Risk Management Report 2018

BANKNORDIK

Board of Directors
and Executive Board

Group objecties of Risk Managemnet Report

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

P/F skr. nr. 10, Tórshavn

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.com/riskmanagement, simultaneously with the release of the Group's Annual Report 2018. 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 Management Report will also be provided in the audited Annual Report 2018.

2. Organisation

2.1 Introduction

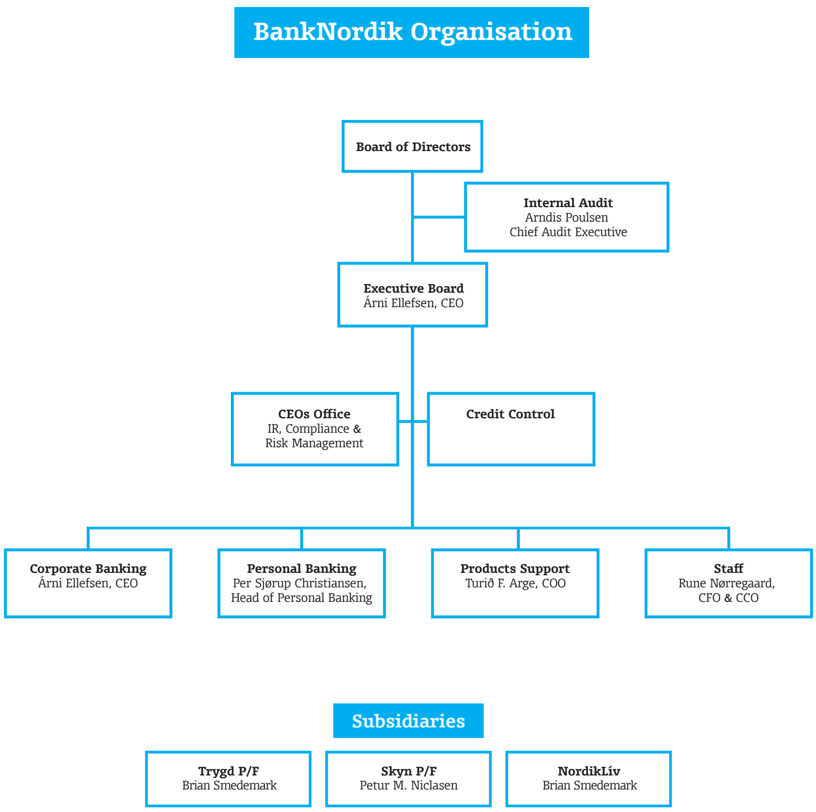
Understanding and ensuring transparency in risk taking are key elements of the BankNordik Group's business strategy. The Group's ambition is to set high standards for risk management. Our risk organization supports this ambition, and it has developed in-depth risk management expertise.

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

The Executive Board consists of Group CEO, Árni Ellefsen. At the chief operational level, the Group is divided into three main business units:

- Corporate Banking operations in the Faroe Islands and Greenland, headed by Árni Ellefsen, CEO
- Personal Banking operations and Private Banking In the Faroe Islands, Denmark and Greenland, headed by Per Sjørup Christiansen, Head of Personal Banking
- Products support, headed by Turið F. Arge, Chief Operating Officer

figure 1



The CEO's Office reports report to Árni Ellefsen, Chief Executive Officer, while the insurance activities (Trygd P/F and NordikLív P/F) and the Real Estate Company (Skyn P/F) report to Turið F. Arge, Chief Operating Officer.

The business units are supported by the following units:

- Credit Services, Finance, Accounting, Treasury, IT and HR, headed by Rune Nørregaard, Chief Credit Officer
- Marketing, headed by Turið F. Arge, Chief Operating Officer

The Group's risk officer and compliance officer are members of CEO's office.

The Chief Executive Officer, Chief Operating Officer, Head of Personal banking and Chief Credit Officer constitute the Group Executive Management Team.

The Board of Directors and the Group Executive Management Team have established various sub-committees, including an Audit Committee, a Credit Committee and a Risk Committee.

The Group allocates resources to manage and monitor risk and to ensure on-going compliance with approved risk limits. The Group has a reporting cycle to ensure that the relevant management bodies, including the Board of Directors, the Chief Executive Officer and the Group Executive Management Team, are kept informed of relevant developments in risk measures.

The Group's risk policies as well as its limits and organizational framework for risk management are described in greater detail in the following sections.

2.2 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 current risk profiles of the Group and its major business units. It includes setting explicit targets, limits and contingency plans in accordance with the risk policies. It also includes monitoring of risk levels.

Key risk elements are identified on an on-going 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

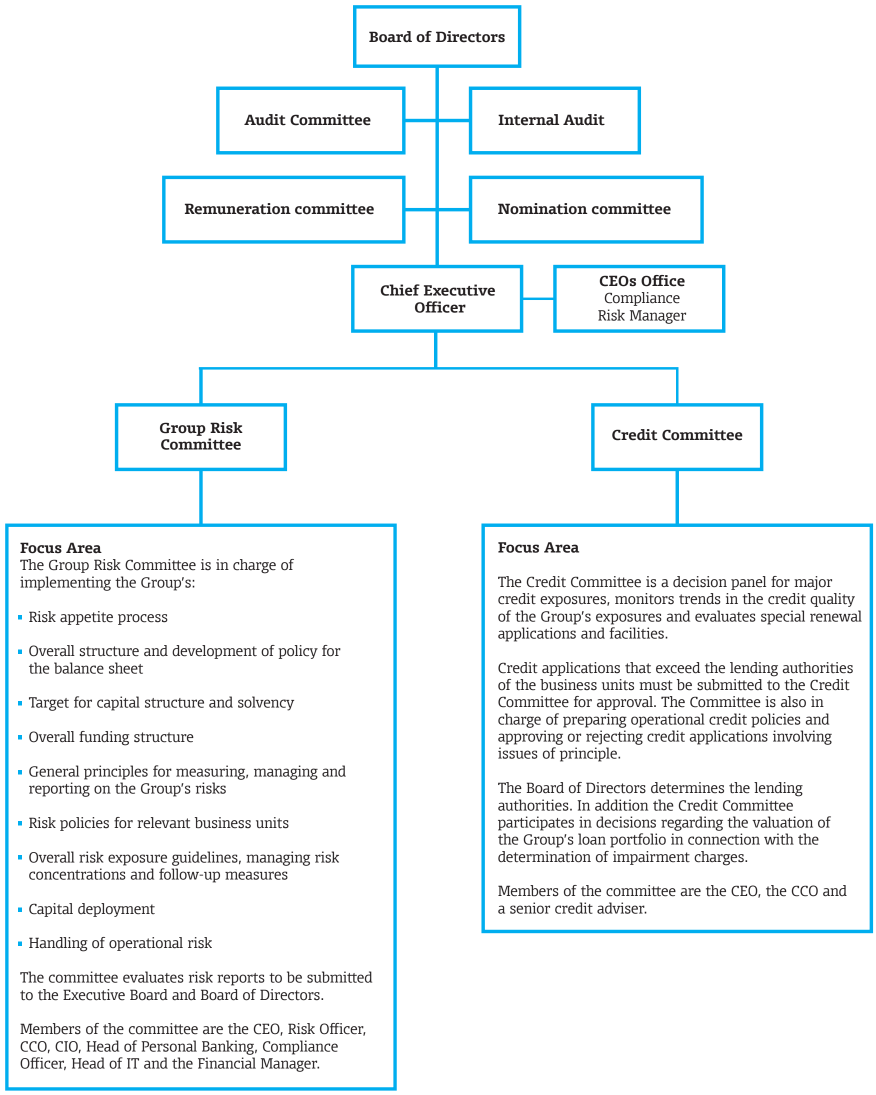
Other risk dimensions are incorporated at the Group and business unit levels where appropriate. They include insurance and concentration risk, financial strength, and earnings robustness. Specific risk instructions for the main business units are prepared on the basis of the overall risk policies and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

2.3 Risk organization

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 organization of risk management and authorizations.

