capital	1.734.785	1.768.845
Deduction of insurance subsidiaries	21.074	25.827
Base capital	1.713.710	1.743.017

3.3. Pillar II

While Pillar I contains uniform rules for capturing a financial institution's risk and determining the capital requirements of the Capital Requirements Directive, Pillar I does not necessarily capture all risk affecting individual institutions. Pillar II contains a framework for an internal capital adequacy assessment process based on the situation and characteristics of the individual institution.

The underlying aim of the Pillar II process is to enhance the link between an institution's risk profile, its risk management systems and its capital. Institutions are expected to develop sound risk management processes that properly identify, measure, aggregate and monitor their risk.

Pillar II is underpinned by four principles

- Assessment of capital adequacy in relation to the institution's risk profile and capital strategy
- Review and evaluation of the assessment and its ability to monitor and ensure compliance with its own requirement.
- The expectation that the institution will operate above the minimum own funds requirements and the ability of the Danish FSA to require a firm to hold capital in excess of the minimum requirement.

- FSA intervention at an early stage to prevent capital from falling below the minimum level required to support the risk profile or to require rapid remedial action if capital is not maintained or restored.

In order to measure and identify all risk exposure to the Group, the Group applies a Danish FSA approved capital adequacy assessment process from The Association of Local Banks, Savings Banks and Cooperative Banks in Denmark (LOPI). The process is designed to pick up on any potential increase in risk.

3.3.1. Solvency requirement

The Group's Executive Board and Board of Directors are responsible for maintaining a sufficient capital base and lay down requirements for individual solvency. The Group's All Risk Committee is responsible for monitoring and making sure on an ongoing basis that the solvency requirements determined by the Executive Board and the Board of Directors are complied with at all times. The overall responsibility for reporting to the Executive Board and the Board of Directors regarding solvency requirements lies with the Finance Department.

3.3.2. The methodology

The Group has implemented methology from LOPI to make sure that BankNordik can expose any potential risk and meet requirements set by the Executive Board and the Board of Directors.

The methodology forms an integral part of the Group's organisation and requires the Group Risk Committee to meet on a regular basis to review checklists and make sure that every possible risk is exposed and evaluated. This translates into a quarterly report that is sent to the Finance Department. The report is then submitted to the Executive Management. The Board of Directors receives a condensed quarterly report and a full annual solvency requirement report that is submitted to the Board for approval.

The model (see Table 4) can be split in two main parts.

The first part involves stress-testing eight variables in the financial report to simulate how the financial results are affected under given circumstances. In its stress test, the Group assesses the amount of capital needed to withstand the effects of a downturn in the economy.

In addition to stress testing different risk parameters, the second part of the model involves additional capital requirements for individual risk exposures, where every potential material risk specific to BankNordik is taken into account and any potential risk is included in order to determine a possible additional capital requirement.

The summary of the stress test and any individual additional capital requirement constitute BankNordik's individual capital requirement.

Table 4 BankNordik's solvency model

	Impairmets	Interest rate risk	Shares	Exchage rate	Derivatives	Net interest	Net fee	Real estate	
Budget 2011									√
Stresstest									
Credit risk	√								
Market risk		√	√	√	√				
Other risk						√	√	√	
Stresstest total									
Capital for growth of business volume									√
Aditional capital to cover credit risk									
Customers with financial problems									√
Large exposures									√
Commercial concentration									√
Geographical concentration									√
Concentration of collateral									√
Deduction of impairmets									√
Total aditional capital to cover credit risk									
Total aditional capital to cover market risk									√
Total aditional capital to cover operational risk									√
Aditional capital to cover other risks									
Strategic risk									√
Reputation risk									√
Risk related to institute size									√
Real estate risk									√
Group risk									√
Raising capital									√
Liquidity risk									√
Other risks									√
Total aditional capital to cover other risks									
Total aditional capital to legal requirements									√
Total capital requirements									

General stress test

Individual additional capital requiremen

3.3.3. Group solvency requirement

The Group's solvency requirement has been calculated using the method illustrated above. As of December 2010, the solvency requirement was 7.9%, the risk-weighted items were DKK 10.08bn and the capital requirement was DKK 811m.

4. Credit Risk

Credit risk is the greatest risk facing the Group constituting about three-quarters of the total capital requirement. BankNordik has loans and advances (exposures) of DKK 12,802m, the vast majority of which has been provided to customers in the Faroe Islands, Denmark and Greenland. The Bank pursues an overall credit policy calling for a balanced distribution of loans and advances.

Set out below is a presentation of the Bank's credit policy, credit scoring process, credit exposure and credit management. The Bank's procedures for writing off bad and doubtful debts form an integral part of this presentation.

4.1. Definition

The Group defines credit risk as the risk of losses arising because counterparties fail to meet all or part of their payment obligations to the Group. Credit risk also includes country, settlement and counterparty credit risks among other things.

BankNordik manages its overall credit risk by way of its general credit policy. One of the purposes of the credit policy is to ensure a balanced relationship between earnings and risk.

4.2. Policy

The Board of Directors sets the overall policies for the Group's credit risk exposure. The Group's risk appetite framework is determined in accordance with these policies. The key components of the credit risk policies are described below.

The Group's aim is to build long-term relationships with its customers. For the vast majority of products, credit is granted on the basis of the customer's financial circumstances and specific individual assessments. Ongoing follow-up on developments in the customer's financial situation enables the Group to assess whether the basis for the credit facility has changed. The credit facilities should match the customer's creditworthiness, capital position and assets.

