Risk Management Report

Eik Banki P/F

1.1.2013 – 31.12.2013

Contents

1 Introduction

The objective of the risk management report is to give an overview of Eik Banki P/F's risk management practices.

The risk management report is published on the Bank's webpage www.eik.fo simultaneously with the release of the Bank's annual report. The risk management report is a separate unaudited document.

Risk and risk management are an integral part of banking. The purpose of Eik Banki's risk management is to ensure that the Bank does not take on more risks than stipulated by the Board of Directors.

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

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

Market risk, defined as the risk that the market value of assets and liabilities, as well as off-balance items, will be affected as a result of changing market conditions. Eik Banki's market risk consists of interest rate risk, equity risk, foreign exchange risk and other price risks.

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

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

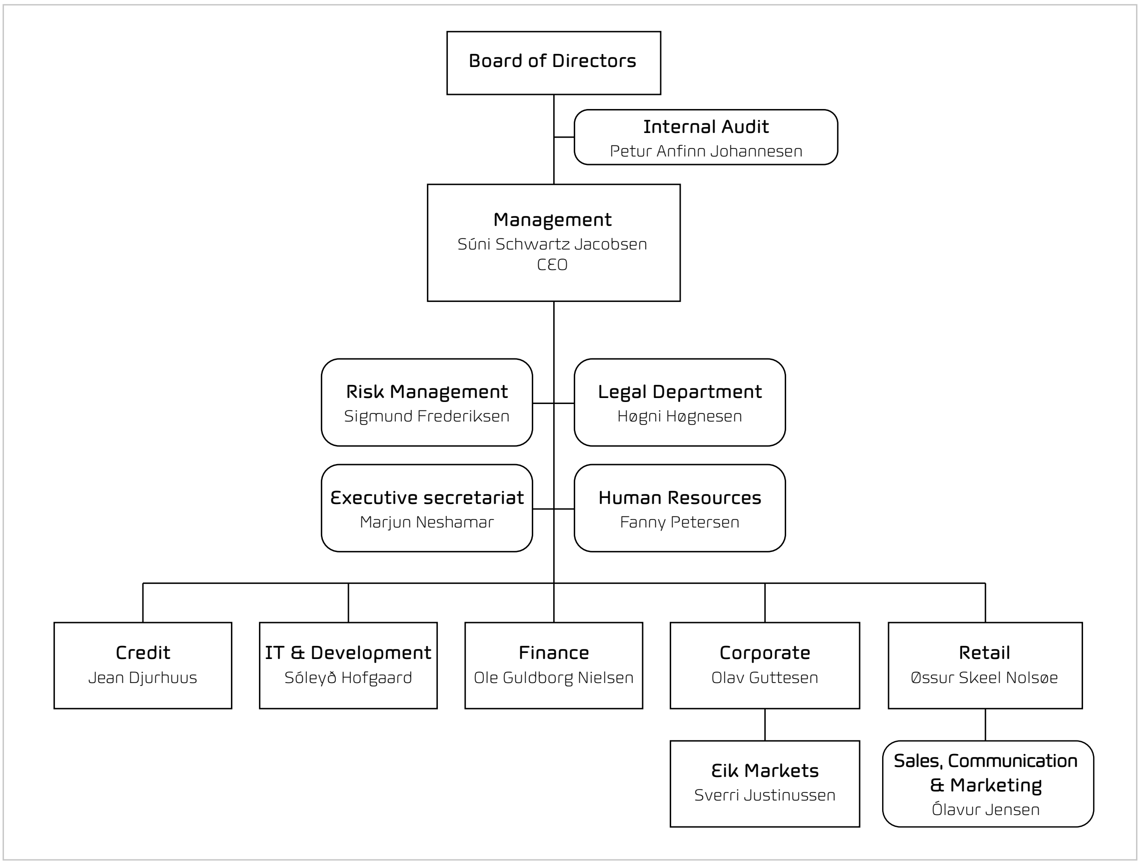
In the risk management report an assessment is made of solvency and individual solvency requirement. The difference between the two is as follows:

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

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

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

2 Organisation



Eik Banki's official organisational structure is illustrated above.