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 2.

figure 2



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 set out in the recommendations issued by the Committee of Corporate Governance. These recommendations apply to companies listed on NASDAQ Copenhagen.

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

The Audit Committee consists of Stine Bosse, Chairman of the Board, Kim Jacobsen, member of the board, and Jógvan Jespersen, member of the board.

The Executive Board has assembled the Group Executive Management Team and established the two risk-orientated sub-committees, the Risk Committee and the Credit Committee.

2.3.1 Board of Directors

The Board of Directors must ensure that the Group is appropriately organized. 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 analyzing the Group's portfolio, particularly information about industry concentrations, large exposures and impaired exposures.

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. Internal Audit also reviews the internal control and risk management systems.

2.3.2 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 assembled the Group Executive Management Team and established two committees to be in charge of day-to-day risk management, the Risk Committee and the Credit Committee.

The Group has also organized 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.

2.3.3 Risk Committee

The Risk Committee consists of:

- The Chief Executive Officer
- The Head of Personal Banking
- The Chief Operating Officer
- The Chief Credit Officer
- The Compliance Officer
- The Risk Officer
- The Financial Manager
- The Head of IT
- The head of Insurance activities

The Risk Committee is in charge of identifying all main risks of the Group with the aim of optimizing the Group's revenue compared to risk, e.g. by setting out guidelines for implementing and changing internal procedures for measuring and controlling risk, modelling principles etc.

The Risk Committee processes all risk-related matters, including:

- The Capital Requirements Directive and related legislation
- Internal procedures for measuring and controlling risk
- The capital structure and targets for and levels of solvency and liquidity
- Allocation of risk capital to units and risk types, e.g. as part of the solvency requirement
- Material changes in model principles for risk management and yearly evaluations of such principles and models

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.

2.3.4 Credit Committee

The Credit Committee consists of the CEO, the CCO and a Senior Credit Adviser.

Credit applications that exceed the lending authorities of the Credit Department (personal customers) or the Group's Corporate Department (corporate customers) must be submitted to the Credit Committee for approval along with a credit recommendation.

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.

2.3.5 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 department oversees the Group's financial reporting, budgeting, liquidity and capital structure. It also has overall responsibility for the Group's compliance with the Capital Requirements Directive and related legislation 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 is carried out by the Group's Risk Officer which is a part of the CEO's office with reporting rights and obligations to the Executive Board and reporting rights to the Board of Directors in risk-related matters. 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 and for providing support to the Risk Committee.

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 by the local units in their day-to-day credit processing.

The Credit Department is in charge of determining the utilization 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 unauthorized 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.

The CEO's office is in charge of analyzing and monitoring strategic business risk and corporate governance. Furthermore the CEO's office is in charge of the Group's investor relations.

2.3.6 Business units

Core risk dimensions such as market risk and liquidity risk are managed centrally. For credit risk, however, lending authority for specific customer segments and products has been delegated 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.

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 for¬ward applications for credit facilities beyond their lending authority to the branch management, which may decide to submit applications to the Credit Department.

2.4 Reporting

The Group has a reporting cycle to ensure that the relevant management bodies, including the Board of Directors, the Executive Board and the Group Executive Management Team, 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 (see Table 1) and the principle solvency requirement in the form of the Group's annual solvency handbook. As part of the quarterly evaluation of the Group's solvency requirement, the Board of Directors receives up-to-date information on any material changes in the Group's risk profile. On a monthly basis the Board of Directors receives a report on the Group's market and liquidity risk.

Table 1

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

BankNordik Group Methodology	Evaluation of the preferred risk and the level of capital according to the FSA's 8+ approach.
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 total capital and the sum of these exposures, including the percentage of the Group's total capital it represents.

Table 3

Liquidity risk	Analysing and stress tests of the Group's current liquidity
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.

3. Capital Management

BankNordik is well capitalised with a high solvency ratio and excess cover relative to the statutory requirements. The Board of Directors is focused on maintaining the capital base necessary to fulfil its strategic goals and sustain the Bank's continued business development. 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 CRD IV requirements and the Internal Capital Adequacy Assessment Process (ICAAP), which consists of three pillars.

- Pillar I contains a set of rules for a mathematical calculation of the Total capital and the 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 CRD IV requirements stipulated in the regulation (EU) No 575/2013 of the European parliament and of the Council of 26 June 2013, total RWA is calculated as the sum of RWA for credit, market and operational risk. Total capital is calculated as the sum of common equity tier 1 (CET1) and additional tier 1 and tier 2 instruments.

Table 4 sets out the Bank's Solvency statement as of 31 December 2018, including the basis for calculating risk-weighted items, core capital, core capital after deductions and Total capital after deductions and equity.

3.3 Pillar II

While Pillar I contains uniform rules for capturing a financial institution's risk and calculating the capital requirements in accordance with the CRD IV requirements, it does not necessarily capture all risk affecting individual institutions. Pillar II contains a framework for an Own Risk Solvency 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 Capital Requirement and the ability of the Danish FSA to require a financial institution to maintain a capital buffer relative to the MCR.
- 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.

Capital and Solvency - BankNordik		Table 4
DKK 1.000	2018	2017
Core capital	1,874,689	1,731,404
Total capital	2,098,167	1,954,272
Risk-weighted items not included in the trading portfolio	8,248,858	7,575,236
Risk-weighted items with market risk etc.	1,176,636	1,022,062
Risk-weighted items with operational risk	1,195,955	1,298,065
Total risk-weighted items	10,621,449	9,895,363
Core capital rato, excl. hybrid core capital	17.7%	17.5%
Core capital ratio	17.7%	17.5%
Solvency ratio	19.8%	19.7%
Core Capital and Shareholders' equity		
Share capital	200,000	200,000
Reserves	10,968	0
Net profit	262,097	189,078
Retained earnings, previous years	1,557,762	1,460,582
Shareholders' equity, before deduction of holdings of own shares	**2,030,828**	**1,849,660**
Deduction of dividend	70,000	40,000
Deduction due to excess holdings of shares in the fincial sector	5,740	0
Deduction of holdings of own shares	44,076	29,568
Deduction of intangible assets	6,678	0
Deductions regarding planned purchase of own chares	6,713	0
Deduction of deferred tax assets	18,496	44,553
Deduction regarding prudent valuation of financial instruments	4,436	4,136
Core capital exclusive of hybrid core capital	**1,874,689**	**1,731,404**
Hybrid core capital before deductions	0	0
Core capital	**1,874,689**	**1,731,404**
Total capital		
Core capital	1,874,689	1,731,404
Subordinated loan capital, before deductions	223,477	222,868
Total capital	**2,098,167**	**1,954,272**

The BankNordik Group holds a license to operate as a bank and is therefore subject to a capital requirement under the Faroese Financial Business Act and to CRR. The Faroese provisions on capital requirements apply to both the Parent Company and the Group. The capital requirementprovisions stipulate a minimum capital of 8% of the identified risks. A detailed body of rules determines the calculation of capital as well as risks (risk-weighted items). The capital comprises core capital and subordinated loan capital. The core capital corresponds to the carrying amount of equity, after deductions of holdings of own shares, deffered tax assets and other minor deductions.