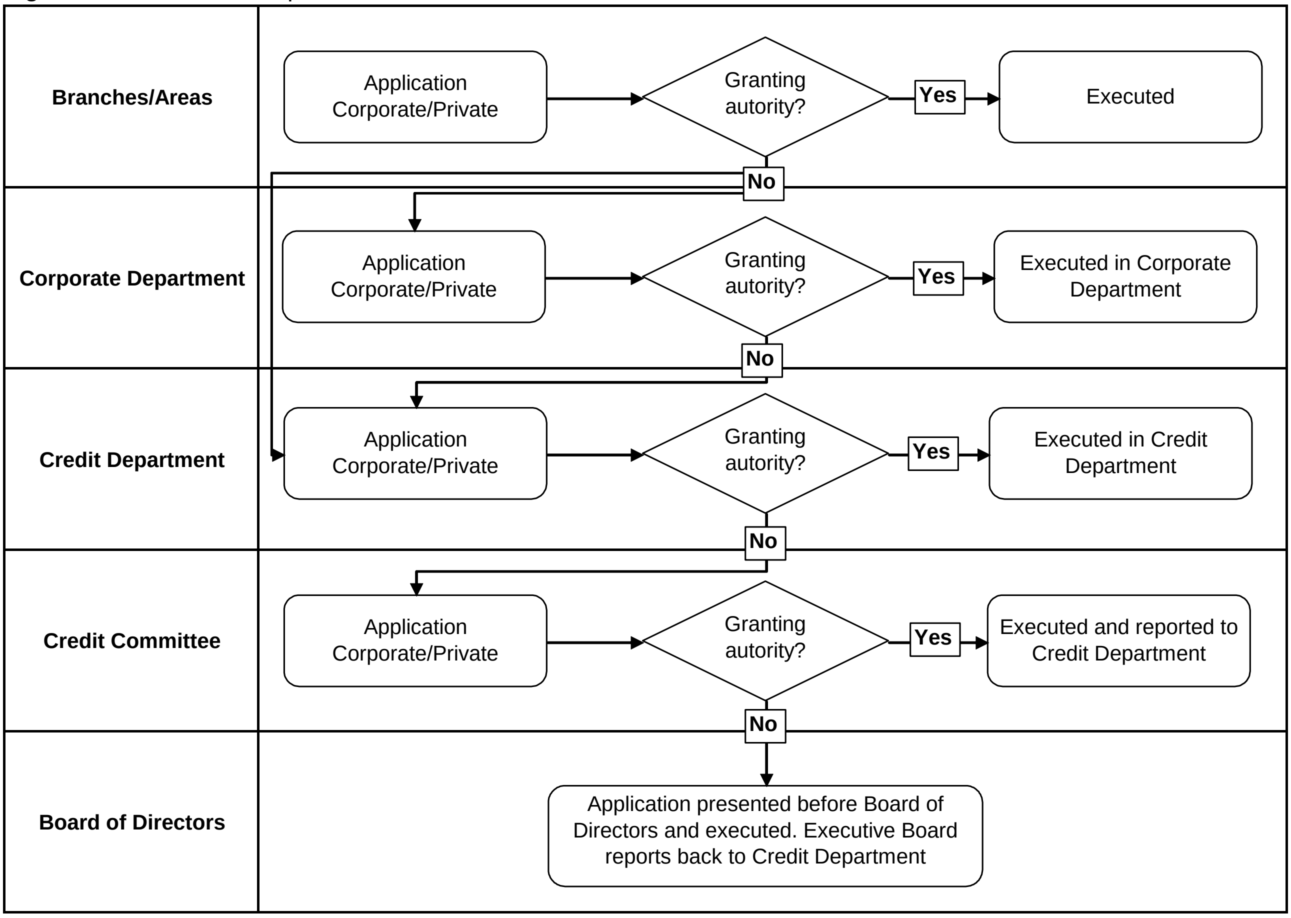
The Group aims to assume risks only within the limits of applicable legislation and other rules, including rules on best practices for financial undertakings. The Group normally considers requiring collateral in order to mitigate credit risk.

4.3. Credit process

In order to ensure a consistent, coordinated credit granting process of a high quality, the Bank has introduced a credit approval procedure that can be adjusted to market conditions (see section 2).

All credit applications are handled according to a pre-defined procedure that provides a consistent, high credit processing quality and ensures that our credit advisory services meet the Bank's guidelines. The figure below sets out the credit processing procedures.

Figure 5 BankNordik Group Credit Process



Bank branches: All branch managers can process and decide on credit applications within branch manager credit lines. Credit applications exceeding credit instructions are submitted to the Credit Department (retail customers) or to the Bank's Corporate Department (corporate customers) along with a credit recommendation. Branches in Denmark and Greenland are submitted directly to the Credit Department.

Corporate Department: The central corporate department in the Faroe Islands handles all of the Bank's major corporate accounts in the Faroe Islands. Credit applications exceeding the Corporate Department's credit lines are submitted to the Credit Department for approval.

The Credit Department: Applications that exceed a branch/Credit Department credit line are submitted to the Credit Department. The Credit Department also processes all staff loan applications.

In addition to processing credit applications, the Credit Department coordinates and prepares credit recommendations to the Bank's Credit Committee and recommendations submitted to the Board of Directors.

The Credit Committee: The Credit Committee reviews all applications that are beyond the Credit Department's granting authority (See section 2). The Credit Committee conducts credit meetings on an ongoing basis. The purpose of the Credit Committee is to:

- process credit applications exceeding the granting authority of the Credit Department;
- process and provide recommendations for all credit applications to be submitted to the Bank's Board of Directors;
- implement the guidelines for the credit area as approved by the Board of Directors; and
- to supervise the overall credit granting procedure.

Credit processing must be conducted on the basis of extensive knowledge of the risks inherent in each individual exposure for the purpose of striking a balance between risk and earnings opportunities and in compliance with the overall goals defined by the Board of Directors.

4.4. Risk classification

BankNordik's lending exposure is subject to very careful management as part of the day-to-day follow-up conducted by the departments with day-to-day responsibility for the individual portfolios. The follow-up and management process is split into the following categories:

- day-to-day management is conducted by the relevant account manager;
- commitments meeting specific criteria are tested individually for impairment four times per year in connection with the Bank's quarterly financial statements;
- reports on exposures due for review by the Credit Department in cooperation with the relevant branch;
- the largest exposures are reviewed annually with the Executive Board;
- constant monitoring of the largest exposures is a key priority.

The Bank does not perform an automatically ratingmodel of customers involving classification into homogenous groups. In 2011 the bank will start the process to implementing a rating system. However, the Bank is currently working on a individually classification system granted on the methodology using by the FSA authority (see table 6).

4.5. Credit exposure

The following section provides a presentation and review of the Bank's loan portfolio. The review deals with the overall loan portfolio, followed by a report on the individual sub portfolios. The exposures in 2009 is mainly to costumers in Faroe Islands (see section 2.2. about new banking activities in 2010 - Denmark and Greenland). Therefore the 2010 figures is not compared with 2009 figures.

The Bank's total loan (exposures) portfolio listed by the categories is set out in Table 5. As can be seen, the Bank's credit facilities are largely equally distributed between the retail and the corporate segments. The Bank had granted credit to public, retail and corporate customers for a total amount of DKK 12,046m at 31 December 2010 (not including Credit institutions and central banks), which was DKK 3,814m higher than at 31 December 2009.

Table 5 Loan portfolio

(DKKm)	**2010**	**2009**
Credit institutions and central banks	756	1356
Public	719	530
Retail	5.475	3.964
Corporate	5.851	3.738
Total	**12.802**	**9.587**

In 2010, the Bank had DKK 756m placed with credit institutions and central banks. These funds are money market placements, not committed lines. In addition, the Bank had loans and advances of DKK 756m to the public sector, equal to 6% of the overall portfolio.

The Bank's loans are mainly granted to domestic customers in the Faroe Islands, Denmark and Greenland. However, some of these customers have material parts of their operations outside the area. This is especially the case for fishery and offshore industries.

Table 6 Credit exposure by Geographical area

(DKKm)	2010			2009
	Exposures	Loan/Credits	Garanties	Esposures
Faroe Islands	7.221	6.522	238	8.232
Denamark	3.303	1753	956	
Greenland	1422	837	402	
Other	99	80	3	
Total	**12.046**	**9.191**	**1.599**	**8.232**

The garanties in Table 4 is exclusive Garantees to DRL, "Private Beredskab" and "Indskydergarantifonden".

4.5.1. Credit exposure, lending activities

In connection with the quarterly IFRS review, the on-going follow-up on the Bank's loan portfolio is classified in the following categories (see section 4.4). Table shows the Bank's portfolio based on the IFRS review. The classification is based on the methodology used by the Danish FSA.