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

Risk Management monitors credit risk, market risk, liquidity risk and operational risk on behalf of the CEO.

Risk monitoring is performed in accordance with the tasks of the Risk Management function as stipulated in the Danish Financial Business Act, section 71, and Executive Order No. 336 of 12 April 2012 for the Faroes on the management and control of banks etc.

Risk Management reports to the CEO every quarter on the risks that are associated with the Bank's operations. In addition to this, Risk Management reports to the Board of Directors annually.

3 Capital base

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

3.1 Policy

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

3.2 Statement of capital base

The table below shows the statement of capital base as of 31 December 2013.

Table 1: Statement of capital base as of 31 December 2013 (DKK 1,000).

Capital requirement	
Core capital before statutory deductions	1,294,584
Proposed dividend	60,000
Intangible assets	145
Tax assets	163
Core capital less statutory deductions	**1,234,276**
Share capital, not included in core capital	**0**
Capital base	**1,234,276**

4 Solvency

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

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

In addition to the solvency, the Bank is also required to determine the individual solvency requirement. This is to ensure that the Bank has sufficient capital to weather difficult periods and in order to meet the demands by the Danish Financial Supervisory Authority. The individual solvency requirement is calculated using the Bank's risk profile, social conditions and budget conditions for the coming year, in addition to other circumstances such as increased provisions for poor and non-performing exposures.

4.1 Objective and policy

4.1.1 Solvency statement

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

The table below shows the Bank's solvency statement.

Table 2: Solvency statement as of 31 December 2013 (DKK 1,000).

Capital requirement	
Core capital before statutory deductions	1,294,584
Proposed dividend	60,000
Intangible assets	145
Tax assets	163
Core capital less statutory deductions	**1,234,276**
Share capital, not included in core capital	**0**
Capital base	**1,234,276**
Weighted assets	
Weighted assets not included in trading portfolio including off balance-sheet items	3,875,185
Weighted items with market risk	468,626
Operational risk	593,611
Total risk weighted assets	**4,937,422**
Solvency ratio in accordance with FIL section 124, subsection 2 (1)	**25.0%**
Core capital after deductions in per cent of weighted assets	**25.0%**

4.1.2 Individual solvency requirement

The calculation of the Bank's individual solvency requirement is based on a model developed by the Local Banks Association (The Association of Local Banks, Savings Banks and Cooperative Banks in Denmark) and on guidelines on adequate capital base and solvency requirement for financial institutions issued by the Danish Financial Supervisory Authority.

The model developed by the Local Banks Association and the guidelines from the Danish Financial Supervisory Authority are both based on the 8+ approach, where the basis is a minimum requirement of 8 % of the risk-weighted items (Pillar I) with a supplement for risks and circumstances, which are not fully reflected in the calculation of the risk-weighted items.

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

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

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

The table below shows the 8+ approach that is used when calculating the individual solvency requirement.

Table 3: Individual solvency requirement based on the 8+ approach

1) Pillar I requirement (8 % of the risk-weighted items)
+ 2) Earnings (capital for risk cover due to weak earnings)
+ 3) Growth in lending (capital to cover organic growth in business volume)
+ 4) Credit risk, of which: 4a) Credit risk on major customers with financial problems 4b) Other credit risks 4c) Concentration risk on individual exposures 4d) Concentration risk on industries
+ 5) Market risk, of which 5a) Interest risk 5b) Equity risk 5c) Foreign exchange risk
+ 6) Liquidity risk (capital to cover more expensive liquidity)
+ 7) Operational risk (capital to cover operational risk in excess of pillar I)
+ 8) Possible supplement due to statutory requirements
Total = Capital requirement and solvency requirement
- of which credit risk (4) - of which market risk (5) - of which operational risk (7) - of which other risks (2+3+6) - of which supplement due to statutory requirements (1+8)

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

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

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

The guidelines from the Danish Financial Supervisory Authority are used when calculating credit risk. These guidelines are outlined in the Danish Financial Supervisory Authority's guidelines on adequate capital base and solvency requirement for financial institutions. For customers with OEI and weak customers (rating category 1 and rating category 2c, – see 5.1.6) where the exposure is larger than 2 % of the Bank's capital base the unsecured exposure is fully reserved.