In order to measure and identify all risk exposure to the Group, the Group applies a Danish FSA approved capital adequacy assessment process.

The method is based on an 8+ approach. An 8+ approach means that a review takes, as its baseline, the minimum requirement of 8 per cent of the risk-weighted items (pillar 1) plus a margin for risks and matters that are not fully reflected in the statement of risk-weighted items. In other words, ordinary risks are assumed to be covered by the 8 per cent requirement, and the question to consider is whether a bank is exposed to other risks that necessitate an increase in the solvency requirement (pillar II).

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 Risk Committee is responsible for monitoring and making sure on an on-going basis that the solvency requirements (methodological) 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 a methodology approved by the Danish FSA to ensure that BankNordik can expose/identify any potential risk and meet the requirements set by the Executive Board and the Board of Directors. The methodology forms an integral part of the Group's organisation and the Finance Department prepares a quarterly report. The report is then submitted to the Executive Board. 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 method can be split into two main parts. The first part involves the calculation of the minimal capital requirement (see the 8+ approach). The second part consists of eight underlying risk factors:

- Earnings
- Growth in lending
- Credit risk
- Market risk
- Liquidity risk
- Operational risk
- Leverage risk
- Statutory requirements

In addition to these eight risk factors, the Bank calculates potential premiums for special risks believed not to be covered by the calculation of minimal risk. See the calculation of the 8+ capital requirement below in table 5.

Capital and solvency adequacy pr. Dec. 31 2018 — Table 5

DKK 1.000	Capital requirement	RWA Capital requirement, per cent
1) Basic Capital requirement, 8 % of RWA	849,716	8.0%
+ 2) Earnings (capital for risk coverage due to weak earnings)	25,559	0.2%
+ 3) Growth in lending (capital to cover organic growth in business volume)		0.0%
+ 4) Credit risk, of which:	69,198	0.7%
4a) Credit risk on major customers in financial distress	22,674	0.2%
4b) Other credit risk	16,583	0.2%
4c) Concentration risk on individual exposures	29,941	0.3%
4d)Concntration risk on industries		0.0%
+ 5) Market risk, of which:	81,000	0.8%
5a) Interest risk	17,600	0.2%
5b) Credit spread risk	63,400	0.6%
5c) Equity risk		0.0%
5d) Foreign exchange risk		0.0%
+ 6) Liquidity risk (capital to cover more expensive liquidity)		0.0%
+ 7) Operational risk (capital to cover operational risk in excess of pillar I)		0.0%
+ 8) Gearing (capital to cover risk due to gearing)		0.0%
+ 9) Margins due to statutoryrequirements		0.0%
Capital requirement and solvency requirement ratio	**1,025,473**	**9.7%**

If any other areas of special risk are identified that are not listed in the model set out above, the Bank calculates an extra capital requirement for such risk. In addition to stress testing different risk parameters, the second part of the model involves additional capital requirements for specific additional 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 minimal 8+ capital requirement and any possible individual additional capital requirement constitute BankNordik's total individual capital requirement.

3.3.3 Group solvency requirement

The Group's solvency requirement has been calculated using the method illustrated above. At the end of December 2018, the solvency requirement was 9.7%, the risk-weighted items were DKK 10.6 bn and the capital requirement was DKK 1,025m.

Excess capital according to adequacy requirements — **Table 6**

DKK 1.000	31.12.2018	31.12.2017	Change
Total risk-weighted items	10,621,449	9,895,363	726,086
Total capital	2,098,167	1,954,272	143,895
Core capital	1,874,689	1,731,404	143,286
Solvency ratio	19.8%	19.7%	0.0%
Core capital ratio	17.7%	17.5%	0.2%
Capital requirement	1,025,473	921,463	104,010
Solvency requirement	9.7%	9.3%	0.3%
Excess Subordinated loan capital (> 2% of RWA), DKK	-11,082	-24,950	13,868
Excess Subordinated loan capital (> 2% of RWA), per cent	-0.1%	-0.3%	0.1%
Excess capital, DKK 1.000	1,061,612	1,007,859	53,753
Excess capital ratio	10.0%	10.2%	-0.2%

4 Credit Risk

Credit risk is the most crucial risk facing the Group. BankNordik has loans and advances (exposures) of DKK 15,700, the vast majority of which has been provided to customers in the Faroe Islands, Denmark and Greenland. The Group pursues an overall credit policy calling for a balanced distribution of loans and advances, however, with an overweight of exposures towards private customers.

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

In connection with the acquisition of Sparbank (2010) and Amagerbanken (2011), the Group took over individually impaired exposures. These impairment charges were included in the determination of the booked value of the acquired exposures or recorded as goodwill. As of 31 December 2018 in total DKK 113.1m was recorded on this account (see Table 16 for more details). If and when these impairments should be redeemed/repaid, these will be recorded as other income.

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 taking.

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. Further and in order to increase the mitigation of credit risk, the Group as a general rule requires collateral.

The Group aims to assume risks only within the limits of applicable legislation and other rules, including rules on best practices for financial undertakings.

4.3 Credit process

In order to ensure a consistent, coordinated credit granting process of a high quality all credit applications are handled according to a pre-defined procedure that provides a consistent, high credit processing quality:

Bank branches: All branch managers can process and approve credit applications within branch manager credit lines. Credit applications exceeding branch manager's credit lines are submitted to the Credit Department along with a credit recommendation.

Corporate Department: The central corporate departments in the Faroe Islands and Greenland handle all of the Group's major corporate accounts, and the winding up of the Danish corporate credits are handled by specialists within the Credit Department. 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 / Corporate Department credit line are submitted to the Credit Department for approval. The Credit Department also processes staff loan applications exceeding the limit of the branch credit lines. In addition to processing credit applications, the Credit Department coordinates and prepares credit recommendations to the Group's Credit Committee and recommendations submitted to the Board of Directors.

The Credit Committee: The Credit Committee reviews all applications beyond the Credit Department's credit line. The Credit Committee conducts credit meetings on a weekly basis. The purpose of the Credit Committee is to:

- Process credit applications exceeding the credit line of the Credit Department;
- Process and provide recommendations for all credit applications to be submitted to the Group'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.

Board of Directors: The Board of Directors reviews all applications that are beyond the Credit Committee's credit line.

Credit processing must be conducted on the basis of extensive knowledge of the risks inherent to 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 Credit risk classification

BankNordik's lending exposure is subject to very careful management as part of the day-to-day follow-up conducted by the branches or 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 Group's quarterly financial statements;
- Reports on exposures due for review by the Credit Department in cooperation with the relevant branch or department;
- The largest exposures are reviewed annually with the Credit Committee;
- Constant monitoring of the largest exposures is a key priority.

The Group apply an automatic rating model and methodology that provides all customers, private and corporate, with a probability of default for the coming 12 months. This probability of default is mainly used in the Groups' IFRS 9 impairment model, but is to some extent also a part of the daily creditmonitoring process. The Group still classifies its customers in accordance with the methodology used by the Danish FSA, see table 7. Currently, more than 99% of the overall exposure is individually classified, see table 7 for more details.