Table 7 Quality of loan portfolio excl. financial institutions

(DKKm)	**2010**	**2009**
Portfolio without weakness or OEI	10.355	7.472
Portfolio with some weakness	622	
Portfolio with OEI	127	313
Portfolio with impairment/provision	942	447
Total	**12.046**	**8.232**

4.5.2.1. Credit exposure, lending activities – Corporate

The Bank's overall target is for no industry to make up more than 10% (see

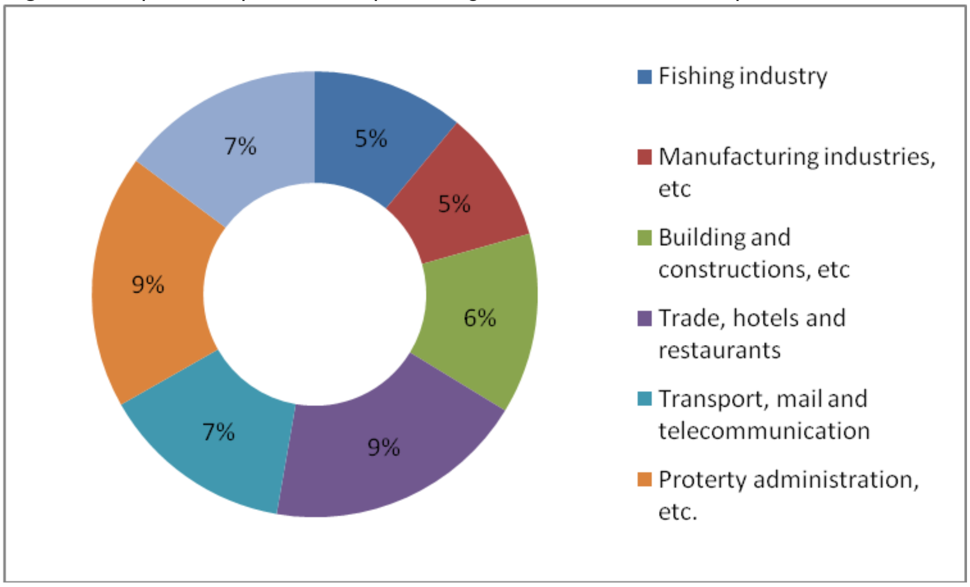
Figure 6) of the Bank's total exposure. In addition, the Bank's long-term target is for no single exposure (on a Group basis) to make up more than 10% of the Bank's equity.

As can be seen from Table 8 below, the Bank has a total corporate loan exposure of DKK 5.851 bn. The table also provides the portfolio breakdown by industry.

Table 8 Corporate exposure

(DKKm)	**2010**	**2009**
Fishing industry	644	680
Manufacturing industries, etc	563	414
Building and constructions, etc	767	299
Trade, hotels and restaurants	1.113	680
Transport, mail and telecommunication	820	727
Proterty administration, etc.	1080	464
Other indurstries	865	474
Total	**5.851**	**3.738**

Figure 6 Corporate exposure as a percentage of the overall credit exposure 2010



4.5.2.2. Credit exposure, lending activities – Retail

Having a strong position in the retail segment is a big priority for the Bank. Retail loans account for about 45% of the Bank's total loans and advances. The vast majority of the retail loans in the Faroe Islands involves loans for the purchase of real estate in which the Bank holds a first mortgage secured against the property.

Table 9 Retail loan balance distribution

(DKKm)	**2010**	**2009**
Real estate	2.771	2.954
Car	356	184
Consumer kredit	313	274
Guarantees	893	-
Other	779	552
Total	**5.112**	**3.964**

The Guarantees in Table 9 is exclusive the Guarantee BankNordik have made to DLR loan in Faroe Islands. At the end of 2010 the total Guarantees to DLR is DKKm 244.

4.6. Risk mitigation

As provided in the Bank's overall credit policy, the Bank seeks to minimise actual risk. Accordingly, the Bank generally requires collateral for any credit facility granted. What kind of collateral the Bank may require when granting a loan depends on the account involved and is subject to an individual assessment of each credit application.

The Group applies the various instruments available to reduce the risk on individual transactions, including collateral in the form of tangible assets, netting agreements and guarantees. The most important instruments with which to reduce risk are charges on tangible and intangible assets, guarantees and netting agreements under derivative master agreements.

The types of collateral most frequently provided are real estate, ships/aircraft and motor vehicles.

The Group regularly assesses the value of collateral provided in terms of risk management. It calculates the value as the price that would be obtained in a forced sale less deductions reflecting selling costs and the period during which the asset will be up for sale.

To allow for the uncertainty associated with calculating the value of collateral received, the Group reduces such value by way of haircuts, see table 9. For real estate, haircuts reflect the expected costs of a forced sale and a margin of safety. In the Faroe Islands, this margin is 20%, while in Danmark and Greenland it is 15% below an expected marked value. These cautious safety margins are only reflected in the 2010 numbers, while in 2009 the collaterals for real estate are presented at fair value. For listed securities, haircuts are 20%. As a general rule, collateral for loans to public authorities is not calculated if there is no mortgage in real estate. For unlisted securities, guarantees by third party (exclusive of guarantees from public authorities and banks) and collateral in movables, the haircut is 100%.

Table 10 Credit exposure and collateral for 2010

(DKKm)	**Retail**	**Corporates**	**Public**	**Total**
Exposure	5.475	5.847	724	12.046
Loan balance	5.112	5.071	607	10.790
Collateral	2.900	2.827	69	5.795
Unsecured	2.575	3.020	655	6.250
Unsecured balance	2.212	2.244	538	4.995
Unsecured ratio	47%	52%	91%	52%
Unsecured ratio balance	43%	44%	89%	46%

Table 11 Credit exposure and collateral for 2009

	Retail	**Corporates**	**Public**	**Total**
Exposure (*DKKm*)	3.964	3.738	530	8.232
Loan balance (*DKKm*)	3.587	2.916	433	6.937
Collateral (*DKKm)*	3.011	2.045	28	5.084
Unsecured (*DKKm*)	953	1693	501	3.147
Unsecured balance (*DKKm*)	576	871	405	1852
Unsecured ratio	24%	45%	95%	38%
Unsecured ratio balance	16%	30%	93%	27%

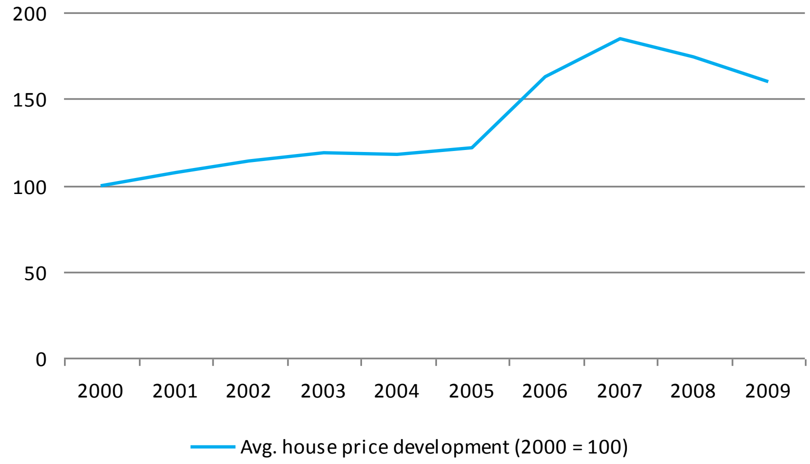
Loan balance incl. impairments and guarantees.

Table shows the Bank’s total credit exposure and the collateral for the loans granted divided into retail, corporate and public sector. Unsecured exposures accounted for 47% of the retail exposure and for 52% of the corporate exposures

The largest part of the Bank’s credit is granted against collateral in real estate.

After several years of rising property prices, we saw declines in 2008 and 2009. Figure below illustrates the general price developments in Faroe Islands.

Figure 7 Developments in average House Prices



Føroya Banki began cooperating with the Danish mortgage instituton DLR in the summer of 2009 (in Faroe Islands). In Denmark, DLR focuses on mortgage loans for the financing of agricultural properties and urban properties.