Market risk is calculated using stress factors related to the maximum risks that the Bank can assume within the authorities that the Board of Directors has granted to the CEO.

The Bank uses the base indicator method for calculating operational risk.

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

Table 4: Individual solvency requirement (DKK 1,000).

Risk area	Adequate capital base DKK 1,000	% of weighted items
Statutory requirements	394,978	8.00%
Credit risk	172,491	3.49%
Market risk	13,455	0.27%
Operational risk	0	0.00%
Other risks	11,960	0.24%
Total	**592,885**	**12.01%**

At the end of 2013, Eik Banki's solvency ratio was 25.0% (DKK 1,234 million) and the individual solvency requirement was 12.01%.

4.2 Counterparty risk - derivatives

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

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

1) All contracts are computed at market value and all contracts with a positive value are included.

2) The contracts' nominal principals or the underlying values are multiplied by percentages fixed by the Danish Financial Supervisory Authority to establish the potential future credit exposure.

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

The Bank allocates capital equivalent to 8% of the positive market value of the derivatives. When Eik Banki enters into agreements with a counterparty regarding derivatives, credit limits must be observed. At the end of 2013 the positive fair value of derivatives was DKK 8.1 million.

5 Credit Risk

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

5.1 Objective and risk policy

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

Credit risk is managed according to Eik Banki's credit policy and instructions from the Board of Directors to the CEO, which stipulate responsibilities and granting authority.

The credit policy is updated, should the Bank wish to change the credit terms in order to take into account external or internal changes that could affect the creditworthiness of customers. Such factors may be that the Bank changes its terms for financing certain customer groups. The credit policy is submitted to and approved by the Board of Directors annually.

The credit policy is prepared in accordance with the Danish Financial Business Act and Executive Order No. 336 of 12 April 2012 for the Faroes on the management and control of banks etc. The credit policy determines the basic rules that apply as to how the Bank handles credit risk in relation to the Bank's business organisation, operations and within the framework set by the Danish Financial Supervisory Authority.

5.1.1 Authority and division of labour

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

The Credit Department is responsible for day-to-day credit granting. This includes developing credit management tools, such as ratings, drawing up procedures for credit granting and value assessments of collateral. The Credit Department must also ensure compliance with limits on e.g. customer concentration and industry concentration. The Credit Department is responsible for the Bank's impairment procedures and credit risk management including monitoring the development in overdrafts and arrears.

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

5.1.2 Credit management and control

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

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

Customer advisers, together with their Branch Manager, are responsible for daily credit control.

Credit exposures above a certain size are sumbitted to the Board of Directors for renewal annually. The credit applications must include the customer's financial situation and the conditions for the exposure to be continued by the Bank.

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

5.1.3 Collaterals

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

5.1.4 Risk concentration

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

In addition to these limits, the Bank aims for an even distribution between retail and corporate lending and no single industry should account for more than 10% of the Bank's total gross loans.

5.1.5 Impairments

Quarterly assessments are made of the need for impairment charges, in accordance with guidelines from the Danish Financial Supervisory Authority. Impairment charges are based on individual estimations and/or collective estimations. The Credit Department is responsible for making impairment evaluations together with the branches. Clear procedures have been adopted for selecting customers and evaluating possible impairments to ensure quality and uniform criteria in the evaluations for all customers.

If the Bank registers an objective evidence of impairment on a loan (OEI), an assessment is made of the impairment charge. An objective evidence of impairment is assessed to be present, if one or more of the following events have occurred:

- Debtor has encountered financial difficulties
- Breach of contract on the side of debtor, e.g. not making repayments and interest
- The Bank has relaxed loan conditions due to the debtor experiencing financial difficulties
- High probability of the debtor going bankrupt or being in need of financial reorganisation

The impairment charge is calculated as the difference between the carrying amount and the discounted value of the expected cash-flows, including the realization value of any collateral. Any subsequent increase of this discounted value of the expected cash-flows results in full or partial reversal of impairments. For fixed interest rate loans and advances, the original effective interest rate is used to calculate the discounted value, while the current effective interest rate is used for floating rate loans and advances.