4.5 Credit exposure

The following section provides a presentation and review of the Group's loan portfolio. The review deals with the overall loan portfolio, followed by a report on the individual sub-portfolios. The figures include individual and collective impairments, which are itemized in part 4.8.

The Group's total loan exposures portfolio listed by category is set out in Table 7. As shown in table 10, the Group's credit facilities are largely equally distributed between the private and the corporate / public segments. Funds placed with credit institutions and central banks are money market placements and not committed lines.

In the annual report 2018, figures for loans and guarantees are adjusted in accordance with the applicable accounting terms and are therefore not directly comparable to the exposure listed in this Risk Management Report.

Quality of loan portfolio excl. financial institutions 2018 — Table 7

		> 7.5m	< 7.5m	Total
Portfolio without weakness (3, 2a)	Exposure in DKKm	2,917	3,490	6,407
Portfolio with some weakness (2b)	Exposure in DKKm	1,407	6,452	7,860
Portfolio with significant weakness (2c)	Exposure in DKKm	247	264	511
	Unsecured	86	65	151
Portfolio with OEI (1)	Exposure in DKKm	237	615	852
	Unsecured	151	326	478
	Impairments/provisions	200	405	605
Portfolio without individual classification	**Exposure in DKKm**	**26**	**45**	**71**
Total	**Exposure in DKKm**	**4,834**	**10,866**	**15,700**

Quality of loan portfolio excl. financial institutions 2017

		> 7.5m	< 7.5m	Total
Portfolio without weakness (3, 2a)	Exposure in DKKm	2,595	3,600	6,195
Portfolio with some weakness (2b)	Exposure in DKKm	1,366	6,074	7,439
Portfolio with significant weakness (2c)	Exposure in DKKm	144	297	441
	Unsecured	36	88	124
Portfolio with OEI (1)	Exposure in DKKm	482	769	1,251
	Unsecured	226	419	645
	Impairments/provisions	117	312	430
Portfolio without individual classification	**Exposure in DKKm**	**0**	**139**	**139**
Total	**Exposure in DKKm**	**4,587**	**10,879**	**15,466**

4.5.1 Credit exposure, quality and concentration

In connection with the quarterly review and the on-going follow-up on the Group's loan portfolio is classified in the following categories:

- Portfolio without weakness (3, 2a5)
- Portfolio with some weakness (2b15, 2b30)
- Portfolio with weakness (2c50)
- Portfolio with impairment/provision (1)
- Portfolio without individual classification

Table 7 shows the Group's portfolio based on the review. The classification is based on the methodology used by the Danish FSA.

In their regular inspections, FSA classifies all larger exposures based on the same methodology as the Group does. If there is any difference in classification, the Group adjusts its classification according to the views of FSA. Thus the classification of the larger exposures will be in line with FSA's classification, adjusted fordevelopments since their last inspection.

One advantage of using the FSA classification is transparency and that it gives a frame of reference, since all exposures in Danish banks are classified by FSA. As such the FSA classification constitutes a market standard. As shown in table 7, more than 99% of total exposures are individually classified. The unclassified part of the portfolio has been steadily decreasing.

The classification gives some important insights to the credit quality of the portfolio. 91% of all exposures are labelled without weakness or only with some weakness. This is of importance bearing in mind that banks with high risk portfolios normally fail in their larger loans.

There is a relatively low unsecured exposure in weak exposures (2c50). Above DKK 7.5m there are DKK 86m unsecured exposures and in exposures less than 7.5m there are DKK 65m unsecured.

The Group's overall target is for no industry to make up more than 10% of the Group's total exposure, see table 10, except for the industry group "Trade" which may be up 15%.

Large exposures — Table 8

DKK 1.000	2018	2017
20 largest Exposures (%) of total capital	122%	119%
20 largest Exposures (DKKm)	2,291,414	2,063,220
Total capital (DKKm)	1,874,689	1,731,404

Credit exposure by geographical area — Table 9

(DKKm)	2018					2017				
	Exposures	in%	Loan/ Credits	Guarantees	Unused credits	Exposures	in%	Loan/ Credits	Guarantees	Unused credits
Faroe Islands	8,509	54%	6,774	873	1,010	8,263	53%	6,405	784	1,074
Denmark	5,802	37%	3,174	1,447	1,191	5,841	38%	3,023	1,346	1,472
Greenland	1,390	9%	637	434	408	1,361	9%	596	431	334
Total	**15,700**	**100%**	**10,586**	**2,754**	**2,610**	**15,466**	**100%**	**10,024**	**2,562**	**2,880**

In special cases, exposures may be above 10%, but only for customers of a high credit quality, and where the Group has accepted collateral. In addition, the Group's long-term target is for no single exposure (on a Group basis) to make up more than 10% of the Group's total capital. The Group has three exposures exceeding 10% of the total capital. These customer are all classified as being without weakness (3 or 2a5).

As can be seen from Table 10 no single industry exceeds 10% of total exposures.

Having a strong position in the personal segment is a crucial priority for the Group. Personal loans account for about 61.3% of the Group's total loans and advances. The vast majority of the personal loans in the Faroe Islands involve loans for the purchase of real estate in which the Group holds a first mortgage secured against the property.

Risk exposure concentrations

Table 10

	2018		2017	
(DKKm)	**DKKm**	**In %**	**DKKm**	**In %**
Public authorities	973	6.2%	641	4.1%
Corporate sector:				
Agriculture and farming, others	67	0.4%	64	0.4%
Aquaculture	35	0.2%	8	0.1%
Fisheries	521	3.3%	490	3.2%
Manufacturing industries, etc.	409	2.6%	394	2.5%
Energy and utilities	203	1.3%	207	1.3%
Building and construction, etc.	542	3.5%	473	3.1%
Trade	766	4.9%	796	5.1%
Transport, mail and telecommunications	466	2.8%	396	2.6%
Hotels and restaurants	37	0.2%	32	0.2%
Information and communication	180	1.1%	162	1.0%
Property administration, etc.	831	5.3%	811	5.2%
Financing and insurance	117	0.8%	114	0.7%
Other industries	941	6.0%	802	5.2%
Total corporate sector	**5,099**	**32.6%**	**4,748**	**30.8%**
Personal customers	9,628	61.3%	10,076	65.2%
Total	**15,700**	**100.0%**	**15,466**	**100.0%**
Credit institutions and central banks	1,320		867	
Total incl. credit institutions and central banks	**17,021**		**16,333**	

Collateral

Table 11

(in %)	**2018**	**2017**
Cars	4%	4%
Real Estate	77%	72%
Aircrafts & Ships	8%	7%
Other	11%	17%
Total	100%	100%

4.6 Risk mitigation

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

The types of collateral most frequently provided are real estate, ships / aircraft and motor vehicles in addition to guarantees provided by owners or, in the Faroese market, by floating charge (virksomhedspant).

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 12. For real estate, haircuts reflect the expected costs of a forced sale and a margin of safety. This haircut is 20% of the expected market value. For unlisted securities, guarantees by third party (exclusive of guarantees from public authorities and banks) and collateral in movables, the haircut is 100%.