4.7. Monitoring and portfolio management

Føroya Banki monitors credit facilities centrally through its credit systems. Costumers showing a weak financial performance are transferred to a watch list enabling the Bank to monitor them more closely and thereby reduce the risk of losses. At least once a year, Føroya Banki reviews all exposures above a certain amount.

Unauthorised overdrafts are automatically referred to the customer's adviser, who decides whether or not to accept the overdraft. For good customers, the bank often accepts one or more accounts being overdrawn for a certain period of time. If the overdraft is not accepted, a reminder procedure is initiated.

Table 12 Distribution of past due amount

	2010			2009	
(DKKm)	Exposure	Past due total	Past due > 90 days	Exposure	Past due total
Portfolio without weakness or OEI	10.355	152	14	7.472	
Portfolio with some weakness	622	29	3		
Portfolio with OEI	127	13	1	313	
Portfolio with impairment/provision	942	65	11	447	
Total	**12.046**	**258**	**28**	**8.232**	**206**

4.7.1. Credit risk management

Credit portfolio risk management involves two sets of portfolios.

One set is used to monitor the overall credit risk broken down by industry. The risk appetite for each portfolio is based on a combination of industry input and the current credit quality of the portfolio.

The other set of portfolios concerns specific areas in which the Bank has identified a need to monitor exposure more closely. The largest exposures are monitored very closely.

Additionally, the business units monitor and review credit quality on a quarterly basis and report to the Credit Committee and the Group Risk Committee. The Credit Committee may take steps to counter negative developments in the portfolio. Detailed monitoring reports are made by the Credit Departments, and general reports are submitted to the Senior Management and the Board of Directors.

4.7.2. Risk concentration

The main objective of the Bank's credit policy is to optimise the risk/return ratio. A key factor of this objective is to have a well-diversified portfolio, both as regards industry composition and individual facility amounts. Føroya Banki has made a dedicated effort to balance the loan portfolio.

Table 13 Risk exposure concentrations

(DKKm)	2010		2009	
Public authorities	719	6%	530	6%
Corporate sector:				
Fishing industry	644	5%	680	8%
Manufacturing industries, etc.	563	5%	414	5%
Building and construction, etc.	767	6%	299	4%
Trade, hotels and restaurants	1113	9%	680	8%
Transport, mail and telecommunicatio	820	7%	727	9%
Property administration, etc.	1080	9%	464	6%
Other industries	865	7%	474	6%
Total corporate sector	5.851	49%	3.738	45%
Retail customers	5.475	45%	3.964	48%
Total	**12.046**	**100%**	**8.232**	**100%**

4.8. Impairment/Losses

The Group estimates the future cash flow on the basis of the most likely scenario. The Bank tests the entire loan portfolio for impairment four times per year. Table shows the Bank's total losses by industry from 1998 to 2010. As the table shows, the average loss ratio during the overall period was 0.8%. As can be seen from the data, there are relatively large variations from year to year and from industry to industry.

Table 14 Historical losses

	Weightet	2010	2009	2008	2007*	2006*	2005*	2004*	2003*	2002*	2001*	2000*	1999*	1998*
Retail	0.3%	0.1%	0.1%	0.0%	0.1%	0.1%	0.2%	0.3%	0.3%	0.5%	0.7%	1.0%	1.1%	1.2%
Agriculture	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	10.3%	0.0%	0.0%	0.0%	4.0%
Aqua Culture	4.1%	0.0%	0.0%	0.0%	0.2%	0.0%	17.7%	31.5%	4.7%	0.5%	0.1%	0.0%	0.2%	0.0%
Fisking indurstry	1.0%	2.1%	5.7%	0.0%	0.0%	0.0%	0.6%	0.0%	3.0%	0.3%	0.0%	0.1%	1.1%	0.7%
Manufacturing industries etc.	0.7%	0.8%	0.0%	0.0%	1.9%	0.1%	5.6%	0.0%	0.0%	0.0%	0.1%	0.1%	2.2%	0.7%
Building and construction etc.	3.0%	4.7%	16.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	2.0%	9.0%
Trade, hotels and restaurants	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	6.4%	1.9%
Transport, mail and telephone	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	6.4%	1.9%
Service	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.4%	1.0%
Property adm., purchace and sale and business services	2.2%	6.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	1.0%	0.0%	0.0%	0.0%	0.0%
Retail other	0.1%	0.0%	0.0%	0.0%	0.0%	0.3%	0.0%	0.0%	0.6%	0.7%	0.9%	0.4%	0.7%	0.3%
Public Autorities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	0.8%	1.4%	1.1%	0.0%	0.2%	0.1%	1.3%	2.7%	0.9%	0.4%	0.4%	0.5%	0.9%	1.2%

According to IAS 39, OEI of a financial asset may appear before default, for example when a debtor is found to be in financial difficulty, likely to go bankrupt or enter into financial restructuring.

If OEI of a loan, advance or amount due exists, the Group determines the individual impairment charge. The charge equals the difference between the carrying amount and the present value of the estimated future cash flow from the asset, including the realisation value of collateral. Loans and advances without OEI are included in an assessment of collective impairment.

Table 15 Exposures and individual impairment charges by sector

(DKKm)	2010		2009	
	Exposures	Impairments	Exposures	Impairments
Public	719	-	530	-
Retail	5.475	53	3.738	251
Corporate	5.851	321	3.964	35
Total	**12.046**	**374**	**8.232**	**286**

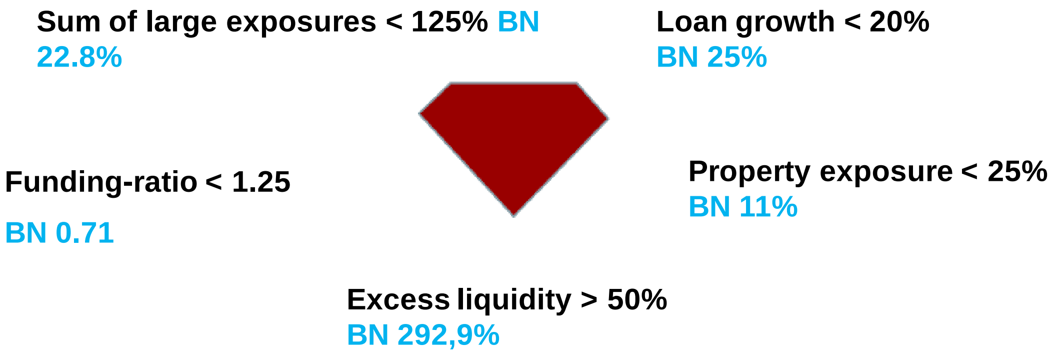
Some of the impairment charges are directly linked to the international financial crisis. Although the Bank's credit policy has been to generally refrain from providing investment credits and from financing investments in securities, the Bank has financed a few investment companies based on their high solvency. The financial crisis has had a negative effect on some of these exposures, since the customers have realised losses on securities to an extent that has considerably weakened their financial strength. The Bank has taken impairment charges on these exposures that are considered to be sufficient and the risks on the remaining exposures related to these customers are considered to be limited.

4.9. The Danish FSA's "Supervisory Diamond"

The Danish Financial Supervisory Authority (the Danish FSA) has introduced a new model for measuring whether a bank has a high-risk profile – the so-called Supervisory Diamond or in Danish "Tilsynsdiamanten". The model identifies five areas considered to be indicators of increased risk if not within certain limits. The model will be fully implemented as a part of the Danish FSA's supervision by year-end 2012.