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

5.1.6 Rating of customers

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

The Bank uses the following rating categories:

3	Unconditionally good customers
2a	Good customers
2b	Average customers
2c	Weak customers
1	Customers with OEI (objective evidence of impairment)

5.1.7 Customers

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

5.1.8 Circumstances that are considered when granting credit

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

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

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

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

5.2 Actual credit risk exposures

This section shows credit risk exposures, risk-weighted items and capital requirements as of 31.12.2013. These are broken down by industry and remaining repayment period. The Bank also analyses non-performing and depreciated assets, transfers on depreciated assets caused by value adjustments and impairment charges, and financial collaterals.

5.2.1 Risk-weighted exposures and capital requirements

This section shows risk-weighted items and capital requirements.

The table below shows risk-weighted items and capital requirements for credit risk, broken down by exposure groups.

Table 5: Risk-weighted exposures in relation to credit risk (DKK 1,000).

Exposure group	Risk-weighted items	Capital req. 8%
Central governments or central banks	0	0
Local authorities	0	0
Public entities	30,998	2,480
Financial institutions	58,722	4,698
Retail customers[1]	541,740	43,339
Corporate customers	1,924,219	153,938
Exposures secured by mortgage in real estate	821,994	65,760
Exposures with arrears or overdrafts	254,487	20,359
Exposures in other items, including assets without counterparties	296,705	23,736
Total	**3,928,865**	**314,309**

1 Includes all exposures ≤ DKK 3 million.

5.2.2 Credit risk and risk of dilution

The Bank adheres to the Executive Order for the Faroes on Financial Reports for Credit Institutions etc. and uses the accounting definition of non-performing and impaired debts as defined in sections 53-56.

Individual impairment charges for all loans are made in accordance with section 54 of the Executive Order for the Faroes on Financial Reports for Credit Institutions etc. Group impairment charges are made in accordance with section 55 of the above mentioned executive order; this applies to loans without individual impairment charges.

Total value of the exposures after value adjustments and before considering credit risk decrease was DKK 7,515 million as of 31.12.2013.

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

Table 6: Exposures after value adjustment before credit risk decrease (DKK 1,000).

Exposure group	Exposure after value adjustment	Average exposure during the year after value adjustment
Governments or central banks	372,400	447,463
Local authorities	368,935	310,630
Public entities	220,574	163,635
Financial institutions	317,117	309,673
Retail customers[1]	935,586	931,832
Commercial customers	2,416,032	2,376,573
Exposures secured by mortgage in real estate	2,344,708	2,287,954
Exposures with arrears or overdrafts	211,339	275,515
Exposures in other items, including assets without counterparties	327,948	370,275
Total	**7,514,640**	**7,473,549**

[1] Includes all exposures ≤ DKK 3 million.

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

Table 7: Exposures broken down by industry (DKK 1,000).
The table below shows the exposures in accordance to the Executive order on Capital Adequacy, Appendix 3, broken down by industry. The table also shows the breakdown between retail customers and corporate customers.

Industries	Central governments or central bank	Local authorities	Public entities	Financial institutions	Retail customers[1]	Commercial customers	Exposures secured by mortgage in real estate	Exposures with arrears or overdrafts	Exposures in other items, including assets without counterparties	Total
Public authorities	**0**	**365,701**	**220,189**	**6,050**	**699**	**37,569**	**5,179**	**2**	**0**	**635,388**
Agriculture, hunting, forestry and fishing	0	0	0	0	12,407	415,289	3,448	28,950	0	460,093
Industry and raw materials extraction	0	0	0	0	10,987	564,370	5,003	14,271	0	594,632
Energy supply etc.	0	0	0	0	0	0	0	0	0	0
Building and construction	0	0	0	0	37,495	69,548	12,474	10,344	0	129,861
Trade	0	0	0	0	59,979	363,134	21,206	28,701	0	473,019
Transport, hotels and restaurants	0	0	0	0	17,225	249,016	5,162	2,394	0	273,796
Information and communication	0	0	0	0	3,007	7,545	0	156	0	10,709
Finance and insurance	372,400	0	0	311,067	-27,372	124,446	1,263	644	327,948	1,110,395
Real estate	0	0	0	0	24,450	289,470	25,092	18,317	0	357,329
Other industries	0	2,884	385	0	150,321	285,513	23,977	4,869	0	467,949
Total corporate	**372,400**	**2,884**	**385**	**311,067**	**288,498**	**2,368,331**	**97,624**	**108,646**	**327,948**	**3,877,784**
Retail	**0**	**350**	**0**	**0**	**646,389**	**10,132**	**2,241,905**	**102,691**	**0**	**3,001,468**
Total	**372,400**	**368,935**	**220,574**	**317,117**	**935,586**	**2,416,032**	**2,344,708**	**211,339**	**327,948**	**7,514,640**