Credit exposure and collateral for 2018 — **Table 12**

(DKKm)	Personal	Corporates	Personal & Corporate	Public	Total
Exposure	9,628	5,099	14,727	973	15,700
Loans, advances and guarantees	8,620	3,575	12,195	487	12,682
Collateral	6,374	2,786	9,161	39	9,200
Unsecured (of exposures)	3,254	2,313	5,566	934	6,500
Unsecured (loans, advances and guarantees)	2,266	797	3,064	448	3,512
Unsecured ratio	34%	45%	38%	96%	41%
Unsecured ratio, loans and advances	26%	22%	25%	92%	28%

Credit exposure and collateral for 2017

(DKKm)	Personal	Corporates	Personal & Corporate	Public	Total
Exposure	10,076	4,748	14,825	641	15,466
Loans, advances and guarantees	8,273	3,434	11,707	392	12,099
Collateral	5,893	2,657	8,550	2	8,552
Unsecured (of exposures)	4,183	2,092	6,275	639	6,914
Unsecured (loans, advances and guarantees)	2,401	786	3,186	390	3,576
Unsecured ratio	42%	44%	42%	100%	45%
Unsecured ratio, loans and advances	29%	23%	27%	99%	29%

* Before deductions of impairments and provisions

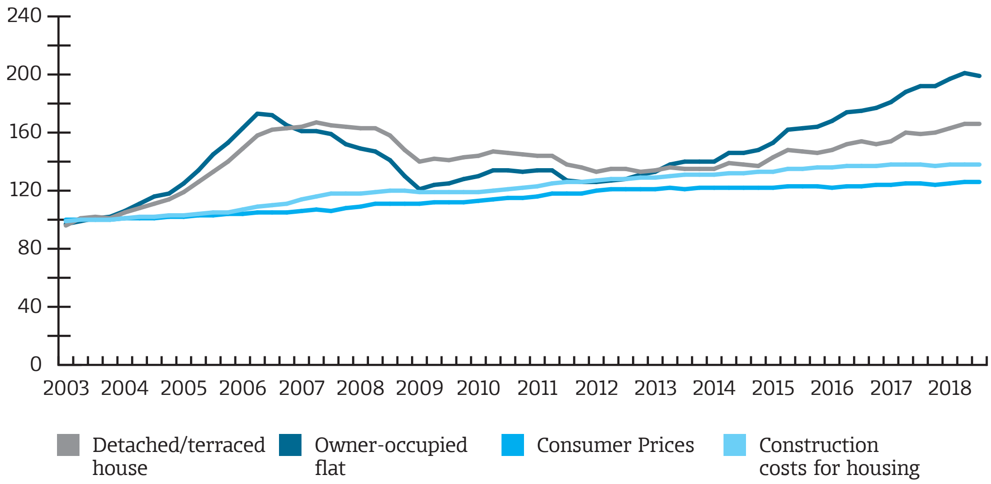
Table 12 shows the Group's total credit exposure and the collateral for the loans granted divided into private, corporate and public sector. The Group's collateral is mainly in real estate.

There are no publicly available statistics illustrating developments in house prices in Greenland. The Group estimates that house prices in the latest years have been relatively stable.

Figure 3

House Price Development Index (2000=100)

Denmark



Faroe Islands

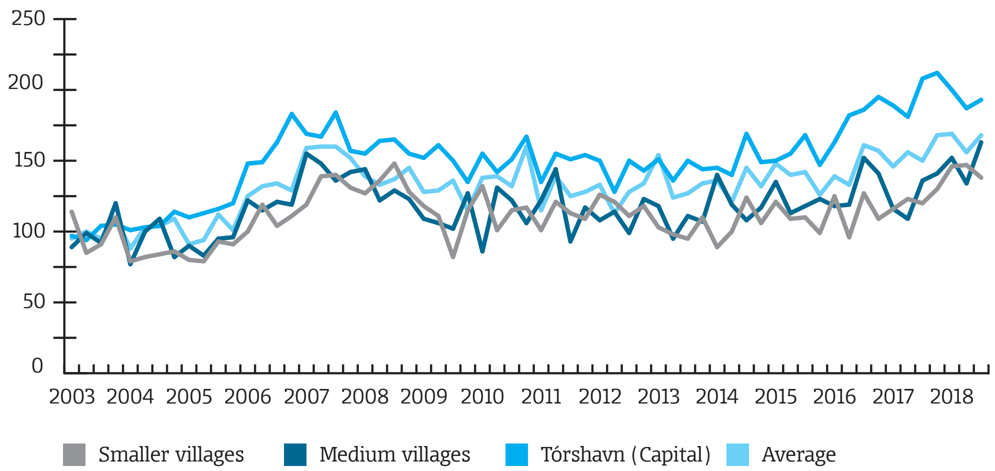


Figure 3 illustrates the general price developments in the Faroe Islands and Denmark.
Source: Statistics Denmark and the Association of Danish Mortgage Banks Source: Own research

The Group offers fixed-rate and floating rate mortgage loans to private customers in the Faroese market in cooperation with Danish mortgage provider DLR Kredit. In the Danish and Greenlandic markets, mortgage loans are distributed in cooperation with Danish mortgage providers Totalkredit and DLR Kredit.

4.7 Monitoring and portfolio management

BankNordik monitors credit facilities centrally through its credit systems. Customers showing a weak financial performance are transferred to a watch list enabling the Group to monitor them more closely and thereby reduce the risk of losses. At least once a year, a review of all exposures above a certain amount is performed.

Distribution of past due amount

Table 13

(DKKm)	2018 Exposure	2018 Past due total	2018 Past due > 90 days	2018 Total balance with past due	2017 Exposure	2017 Past due total	2017 Past due > 90 days	2017 Total balance with past due
Portfolio without weakness (3, 2a)	6,407	37	0	670	6,195	18	0	542
Portfolio with some weakness (2b, 2b)	7,860	65	0	1,488	7,439	42	1	1,495
Portfolio with significant weakness (2c)	511	14	0	239	441	2	0	104
Portfolio with impairment/provision (1)	852	17	3	241	1,251	13	4	328
Portfolio without individual classification	71	1	0	3	139	4	0	17
Total	**15,700**	**134**	**4**	**2,641**	**15,466**	**77**	**6**	**2,486**
Past due in % of exposure		0.84%	0.02%			0.50%	0.04%	

Unauthorised overdrafts are automatically referred to the customer's adviser, who decides whether or not to accept the overdraft. For good customers, the Group 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. As shown in table 13, DKK 4m is more than 90 days past due.

4.7.1 Credit risk management

The Group monitors on a continuing basis and reviews at least once a year which segments should be given extra attention.

On a continuing basis credit audits are conducted and additionally, based on monthly generated credit risk reports, the business units and the Credit Department monitor and review credit quality and on a quarterly basis the Credit Department prepares a credit risk report to the Credit Committee and the Board of Directors.

4.8 Impairment/Losses

The Group tests the entire loan portfolio for impairment four times per year. Table 14 shows the Group's total losses by industry from 2005 to 2018. As the table shows, the average loss ratio during the overall period was 0.9% of the Group's total loans and guarantees. As can be seen from the data, there are relatively large variations from year to year and from industry to industry.