The Bank meets by a wide margin the limits for large exposures, exposures towards real estate, excess liquidity and stable funding, and by a narrow margin the limits for lending growth (the lending growth in 2010 was influenced by the acquisition of the Danish and Greenlandic activities in February 2010.)

Figure 8: The Supervisory Diamond – BankNordik (BN)



The Groups exposures in Property administration in total is 9% (see Figure 1). The FSA has annonced in an update of the diamant, that the sector has to incl. costumers with property related activities from the segment "Building and construction" into the "Property exposures". Thus in total BankNordiks "Property exposures" amount 11% according the new requirements, although well in range.

5. Market Risk

In 2010, BankNordik's market risk exposures were higher than in prior years, reflecting the banks strong liquidity and growth in volumes following the acqusition of branches from Sparbank.

5.1. Definition

The Group defines market risk as the risks taken in relation to price fluctuations in on the financial markets. Several types of risk may arise and the Bank manages and monitors these risks closely.

BankNordik's market risks are

- Interest rate risk: risk of loss caused by changes in interest rates
- Exchange rate risk: risk of loss from positions in foreign currency when exchange rates change
- Equity market risk: risk of loss from falling equity values

5.2. Policy and responsibility

The Group's market risk management relates to the Group's assets, liabilities and off-balance-sheet items.

The Board of Directors defines the overall policies/limits for the Group's market risk exposures, including the overall risk limits. The limits on market risks are is set with consideration of the risk they imply, and how they match the Group's strategic plans.

On behalf of the Executive Board, the Group Risk Committee is responsible for allocating the market risk to the Group's major business areas, mainly to Markets in BankNordik, reflecting the Group's conservative approach to market risk.

The Markets division takes positions for the Group's own account. This primarily involves positions in Danish mortgage bonds for the purpose of investing the current liquidity. Finance and Accounting monitors and reports these risks to the Executive Board on a monthly basis.

Table 16 Reporting of market risk to the Board of Directors and the Executive Board

	Board of Directors
Quarterly	Overview of - Interest risk - Exchange risk - Equity market risk - Liquidity risk
	Executive Board
Monthly	Overview of - Interest risk - Exchange risk - Equity market risk - Liquidity risk
Daily	At the moment the daily reporting of market risk is performed on an ad-hoc basis upon request, w hile the IT provider is finalizing a more permanent solution for performing the daily reporting of market risk.

Counterparty risk is the risk of not receiving the agreed value for any payment/trade. The Bank incurs counterparty risk when participating in clearing and settlement systems with counterparties. BankNordik participates in the Danish securities settlement system.

Danish mortgage and government bonds are the primary asset classes in the Group's portfolio of securities. This is due to the fact that these asset classes have high liquidity, good credit rating, no currency risk, and have limited interest rate and credit risk. Limits for interest rate and counterparty risk are defined by the Board of Directors.

5.3. Control and management

Table 17 Market risk management

	Board of Directors	Executive management	Head of Finance & Accounting	Head of Markets
Strategic	Defines the overall market risk			
Tactical		Delegates risk authorities to relevant divisions	Manages the Bank's market risk	Implementing
Operational			Controlling & reporting	Trading

Head of Finance & Accounting monitors and produces reports on market risk to the Board of Directors on a quarterly basis and to the Executive Board on a monthly basis.

5.4. Market risk

The table of market risk shows that the Bank's interest rate risk and exchange rate risk increased were higher in 2010 (see table 20), reflecting the Banks strong liquidity invested in bonds. BankNordik's liquidity was all time high in 2010 and the interest rate risk reflect's the large bond portfolio. The foreign exchange position is high, but this primarily explained by early repayment of EUR loans in December, since the matching hedge of the EUR position was eliminated in January 2011. .

Table 18 Market risk in % of Equity

	2010	2009
Interest rate risk, %	3,2	1,3
Foreign exchange position, %	25,2	1,5

5.5. Interest rate risk

The Group's policy is to invest most of its excess liquidity in highly liquid bonds. As a consequence, BankNordik holds a large portfolio of bonds and most of the Group's interest rate risk stems from this portfolio. Furthermore, as can be seen from the table below, the credit quality of the bond portfolio is high. BankNordik does not hold unlisted bonds.

Table 19 Rating of bonds

	2010	2009
AAA	73%	84%
AA1-A2	26%	14%
Other	1%	2%

The Group's interest rate risk is calculated according to the requirements of the Danish FSA. The interest rate risk is defined as the effects of a one percentage point parallel shift of the yield curve.

BankNordik offers fixed rate loans to corporate customers. The interest rate risk from these loans is hedged with interest rate swaps on a one-to-one basis. BankNordik has also granted fixed-rate mortgage loans and rate cap loans to retail customers. These loans are hedged in portfolios significantly reducing the interest rate risk. Fixed rate mortgage loans to retail customers are now only offered in cooperation with DLR Realkredit and Totalkredit.

Table 20 Interest rate risk broken down by currency

(*DKKm*)	**2010**	**2009**
DKK	52	22
EUR	1	1
JPY	0	0
USD		
CHF		
GBP	0	0
Interest rate risk	**53**	**23**

Table shows the Group's overall interest rate risk measured as the expected loss on interest rate positions that would result from a parallel upward shift of the interest rate curve – in line with the Danish FSA requirements.

5.6. Exchange rate risk

BankNordik's base currency is DKK and assets andliabilities in other currencies therefore imply an extra risk as they can vary over time relative to DKK. BankNordik's core business as a commercial bank makes it necessary to have access to foreign currencies and to hold positions in the most common currencies. Given the uncertainty of currency fluctuations, BankNordik´s policy is to maintain low currency risk at a low level.

The Group's exchange rate risk mainly stems from:

- customer loans/deposits in foreign currency
- treasury's positions in foreign currency; and
- funding in foreign currency.

Table 21 Foreign exchange risk

(DKKm)	**2010**	**2009**
Assets in foreign currency	675	1.546
Liabilities and equity in foreign currency	267	1.547
Exchange rate indicator 1	423	26

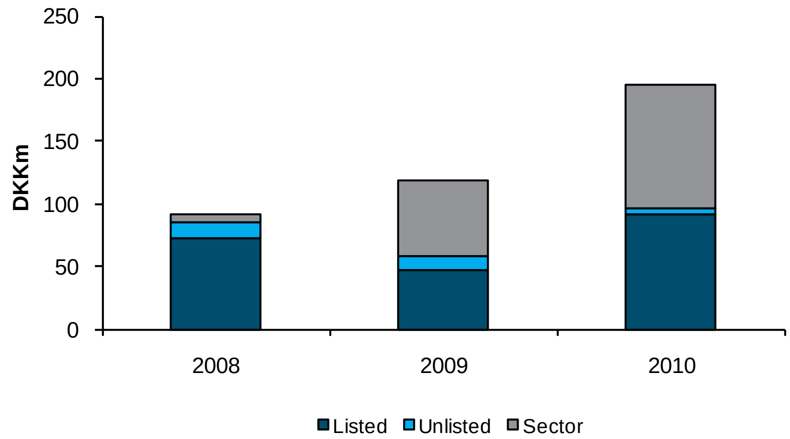
The Bank's exchange rate risk is measured by way of two key figures, the currency position and the currency risk calculated according to the requirements of the Danish FSA. The exchange rate risk is monitored on a daily basis with respect to the limits defined for each currency.