[1] Includes all exposures ≤ DKK 3 million.

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

Table 8: Credit exposure broken down by maturity (DKK 1,000).

Exposure group	On demand	0-3 months	3 months – 1 year	1-5 years	Over 5 years	Total
Central governments or central banks	372,148	0	0	252	0	372,400
Local authorities	95,562	0	0	14,185	259,188	368,935
Public entities	45,584	40,000	0	30,439	104,552	220,574
Financial institutions	279,715	14,699	975	0	21,728	317,117
Retail customers[1]	203,333	14,966	15,455	139,957	561,875	935,586
Commercial customers	593,180	72,772	20,758	377,610	1,351,712	2,416,032
Exposures secured by mortgage in real estate	20,482	38,241	7,096	145,387	2,133,502	2,344,708
Exposures with arrears or overdrafts	14,681	2,918	5,503	24,867	163,371	211,339
Exposures in other items, including assets without counterparties	31,243	0	0	164,198	132,507	327,948
Total	**1,655,927**	**183,595**	**49,788**	**896,894**	**4,728,436**	**7,514,640**

[1] Includes all exposures ≤ DKK 3 million.

5.2.3 Defaulted and depreciated claims

This section shows defaulted and depreciated claims.

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

Table 9: Defaulted and depreciated claims broken down by industries (DKK 1,000).

	Bad debts exposure	Depreciated claims exposure	Impairments/ provisions at the end of the year	Amounts booked as costs concerning value adjustments and impairments/provisions during the period
Public authorities	**20**	**20**	**24**	**22**
Agriculture, hunting, forestry and fishing	88,995	85,801	61,631	6,281
Industry and raw materials extraction	41,895	87,452	57,845	-16,625
Energy supply etc.	0	0	0	-905
Building and construction	36,264	41,720	29,402	-3,729
Trade	43,546	31,296	29,863	374
Transport, hotels and restaurants	7,243	119,723	59,681	-10,700
Information and communication	153	0	303	3,095
Finance and insurance	2,494	4,112	2,401	39,819
Real estate	23,179	19,494	18,629	519
Other industries	16,003	27,808	22,678	-2,512
Total corporate	**259,773**	**417,405**	**282,435**	**15,618**
Retail	**146,639**	**145,216**	**78,694**	**7,714**
Total	406,432	562,642	361,153	23,354

Amounts booked as costs are calculated as: impairments/provisions at the end of 2013 less impairments/provisions at the start of 2013 including total annual loss.

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

Table 10: Movements on claims with reduced value caused by value adjustments and impairment charges (DKK 1,000).

	Individual impairments / provisions		Collective impairments
	Loans	Guarantees	Loans
Accumulated impairments/provisions on loans and guarantees, at the beginning of the year	343,811	2,500	57,425
Impairments/provisions during the year	40,344	158	5,431
Reversal of impairments/provisions from previous year, where there is no longer OEI or the impairment has decreased	-58,242	-1,000	-11,658
Other changes	-35,527	0	2,677
Value adjustment of acquired assets	50,579	0	
Loss (written off), previously individually impaired/provisions made	-35,346	0	
Total impairments/provisions on loans and guarantees at year end	**305,619**	**1,658**	**53,875**
Total loans and guarantees, where there have been made individual impairments/provisions (calculated before impairments/ provisions)	**551,781**	**10,861**	**3,634,188**

5.2.4 Financial collateral

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

Table 11: Financial collateral (DKK 1,000).