Historical Losses

Table 14

Sector:	Weigthed	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2006	2005
Personal	0.4%	0.0%	0.6%	1.3%	0.7%	0.6%	0.4%	0.2%	0.3%	0.1%	0.1%	0.0%	0.1%	0.2%
Agriculture	0.3%	0.8%	0.0%	1.6%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Aquaculture	5.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	17.7%
Fishing indurstry	2.0%	0.5%	1.7%	0.5%	1.1%	3.1%	1.5%	11.9%	14.0%	2.8%	5.7%	0.0%	0.0%	0.6%
Manufacturing industries etc.	1.1%	0.1%	12.1%	3.2%	0.0%	0.0%	0.2%	0.2%	0.3%	0.6%	0.0%	0.0%	0.1%	5.6%
Building and construction etc.	1.8%	0.0%	3.3%	0.2%	0.4%	0.6%	0.2%	0.9%	0.3%	6.2%	16.0%	0.0%	0.0%	0.1%
Trade, hotels and restaurants	1.1%	0.3%	0.5%	0.6%	0.1%	0.6%	1.3%	4.0%	2.7%	3.1%	0.0%	0.0%	0.0%	0.1%
Transport, mail and telephone	0.2%	0.0%	1.1%	0.2%	0.0%	0.1%	0.1%	2.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Service	1.1%	0.0%	0.1%	0.2%	0.0%	0.1%	0.4%	2.0%	3.0%	1.6%	0.0%	0.0%	0.0%	0.0%
Property adm., purchace and sale and business services	2.4%	0.1%	9.4%	0.8%	1.8%	7.0%	2.5%	0.4%	0.5%	5.7%	0.0%	0.0%	0.0%	0.0%
Personal other	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.3%	0.0%
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	**0.9%**	**0.2%**	**1.5%**	**1.1%**	**0.6%**	**1.0%**	**0.7%**	**1.1%**	**0.9%**	**1.5%**	**1.1%**	**0.0%**	**0.1%**	**1.3%**

Loans & guarantees, individual impairments, collateral and unsecured by sector

Table 15

(DKKm)	2018				2017			
	Loans and Guarantees	Impairments/ Provisions	Collateral	Blanco	Loans and Guarantees	Impairments/ Provisions	Collateral	Blanco
Public								
Private	310	204	99	7	314	199	111	4
Corporate	533	274	174	85	372	233	116	24
Total	**843**	**479**	**273**	**91**	**686**	**432**	**227**	**27**

From 1 January 2018, the Group's impairments reflect the expected credit loss impairment model in IFRS 9 and Executive Order on Financial Reports for Credit Institutions and Investment Firms, etc. as valid in the Faroe Islands. The expected credit loss is calculated for all individual facilities as a function of the probability of default (PD), the exposure at default (EAD) and the loss given default (LGD). All expected credit loss impairments are allocated to individual exposures. For all exposures with objective indication of being subject to an impairment in creditworthiness, stage 3 exposures, the Group determines the expected credit losses individually.

If a loan, advance or amount due is classified to stage 3, 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, in three weighted scenarios – the basecase, upside and downside scenario. Loans and advances not classified as stage 3 are classified in stage 1 or stage 2 and the expected credit loss is calculated in accordance with the function described above and then impaired. Table 16 provides a breakdown of individual impairments, stage 3, and statistical based impairments, stage 1 and 2.

In connection with the acquisition of Sparbank (2010) and Amagerbanken (2011), the Group took over some of the exposures that were individually impaired. These impairments are recognised as part of the purchase price for the acquired exposures. In 2018 DKK 134.2m of the impairments reflected in the table below are individual impairments recognised up to 12 months after the acquisition of the relevant exposure, see Table 16 second column.

Specification of individual and statistic impairments

Table 16

	2018		2017		
DKKm	**Loans gross**	**Individual impairments**	**Loans gross**	**Individual impairments**	**Impairments from acquired portfolio**
Individual impairments:					
Faroe Islands	369	164	263	196	
Denmark	422	268	344	185	135
Greenland	72	31	33	27	0
Total	**862**	**463**	**640**	**408**	**135**
Statistic impairments*:					
Faroe Islands	6,391	46	6,038	40	0
Denmark	2,839	45	3,346	38	0
Greenland	558	26			0
Total	**9,788**	**117**	**9,384**	**78**	**0**

In 2018 the IFRS 9 implementation has caused a change in calculation of impairments. The 2017 comparison figures are based on Group impairments, and not statistic impairments

4.9 The Supervisory Diamond

The Danish FSA applies a model for measuring whether a bank has a high-risk profile – the Supervisory Diamond. The model identifies five areas considered to be indicators of increased risk if not within certain limits. The Group meets by a wide margin the limits for large exposures, loan growth, exposures towards property, funding-ratio and the liquidity indicator.

figure 4

The Supervisory Diamond

Sum of large exposures < 175 %

2018	2017
122.2%	119.2%

Loan growth <20 %

2018	2017
4.7%	4.3%

Funding-ratio < 1.0

2018	2017
0.63	0.64

Property exposure < 25%

2018	2017
5.6%	5.6%

Liquidity indicator >100%

2018	2017
266.0%	N/A

5. Market Risk

5.1 Organisation

The Bank has established an Investment Working Group to monitor the financial markets and continuously update its view on the financial markets. The Investment Working Group meets once a month to discuss the outlook for the financial markets and make an update containing a recommendation on tactical asset allocation to the Investment Group.

The Investment Working Group refers to the Investment Group. Participants in the Investment Group are the CEO, the CFO, the COO, the CIO, the Financial Manager and Treasury. Based on the recommendation, the Investment Group decides whether to retain or revise the Bank's official outlook.

The Investment Group's decisions are communicated throughout the organization and form the basis for all advice provided to customers and included in the Bank's official Markets Update, which is forwarded by e-mail to a wide range of recipients and published on the Bank's website.

5.2 Definition

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

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

5.3 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 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. Historically, lines have mainly been granted to Treasury.

Treasury is responsible for monitoring and handling the Bank's market risks and positions. Markets have been granted small market risk lines for its daily operations. The Finance Department reports market risks to the Executive Board on a monthly basis.

Reporting of Market risk — Table 17

	Board of Directors
Monthly	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	Overview of – Interest risk – Equity market risk – Liquidity risk

5.4 Control and management

The stringent exchange rate risk policies support the Group's investment policy of mainly holding listed Danish government and mortgage bonds, and to a lesser extent investing in other markets and currencies.

Market Risk Management — Table 18

Level	Board of Directors	Executive Board	CFO	Financial Manager	Treasury
Strategic	Defines the overall market risk				
Tactical		Delegating risk authorities to relevant divisions		Managing the Bank's market risk	Implementing
Operational			Controlling & Reporting		Trading

The Finance Department monitors and reports market risk to the Board of Directors and the Executive Board on a monthly basis.

5.5 Market risk

Table 19 shows the likely effects on the Bank's share capital from likely market changes.

Likely effects from changes in markets value — Table 19

DKKm	Change	2018	% of Core Capital	2017	% of Core Capital
Equity risk DKKm (+/-)	10%	30	1.6%	25	1.4%
Exchange risk DKKm (+/-) EUR	2.25%	0	0.0%	0	0.0%
Exchange risk DKKm (+/-) Other currencies	10%	1	0.0%	1	0.0%
Interest rate risk DKKm (parallel shift)	100 bp	31	1.7%	27	1.6%

- All equity prices fall by 10%.
- All currencies change by 10% (EUR by 2.25%)
- Upwards parallel shift of the yield curve of 100 bp.

The calculations show the potential losses for the Group deriving from market volatility.

5.6 Interest rate risk

The Group's policy is to invest most of its excess liquidity in LCR compliant bonds. As a consequence, BankNordik holds a large portfolio of bonds, and most of the Group's interest rate risk stems from this portfolio.

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.

Table 20 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 yield curve. Interest rate risk in EUR is mainly from corporate bonds.