5.7. Equity market risk

BankNordik's stringent risk policy restricts positions in equities to listed and liquid shares and shares related to the Danish banking sector, but occasionally the Bank holds unlisted shares, if they are part of the enforcement of a defaulted loan.

The Group has acquired holdings in a number of unlisted banking-related companies. These are mainly investments in companies providing financial infrastructure and financial services to the Bank. For some of these investments, BankNordik's holding is rebalanced yearly according to the business volume generated by the Bank to the company in question. These unlisted shares are recognised at cost. The Group has increased the amount of unlisted shares as a consequence of the strategic cooperation with DLR and SDC.

Figure 9 Group equity risk



At 31 December 2010, the Group held listed shares valued at DKK 92m, unlisted shares of DKK 4m and sector shares amounting to DKK 99m.

6. Liquidity Risk

6.1. Definition

Liquidity risk is defined as the risk of losses resulting from
- increased funding costs
- a lack of funding of new activities
- a lack of funding to meet the Group's commitments

The Board of Directors has set the Bank's liquidity limits at the daily operational level and for budgeting plans.

6.2. Control and management

Liquidity risk is a fundamental part of the Group's business strategy.

The Group's liquidity is managed by Markets and reported to the Executive Board by Finance & Accounting in accordance with the limits set by the Board of Directors.

A liquidity report with stress tests is submitted to the Executive Board and the Group Risk Committee on a monthly basis.

Markets has the operational responsibility for ensuring that the Group observes the operational liquidity risk limits while Finance & Accounting is responsible for reporting and monitoring liquidity. The Group has implemented contingency plans to ensure that it is ready to respond to unfavourable liquidity conditions.

Table 22 Liquidity management

	Board of Directors	Executive Board	Finance & Accounting	Head of Markets
Objective	Defines the objectives for the liquidity policy			
Tactical		Sufficient and well diversified funding	Planning	Providing background materials
Operational			Monitoring	Establish contact

6.2.1. Operational liquidity risk

The objective of the Group's operational liquidity risk management is to ensure that the Group has sufficient liquidity at all times to handle customer's transactions and changes in liquidity.

BankNordik's bond portfolio forms a substantial part of the Bank's liquidity. It is therefore essential that the portfolio can be traded at fair prices at any time. BankNordik's believes that a solid rating is one of the conditions for ensuring a fair price in the market. Hence, BankNordik's policy is to invest in bonds with high ratings and thereby minimise the liquidity risk of the Bank's bond portfolio. Most of these bonds are also accepted by the Danish central bank for performing repurchase transactions.

The Bank has obtained a DKK 800m committed facility with the Danish central bank which expired in February 2011. This is a part of Bank Package I.

6.2.2. Liquidity stress testing

BankNordik has incorporated a liquidity stress testing model. This model is used at least monthly to forecast developments in the Bank's liquidity on a 12-month horizon and to forecast whether, on a 3-month horizon, the Bank will achieve the Board of Directors' target of excess liquidity equal to at least 100% of the statutory requirement. The test is based on the business-as-usual situation with outflows from undrawn committed facilities and further stress measures. If the 3-month target is not met, the Executive Board can implement a contingency plan.

6.2.3. Twelve-month liquidity

In its rating methodology, "Bank Financial Strength Ratings: Global Methodology", Moody's, the international rating agency, has established a range of qualification criteria to be met in the liquidity management of a credit institution. One of these criteria is that the liquidity curve must, when submitted to a stress test, in general be positive for the following 12 months. The calculations in such a liquidity stress test are based on a condition of no access to unsecured capital markets during the period. The Bank would have positive net funding throughout the following 12-month period under such stressed circumstances.

6.2.4. Structural liquidity risk

Deposits are generally considered a secure funding source. Deposits are generally short term but their historical stability enables BankNordik to grant customer loans with much longer terms e.g. 25 years to fund residential housing. This maturity mismatch and associated risk is crucial for any bank to handle, and therefore it is essential to have a reputation as a safe bank for deposits.

Table 23 Loans and advances specified by maturity

(DKKm)	**2010**	**2009**
On demand	163	206
3 monts or less	226	238
3 monts to 1year	617	489
Over 1year to 5 years	2.591	1721
Over 5 years	5.077	4.284
Total	**8.674**	**6.938**

External medium to long-term funding in the international credit markets has proven uncertain and cannot be relied on entirely at all times. Hence, the Board of Directors has set a strategic goal of reducing the dependency on this source of funding to a maximum borrowing level amounting to the statutory requirement of the Bank's liquidity. After the acquisition in February 2010 of the Danish and Greenlandic bank branches, which held a deposit surplus of more than DKK 1 billion, the Group achieved this strategic goal of independency of the international credit markets. With the recent adjustments of the Supervisory Diamond (see section 4.9), under which the Danish FSA from 2013 requires the banks to have stable funding measured by a minimum ratio of 1 between loans and deposits plus funding loans with longer than one year to redemption.

To enhance access to international funding, the Bank has obtained a rating from Moody's and has taken initial steps to address the factors that Moody's have pointed out. A possible downgrade of the Bank's external rating would have a negative impact on the ability to attract competitive funding. An upgrade of the rating would be positive and improve access to funding.

In order to minimise liquidity risk, BankNordik's policy is to have strong liquidity from many different funding sources. It is therefore the Bank's policy to further diversify the deposit base in terms of amounts, products and, to an increasing extent, geography.

BankNordik has entered into a cooperation with DLR Kredit A/S for the purpose of providing mortgage loans in the Faroe Islands and Greenland for retail and corporate loans and corporate loans in Denmark. BankNordik has also entered into a cooperation with Totalkredit A/S for the purpose of providing retail loans in Denmark. These agreement's strengthen the Bank's funding base.

6.2.5. Funding sources

The Group monitors its funding mix to make sure that there is a satisfactory diversification between deposits, equity, hybrid capital, and long-term loans from the financial markets.

Table 24 Funding

(DKKm)	2010	2009
Due to credit institutions and central banks	245	1498
Issued bonds	2.200	1000
Debposits	8.891	5.497
Core hybrid capital	203	204
Total	**11.539**	**8.199**

BankNordik's long term policy is to diversify the deposits by type, maturities and counterparty.

Table 25 Deposit by maturity

(DKKm)	2010	2009
On demand	4.355	2.223
3 monts or less	2.707	3.128
3 monts to 1 year	17	4
Over 1 year to 5 years	663	140
Over 5 years	1149	1
Total	**8.891**	**5.497**

The Groups strategy is to reduce external funding to a level corresponding to the Banks excess liquidity coverage goal of 100%. The external funding which was DKK 2.2bn at the end of 2010, will be reduced over the next year. Allready at the end of February 2011 issued bonds were down to DKK 1.6bn.

6.3. Collateral provided by the Group

BankNordik has in 2010 entered into ISDA and CSA agreements with derivatives counterparties. These agreements commit both parties to provide collateral for negative market values. As a consequence of these agreements BankNordik at year-end 2010 had pledged bonds valued at DKK 50 million under these agreements.

BankNordik also provides collateral to the Danish central bank to give the Bank access to the intra-day draft facility with the central bank as part of the Danish clearing services for securities. At year end 2010, this collateral amounted to DKK 60 million.

7. Operational Risk

The capital adequacy regulation stipulates that banks must disclose all operational risks.

7.1. Definition

According to the Basel Committee, operational risk is defined as follows:

"Risk of loss resulting from inadequate or faulty internal procedures, human errors and system errors, or because of external events, including legal risks."