Exposure group	Collateral with substitution	Financial collateral expanded
Governments or central banks	0	0
Local authorities	0	0
Public entities	0	476
Financial institutions	0	0
Retail customers[1]	447	42,144
Commercial customers	3	70,471
Exposures secured by mortgage in real estate	0	0
Exposures with arrears or overdrafts	525	2,914
Exposures in other items, including assets without counterparties	0	0
Total	**975**	**116,006**

[1] Includes all exposures ≤ DKK 3 million.

6 Market Risk

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

6.1 Objective and risk policy

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

Taking on market risk is an integral part of banking. The market risk in Eik Banki is divided into interest rate risk, equity risk, foreign exchange risk and other price risks.

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

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

6.1.1 Interest rate risk

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

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

6.1.2 Equity risk

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

6.1.3 Foreign exchange risk

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

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

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

6.1.4 Other price risks including commodity risk

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

At year end 2013 Eik Banki had no other price risks.

6.1.5 Reporting and division of responsibility

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

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

6.1.6 Responsibility and monitoring

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

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

The Finance Department checks that the market risk policy and limits are complied with.

6.2 Actual market risk

This section concerns the actual market risk exposures as of 31.12.2013. These concern risks related to the trading portfolio, exposures in equities etc., which are not part of the trading portfolio and interest rate risk.

6.2.1 Risk pertaining to the trading portfolio

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

Table 12: Risk-weighted exposures with market risk (DKK 1,000).

	Risk-weighted items	Capital requirement 8%
Bonds	292,078	23,366
Shares	85,416	6,833
Currency position	91,132	7,291

6.2.2 Exposures in equities that are not part of the trading portfolio

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

Table 13: Exposures in equities that are not part of the trading portfolio (DKK 1,000).

Type	Exposure 31.12.2013	Operating effect
Shares relating to the Bank's suppliers	17,415	-12
Corporations	15,432	-6,580

6.2.3 Interest rate risk

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

Table 14: Interest rate risk in and outside the trading portfolio (DKK 1,000).

	Interest rate risk
Interest rate risk on items outside the trading portfolio	
Balance (loans, deposits, receivables/ debt with financial institutions)	1,355
Total outside the trading portfolio	1,355
Interest rate risk broken down by items in the trading portfolio:	
Securities in balance (incl. spot market)	20,193
Futures, forwards etc.	0
Total in trading portfolio	20,193
Total interest rate risk	**21,549**

7 Liquidity Risk

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

7.1 Objective and risk policy

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

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

Eik Banki identifies the following as liquidity risks:

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

The Bank's liquidity policy is to maintain liquidity, which is at least 50 per cent above the statutory minimum requirement. At year-end 2013 the Bank had an excess liquidity that was 2.2 times higher than the statutory minimum requirement.

7.1.1 Reporting and division of responsibility

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

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

7.1.2 Responsibility and monitoring

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

The Finance Department is responsible for reporting on daily and monthly liquidity; this also includes checking that the Bank has sufficient liquidity.

8 Operational Risk

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

8.1 Objective and risk policy

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

The Board of Directors approves the risk policy for operational risk, decides on procedures and how monitoring and follow-up on the risks is to be organised.

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

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

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

8.1.1 Reporting and division of responsibility

The operational policy stipulates procedures, registration and reporting. Employees are responsible for reporting all risk events to their nearest manager and Risk Management. Risk Management registers the events and briefs the CEO every quarter.

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

8.2 Actual operational risk

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

Eik Banki's IT-systems are hosted by Skandinavisk Data Center (SDC). A risk analysis of all IT-systems is conducted annually in order to determine what business impact the risk has on Eik Banki. This is conducted in accordance with analyses from BIR, Business Impact Assessment from ISF, International Security Forum. A risk analysis was conducted in January 2014.

The solvency requirement for operational risk is DKK 47.5 million, and this is included in the individual solvency requirement.