Interest rate risk broken down by Currency — Table 20

(DKKm)	2018	2017
DKK	22	21
EUR	9	7
Interest rate risk	31	28

5.7 Exchange rate risk

BankNordik's base currency is DKK and assets and liabilities in other currencies therefore imply an extra risk as they may vary in value 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 a low currency risk.

The Group's exchange rate risk mainly stems from:

- Customer loans / deposits in foreign currency
- Treasury's positions in foreign currency

Foreign exchange position Table 21

(DKKm)	2018	2017
Assets in foreign currency	12	15
Liabilities and equity in foreign currency	0	0
Exchange rate indicator 1	12	15

5.8 Equity market risk

BankNordik's stringent risk policy restricts equity positions to listed and liquid shares and shares related to the Danish banking sector. The Group occasionally holds unlisted shares, for example in connection with taking over and reselling collateral from defaulted loans.

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.

Equity risk Table 22

DKKm	2018	2017
Shares/unit trust certificates listed on the Copenhagen Stock Exchange	52	22
Shares/unit trust certificates listed on other stock exchanges		19
Other shares at fair value based on the fair-value option	252	207
Total shares etc.	**304**	**248**

6. Liquidity Risk

6.1 Definition

Liquidity risk is defined as the risk of loss 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 defined the Bank's liquidity limits for the daily operational level and for budgeting plans. The Danish FSA designated BankNordik as a systematically important financial institution (SIFI) in 2015. With a liquidity coverage ratio (LCR) of 266 % at 31. December 2018 BankNordik's liquidity position remains robust.

6.2 Control and management

Liquidity risk is a fundamental part of the Group's business strategy. The Group's liquidity is monitored and managed by Treasury on a daily basis in accordance with the limits set by the Board of Directors and reported to the Executive Board by the Finance Department. A liquidity report with stress tests is submitted to the Executive Board and the Group Risk Committee on a monthly basis. Treasury has the operational responsibility for investment of the liquidity, while Finance Department is responsible for reporting and monitoring liquidity. The Group has implemented contingency plans to ensure that it is ready to respond to unfavorable liquidity conditions.

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 transactions and changes in liquidity. BankNordik complies with LCR requirements and therefore closely monitors the bond portfolio with regards to holding sufficient LCR compliable bonds.

Liquidity Management — Table 23

	Board of Directors	Executive Board	CFO	Financial Manager	Treasury
Objective	Defines the objectives for liquidity policies				
Tactical		Sufficient and well diversified funding		Planning	Providing background materials
Operational			Controlling & reporting	Monitoring	Establish contact

6.2.2 Liquidity stress testing

BankNordik has incorporated a liquidity stress testing model based on LCR. This model is used at least monthly to forecast developments in the Bank's liquidity on a 3-month and a 3-12-month horizon. 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 must implement a contingency plan.

6.2.3 Twelve-month liquidity

The Bank's 12-month funding requirements are based on projections for 2019, which were revised in December taking the market outlook into account.

6.2.4 Structural liquidity risk

Deposits are generally considered a secure source of funding. 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. It is crucial for any bank to handle such maturity mismatch and associated risk, and therefore it is essential to have a reputation as a safe bank for deposits. Table 24 shows assets and liabilities by a maturity structure.

In order to minimize liquidity risk, BankNordiks policy is to have strong liquidity from different funding sources. It is therefore the Bank's policy to further diversify the deposit base in terms of maturity.

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 loans from the financial markets.

6.3 Collateral provided by the Group

As customarily used by financial market participants BankNordik has entered into standard CSA agreements with other banks. These agreements commit both parties to provide and daily adjust collateral for negative market values. The bank with negative value exposure receives collateral. Thereby reducing counterparty risk to daily market fluctuations of derivatives and pledged amount. As a consequence of these agreements BankNordik at yearend 2018 had pledged bonds and cash deposits valued at DKK 31m under these agreements. End of period BankNordik had negative market value to all counterparties and has therefore not received any collateral yearend 2018.

BankNordik also provides collateral to the Danish central bank to give the Bank access to the intraday draft facility with the central bank as part of the Danish clearing services for securities. At yearend 2018, this collateral amounted to DKK 33m.

Remaining maturity

Table 24

DKK 1,000

2018	0-1 months	1-3 months	3-12 months	More than 1 year	Without fixed maturity	Total
Cash in hand and demand deposits with central banks	179,573					179,573
Due from Credit institution	430,270	166,135		317,100		913,506
Loans and advances	114,364	370,202	1,205,025	12,059,490		13,749,081
Bonds and Shares	62,809	80,341	575,040	3,984,526	251,665	4,954,381
Derivatives	1,510					1,510
Other Assets	94,375	58,834		486,408	266,027	905,644
Total assets	**882,902**	**675,512**	**1,780,064**	**16,847,525**	**517,692**	**20,703,696**
Due to credit institutions and central banks			70,960	246,945		317,905
Deposits	11,682,224	1,351,483	15,278	403,265		13,452,250
Derivatives						
Other liabilities	571,453	70,644	1,898	3,629	105,980	753,605
Subordinated debt	954	1,908	6,680	282,731		292,274
Equity					**2,104,088**	**2,104,088**
Total	**12,254,631**	**1,424,036**	**94,817**	**936,570**	**2,210,069**	**16,920,122**
Off-balance sheet items						
Financial Guarantees	447,542					447,542
Other commitments	105,600					105,600
Total	**553,142**					**553,142**
2017						
Cash in hand and demand deposits with central banks	250,509					250,509
Due from Credit institution	290,234	112,065		213,897		616,196
Loans and advances	71,769	726,656	1,284,338	11,219,854		13,302,618
Bonds and Shares	51,011	4,709	504,293	3,833,655	204,150	4,597,818
Derivatives	3,810					3,810
Other Assets	98,252	56,808		503,971	205,825	864,856
Total assets	**765,586**	**900,238**	**1,788,631**	**15,771,377**	**409,975**	**19,635,807**
Due to credit institutions and central banks	31,361			348,628		379,989
Deposits	9,816,643	1,732,581	41,754	1,065,798		12,656,776
Derivatives						
Other liabilities	576,971	70,644	1,898	39,104	380	688,998
Provisions for liabilities				29,880		29,880
Subordinated debt	952	1,903	6,662	281,968		291,484
Equity					**1,935,362**	**1,935,362**
Total	**10,425,927**	**1,805,128**	**50,314**	**1,735,498**	**1,935,742**	**15,952,609**
Off-balance sheet items						
Financial Guarantees	318,943					318,943
Other commitments	157,480					157,480
Total	**476,423**					**476,423**

7. Operational Risk

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

7.1 Definition

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 non-recurring events, such as clerical or record-keeping errors, defects or breakdowns of the technical infrastructure, fraud by employees or third-parties, 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 means of an extensive system of policies and control arrangements, which are designed to optimise 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 has therefore taken out insur¬ance in respect of property, office equipment, vehicles and employee compensation as well as general liability and directors' and officers' liability. In addition, the Bank has taken out insurance against theft, robbery, amounts lost in cash transports between branches or in the post up to 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.

Assessing the Bank's operational risks in the IT field is considered an important area. The Bank's IT department and management regularly review IT security, including contingency plans for IT breakdowns etc., that are designed to ensure that operations can continue at a satisfactory level in case of extraordinary events. All IT systems running at BankNordik and from the bank's service providers must adhere to documented running schedules and guidelines. IT operations must be safe and stable, a requirement complied with through the greatest possible degree of automation and capacity adjustments. 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 (nor is the Bank aware of any such proceedings pending or being threatened) during a period covering at least the preceding 12 months, which may have, or have had in the recent past a material adverse impact on the Bank's financial position or profitablity.