Operational risk is thus often associated with specific and one-off events, such as clerical or record-keeping errors, defects or breakdowns of the technical infrastructure, fraud by employees or outsiders, failure to comply with regulatory requirements, fire and storm damage, litigation or codes of conduct or adverse effects of external events that may affect the operations and reputation of the Bank.

7.2. Policy

The Bank seeks to minimise its operational risks throughout the organisation by an extensive system of policies and control arrangements, which are constructed for the purpose of optimising procedures.

7.3. Measurement and control

At the organisational level, banking activities are kept separate from the control function. Independent auditors perform the internal auditing in order to ensure that principles and procedures are complied with at all times.

Although the Bank has implemented risk controls and taken loss-mitigating actions, and substantial resources have been devoted to developing efficient procedures and training staff, it is not possible to implement procedures that are fully effective in controlling all operational risks. The Bank therefore holds insurance policies in respect of property, office equipment, vehicles and employee compensation as well as general liability and directors' and officers' liability. In addition, the Bank holds insurance policies in respect of theft, robbery, transportation between branches and conveyance by post of amounts below a reasonable figure. The Bank believes that the type and relative amounts of insurance that it holds are in accordance with customary practice in its business area.

One important area in assessing the bank's operational risks is the IT field. In these cases the bank's IT department and management regularly review the IT security, including prepared contingency plans for IT failure, etc., that is designed to ensure continued operation at a satisfactory level in case of extraordinary events. All IT systems running at BankNordik and from the bank's service providers must operate according to documented running schedules and guidelines. IT operations must be safe and stable, a requirement which is guaranteed by the greatest possible degree of automation and continuous adjustments in capacity. IT services run by service providers must be based on written agreements.

The Bank has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Bank is aware) during a period covering at least the previous 12 months, which may have, or have had in the recent past, significant effects on the Bank's financial position or profitability.

7.4. Calculation of the capital requirement

BankNordik applies the Basic Indicator Approach to determine the capital requirement for operational risk as outlined in the Capital Requirements applying to the Faroe Islands dated of 21 May 2008. This implies that the capital requirement for operational risk is calculated as: 15 per cent of the average "basic income" over the previous three years. Basic income is the sum of net interest income and non-interest net income.

BankNordik continually monitors the level of operational risk and assesses on a quarterly basis the capital requirement for operational risk. If the capital requirement is estimated to be higher than the limit mentioned above, this will be taken into account in the Bank's solvency requirements.

Figure 10 Basic Indicator Approach

(DKKm)	2010	2009	2008	Total	Average	15%
Basic Indicator	582	461	294	1,336	445	67

The basic indicator is a three-year average of the sum of net interest income and non-interest net income. Net interest income and non-interest net income is calculated as the sum of the following items:

+ Interest income
- Interest expense
+ Dividends on shares and other investments
+ Fees and commission income
- Fee and commission expenses

+/- Rate adjustments

+ Other operating income

Basic Indicator

7.5. Long-term goals in operational risk management

In addition to monitoring the level of risk for assessing the capital requirement for operational risk, the Bank's monitoring system is designed to gather new statistics on operational risk. Thus, the long-term objective is that the monitoring system, which monitors the level of operational risk in the Bank's branches on a monthly basis, will have a preventive effect and thus help to minimise the Bank's operational risk.

8. Trygd insurance

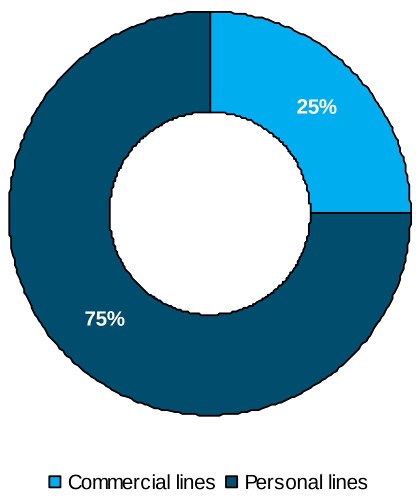
8.1. Insurance risk

Other risk types are measured and assessed under Pillar II. These include insurance risk, although insurance risk is not included in the calculation of the minimum capital requirements. Insurance risk in the Group mostly involves non-life risk. The Group has two non-life insurance companies: TRYGD, which is wholly owned and Vørður, which is 51%-owned. Vørður holds a 30%-stake and the Bank holds 21%-stake in life insurance company Vørður Life.

Careful and prudent risk management is central to any insurance operation. The nature of insurance is to deal with unknown future incidents resulting in a payment obligation. An important part of managing insurance risk is reinsurance. The Group has to protect itself against dramatic fluctuations in technical results by entering into agreements on reinsurance so that the risk of the Group having to pay claims from its own funds is reasonable in relation to the size of the risks assumed, their composition and TRYGD and Vørður's equity. Such obligations are met through a statistical spread of risk and accumulation of funds, quantified by statistical methods.

A part of risk management is to hold a well diversified insurance portfolio. The combined insurance portfolio of TRYGD and Vørður is well diversified in personal and commercial lines (see table)

Figure 11 Insurance portfolio of TRYGD and Vørður



8.1.1. Definition

Risk exposure for an insurance company can be defined as a contingency event, chain of events or bad management which can on its own, or by accumulation, seriously affect the annual results of the insurer and in extreme cases make it unable to meet its liabilities. Risks for an insurance operation are traditionally categorised as insurance risk, credit and market risk, operational risk, currency exchange risk and investment risk.

8.1.2. Control and management

The Board of Directors sets out the instructions under which the companies operate. The Executive Management's role is to have internal procedures to monitor any risk on an ongoing basis to ensure compliance with the framework and to be able to meet future obligations.

8.3 Trygd insurance

The Board of Directors and Executive Management of Trygd must ensure that the company has an adequate capital base and internal procedures for risk measurement and risk management to assess the necessary capital base applying a spread appropriate to cover Trygd's risks.

The insurance portfolio is split as follows:

• Personal lines	70 %
• Commercial lines	30 %

In order to meet these requirements Trygd´s policies and procedures are regularly updated.

Risk management at Trygd is based on a number of policies, business procedures and risk assessments which are reviewed and must be approved by the Board of Directors annually.

Financial risk is related to insurance obligations and assets available to cover these obligations. Financial risk includes insurance risk and market risk.

Insurance risk is the risk related to pricing insurance products and making provisions to cover the insurance obligations. Price setting is when insurance is taken out on the basis of tariffs calculated from analyses of historical and market experience.

The market risk is the risk that fluctuations in the financial markets affect the operating profit and financial position of Trygd. In this respect interest-rate, credit risk, exchange risk and property risk are examined.

The size of provisions for claims is based on individual assessments of the final costs of individual claims, supplemented with statistical analyses.

Trygd policy

- Acceptance policy
- Business and service policy
- Reinsurance policy
- Claims handling policy
- Technical provision policy

The Company´s acceptance policy is based on a full customer relationship, which is expected to contribute to the overall profitability of the Group. In relation to acceptance of corporate insurance products, the Board of Directors has approved a separate acceptance policy, which is implemented in the handling process of the corporate department.

Insurance is primarily sold by the Group´s employees at Trygd and in BankNordik branches, and secondarily through selected collaboration partners. Insurance to commercial customers is mainly sold by employees at Trygd.

An important part of managing insurance risk is reinsurance. The Group must protect itself against dramatic fluctations in technical results by entering into agreements on reinsurance so that the risk of the Group having to pay claims from its own funds is reasonable in relation to the size of the risks assumed, their composition and Trygd´s equity. Trygd has organised a reinsurance programme which ensures that large natural disasters and significant individual claims do not threaten Trygd´s ability to meet its obligations. For large natural disasters, the total cost to Trygd will amount to a maximum of DKK 1m. The reinsurance program is reviewed once a year and approved by the Board of Directors. Trygd uses reputable reinsurance companies with good ratings and financial positions.

The Claims Department in Trygd is responsible for handling all claims and only claims employees may deal with claims matters or advise claimants in specific claim cases.

Technical provisions to cover future payments for claims arising are calculated using appropriate and generally recognised methods. Insurance provisions are made to cover the future risk on the basis of experience from previous and similar claims. These methods and analyses are subject to the natural uncertainty inherent in estimating future payments, both in terms of size and date of payment.

The board of directors at Trygd applies on a low risk investment policy. The company´s main investments are in bonds and deposits. There are no exchange risk, as all business is done in DKK.

Trygd´s interest risk is included in the consolidated figures of BankNordik.

8.4 Vørður insurance

Vørður tryggingar hf. was established in Iceland in 2002 but can trace its roots back to 1926 as a small marine mutual operating in Akureyri, Iceland. Vørður tryggingar hf. is headquartered in Reykjavik and operates four branches outside the Reykjavik area. Vørður tryggingar hf. is 51%-owned by Føroya Banki and 49%-owned by Eignarhaldsfélagið ehf.

Vørður tryggingar hf. sells all classes of non-life insurance except aviation.

Vørður tryggingar hf. operates risk management under the supervision and guidelines of the Icelandic FSA and according to recognized best practices within the insurance industry. The responsibility of risk management lies with the Board of Directors and the CEO of Vørður.

8.5 Risk exposure and sensitivity analysis

Careful analysis of insurance risk exposure is performed annually in connection with reinsurance renewals. The objective of this analysis is to identify possible worst case scenarios, especially in relation to property and marine risks with regards to known and unknown accumulation of risks which might involve a loss from a single event. Reinsurance placements are tailored to meet those risks. The company purchases “Clashes of Retention” reinsurance to meet possible worst case scenarios such as a major storm, affecting many different classes of insurance.

Another factor of risk exposure is the number of risks underwritten by the company within different portfolios of insurance classes. These numbers are monitored and reported monthly to the management team.

Insurance risk:
Correct pricing is set in rating tariffs based on analysis of historical experience within the relevant portfolio. The Claims Department issues a monthly report setting out both frequency and value of losses within the portfolios and enabling early warning of any adverse changes. Tariffs, deductibles and/or insurance conditions are adjusted to meet developments in losses.

The companies protect their balance sheet from large losses by purchasing reinsurance. Maximum losses payable by the companies are therefore fully known factors. The companies' own risk is determined by known recognised principles based on their own assets, annual premiums of the relevant portfolio and actuarial calculations to ensure efficiency.

The reserving for outstanding losses is based on a case-by-case assessment of the final cost of each claim, supplemented by statistical and historical analysis and actuarial calculations. Reserves are adjusted individually as new information is gathered and the claim develops. In addition, a complete review is performed at least twice a year and by the end of each year an actuarial calculation is performed.

Credit and market risk

The current investment strategies are extremely conservative with both predetermined spread of investments and with respect to type of assets. Furthermore, the companies are bound by regulation that determines allowable investments and how they are spread.

The current investment strategy is based on investments which ensure stable and reliable returns, such as government and mortgage bonds with high ratings or deposits. Furthermore, the company applies prudent operational planning as regards expected investment income.

A monthly report is issued and presented to the Board of Directors of all outstanding default premiums. Accordingly, the default rate is carefully monitored. In addition, a procedure has been applied to ensure that the company gets off risk if premiums are not paid within 90 days of the due date.

Vørður only deals with reinsurance companies with an S&P A rating or better for all long-tail business and BBB or better for short-tail business. Current reinsurers of the company are all rated A or better. The risk of each reinsurance treaty is also spread to 2-10 different reinsurance companies according to the capacity of the treaty, spreading the risk of reinsurance default. The company sends quarterly reports on assets to the Icelandic FSA as required.

Operational risk

The company applies a detailed operational plan, which is reviewed once a year and approved by the Board of Directors. Yearly reviews take into account recent changes and information to make all underlying factors as precise as possible.

A detailed security plan is in operation regarding the security of the IT systems and data banks. All data are backed-up at least once daily and kept in secure off-site locations.

Vørður has an emergency plan for how to react if the company's offices are hit by a natural disaster as well as security arrangements such as off-site access to the data banks storing the operational back-ups. This plan is reviewed once a year.

At Vørður, the financials of the company are updated monthly and balanced. Procedures are in place regarding signatures on all invoices or claims received by the company. Actual payments are handled by a different employee. Co-signatures are needed if payments exceed certain amounts.

The Claims Department monitors court rulings in areas affecting the insurance operations for possible changes or clarification of legal principles which might result in added exposure for the company. The company is a member of the Icelandic Financial Services Association which monitors and reports to members any proposed changes of statutes relating to the insurance industry.

Currency risk

Vørður tryggingar hf. operates only in ISK and only issues insurance policies in ISK. All reinsurance agreements prior to October 2008 were in ISK whereas premiums and claims are settled in ISK. Following the collapse of the Icelandic banking sector, this policy was changed effective from October 2008. Current reinsurance treaties are strictly in ISK, but a clause has been added to the treaties, under which it is agreed that the parties to the contract may exchange premiums as well as claims to EUR/ISK four times a year applying the Icelandic Central Bank's official exchange rate prevailing at the date of payment. This means that Vørður does not carry any currency risk, as reinsurers are always obliged to pay ISK-denominated claims amounts in EUR at the Icelandic Central Bank's official exchange rate applying at the time of payment. Accordingly, Vørður always receives correct settlement in ISK.

Natural disaster risk

Vørður tryggingar hf. does not write any policies which include any natural disaster risk other than storm. In Iceland, there is a separate government-owned insurance company, the Icelandic Natural Catastrophe Fund, which insures property in Iceland against natural disasters such as earthquakes, volcanic eruption, avalanches, landslides and floods. As for storm coverage in relation to possible exposure, Vørður's standard property reinsurance with a limit of ISK 1,500,000,000 is deemed sufficient to cover possible loss due to a major storm, whereas the MPL (Maximum Probable Loss) is less than ISK 200m for such incident.

8.6 Vørður Life

Vørður Liftryggingar hf. is a small life insurance company established in 2007. The company began operations in early 2008. The company is owned by NBI hf. (49%), Vørður tryggingar hf. (30%) and Føroya Banki P/F (21%).

Vørður Liftryggingar hf. conducts regular life and critical illness business in the Icelandic market. The insurance portfolio has grown slowly but steadily and the number of issued policies is now at just over 3,000.

Traditionally, life insurance is a very stable business as the underlying risks are statistically very well known and calculated. All life insurance companies operate with mortality rates derived from the entire population and calculated by qualified actuaries.

Vørður Liftryggingar hf. has proportional reinsurance treaties for all of its business with a AA- rated reputable reinsurance company in Europe, resulting in a large diversification of insurance risk and therefore stable underwriting results. This is a common method among small life insurance companies as the reinsurance company becomes a direct partner in the operation, which provides access to large databases of statistical support for the ceding company.

As Vørður tryggingar hf. operates Vørður liftryggingar hf. through an outsourcing contract, all of the risk management processes for Vørður tryggingar hf. described above also apply exact to Vørður liftryggingar hf.