Pursuant to the Executive Order for the Faroe Islands on the governance and management of banks, etc. (Bekendtgørelse for Færøerne om ledelse og styring af pengeinstitutter m.fl.) and the Danish FSA's guidelines, the Bank is required to perform a qualitative assessment of its control environment. Control environment is a collective term for the resources the bank applies to minimise the risks involved in carrying on the financial business. Such resources would include an assessment of the scope of internal business procedures, the degree of functional segregation, and whether the necessary management and control tools are in place in all relevant business areas.

7.4 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. The long-term objective is for the monitoring system monitoring the level of operational risk in the Bank's branches on a monthly basis to have a preventive effect and to help to minimise the Bank's operational risk.

8. Insurance Risk

Insurance risk in the Group consists mostly of non-life insurance risk. The Group has a non-life insurance company, Trygd and a life insurance company, NordikLív.

Risk exposure for an insurance company can be defined as a contingency event, chain of events or bad management which can by itself, 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 typically categorized as insurance risk and market risk. Among other risks are currency exchange risk, liquidity risk, counterparty and concentration risk and operational risk.

Careful and prudent risk management forms an integral part of any insurance operations. 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 must 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 risks assumed, their composition and Trygd's equity. This is done with statistical spread of risks and accumulation of funds, quantified by statistical methods, to meet these obligations.

The Group has defined internal procedures to minimise the possible loss regarding insurance liabilities. Trygd evaluate their insurance risk on a regular basis for the purpose of optimising the risk profile. Risk management also involves holding a well-diversified insurance portfolio. The insurance portfolio of Trygd is well diversified in personal and commercial lines (see table 25).

8.1 Insurance risk

Trygd covers the insurance liabilities through a portfolio of securities and investment assets exposed to market risk.

Distrubution of portfolio of Trygd — Table 25

(in %)	2018	2017
Commercial lines	65%	67%
Personal lines	35%	33%

Financial assets linked to insurance risk — Table 26

DKKm	2018	2017
Listed securities on stock exchange	154	140
Accounts receivable (total technical provisions)	3	2
Cash and cash equivalents	13	16
Total	170	158

Trygd has invested in investment securities and cash and cash equivalents in the effort to balance the exposure to market and currency risk (see table 26).

Likely effects from changes in markets value — Table 27

DKKm	Change	2018	2017
Equity risk DKKm (+/-)	10%		
Exchange risk DKKm (+/-) in euro	2.25%		
Exchange risk DKKm (+/-) others currency	10%		
Interest rate risk DKKm (parallel shift) - Trygd	100 bp	1.2	0.66
Interest rate risk DKKm (parallel shift) Total	**100 bp**		

8.2 Capital requirements

The effects on BankNordiks solvency, due to the ownership of the insurance company's Trygd and NordikLív, are considered low. According to CRR the risk weighted assets has increased DKK 299m. The negative effect on the solvency thus is 0.5% points.

8.3 Trygd non-life 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.

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.

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

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.

Reinsurance is an important aspect of managing insurance risk. The Group must protect itself against dramatic fluctuations in technical results by entering into agreements on reinsurance so as to make the risk of the Group having to pay claims from its own funds reasonable in relation to the size of the risk assumed, the risk composition and Trygd´s equity.

Run-off gains/losses in Trygd — Table 28

DKKm

Sector:	2018	2017	2016	2015	2014
Industry	-0,68	1,25	2,5	1,12	1,95
Private	-0,10	0,46	0,43	0,64	-0,18
Accidents	-1,05	0,19	-0,32	0,27	-0,07
Automobile	3,11	2,93	3,39	2,3	0,99
Total	1,28	4,82	6,00	4,33	2,69

Trygd has organised a reinsurance programme which ensures that e.g. large natural disasters and significant individual claims do not compromise Trygd´s ability to meet its obligations. For large natural disasters, the total cost to Trygd will amount to a maximum of DKK 10m. The reinsurance program is reviewed once a year and approved by the Board of Directors. Trygd uses reputable reinsurance companies with strong ratings and financial positions.

Trygd's Claims Department 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 of Trygd applies a low risk investment policy. The company´s main investments are in bonds and deposits. There is no exchange rate risk, as all investements are based in DKK.

Contractual maturity for the insurance segment

Table 29

2018	On demand	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets						
Securities	191,023					191,023
Reinsurance assets		2,399				2,399
Accounts receivables		3,451				3,451
Restricted cash						
Cash and cash equivalents	17,089					17,089
Total financial assets	**208,111**	**5,850**				**213,961**
Liabilities						
Technical provision		90,243				90,243
Account payable		7,133				7,133
Total financial liabilities		**97,377**				**97,377**
Assets - liabilities	**208,111**	**-91,527**				**116,584**

Contractual maturity for the insurance segment

2017	On demand	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets						
Securities	171,553					171,553
Reinsurance assets		6,383				6,383
Accounts receivables		2,191				2,191
Restricted cash						
Cash and cash equivalents	19,846					19,846
Total financial assets	**191,399**	**8,574**				**199,973**
Liabilities						
Technical provision		81,736				81,736
Account payable		5,445				5,445
Total financial liabilities		**87,182**				**87,182**
Assets - liabilities	**191,399**	**-78,608**				**112,791**

Assets and liabilities are offset when the Group and the counterparty have a legally enforceable right to offset recognised amounts and have agreed to settle the balances on a net basis or to realise the asset and settle the liability simultaneously. Master netting agreements or similar agreements give the right to additional offset in the event of default.

8.4 NordikLív — Life insurance

NordikLív is a life insurance company established in 2015 and wholly owned by BankNordik. The company began operations in 2016.

NordikLív issues regular life, disability and critical illness insurance covers in the Faroese market and in 2018 the total premiums amounted to DKK 14.4m compared to DKK 13.2m in 2017, and the individual solvency requirement was much lower than the minimum capital requirement defined by law, leaving NordikLív with a capital requirement of DKK 27.7m compared to a total capital of DKK 33.9m

The primary risks of NordikLív are financial risks, insurance risks, operational risks and commercial risks.

NordikLív's investment policy is restrictive and at present NordikLív only holds government bonds and Danish mortgaged backed bonds limiting the primary financial risk to interest rate risk.

In respect of insurance risks these are, due to the company's limited product portfolio, mainly related to disability, costs and the occurrence of a catastrophe. To mitigate these risks NordikLív's under-writing policy is aimed at securing that only risks that can be characterized as normal for the relevant area of insurance are accepted. Further, NordikLív reinsures it's against larger claims, e.g. because of the occurrence of a catastrophe.

Operational risks are the risks of suffering an economic loss due insufficient or the complete lack of internal procedures, human or system based errors or due to external events, including a change in legislation. In respect of the latter, besides an expected minor increase in the minimum capital requirement defined by law, the proposed upcoming Solvency II inspired Faroese regulation is not expected to have any major influence on NordikLív.

Commercial risks are related to the uncertainty of the development of the Faroese life insurance market, change in customer behaviour and demands, a shift in technology and reputational risk.

In order to mitigate operational and commercial risks NordikLív has entered into a cooperation agreements with Forenede Gruppeliv and BankNordik providing the company with expert resources within production, administration, internal audit, risk management and compliance.