Risk Management Report 2013

BANKNORDIK

Board of Directors and Executive Board

Group objectives of Risk Management Report

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

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

2 Organisation

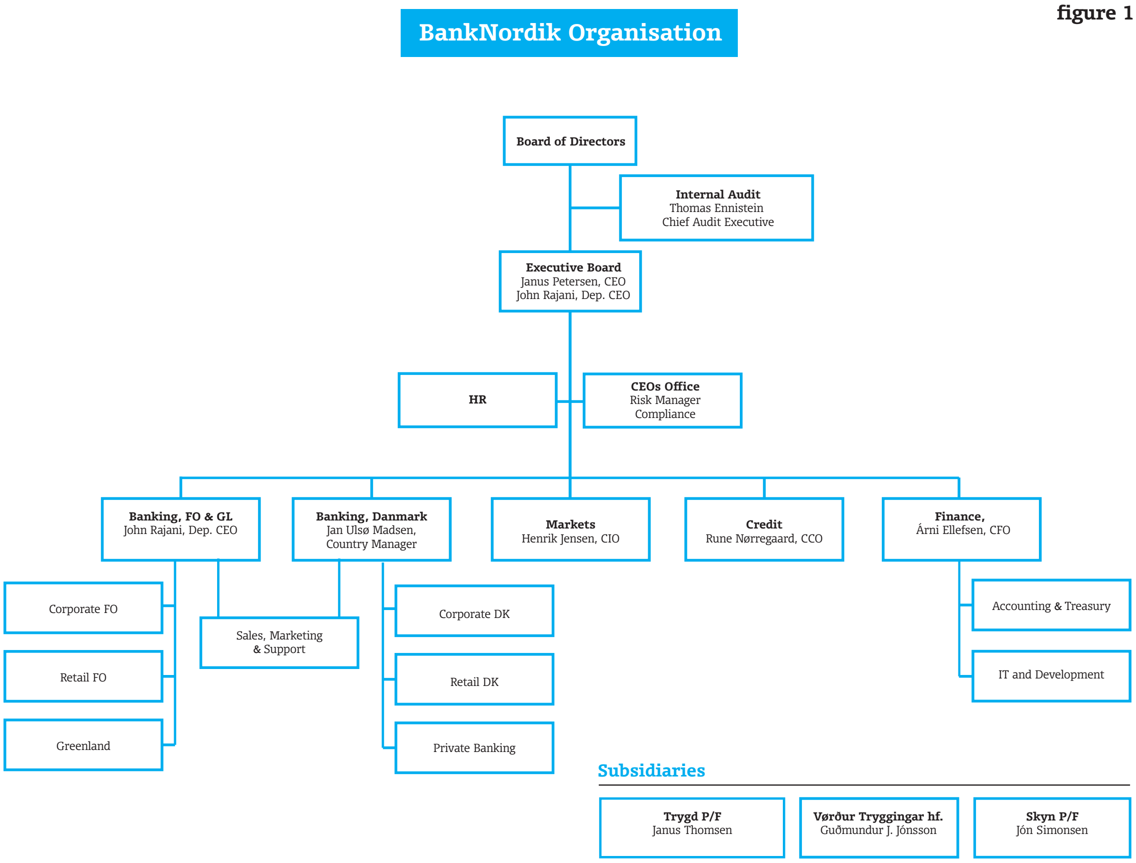
2.1 Introduction

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

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

The Executive Board consists of Group CEO Janus Petersen and Deputy CEO John Rajani, as shown in figure 1.

figure 1



At the chief operational level, the Group is divided into three main business units:

- Banking operations, sales and marketing in the Faroe Islands and Greenland, headed by John Rajani, BankNordik's Deputy CEO
- Banking operations, sales and marketing in Denmark, headed by Jan Ulsø Madsen, Country Manager
- Markets, headed by Henrik Jensen, Chief Investment Officer

The Faroese and Icelandic insurance activities, along with the Executive Secretariat and Human Resources report to Janus Petersen, Chief Executive Officer

The business units are supported by the following units:

- Credit, headed by Rune Nørregaard, Chief Credit Officer
- Finance, Accounting, Treasury & IR, IT and Development headed by Árni Ellefsen, Chief Financial Officer

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

The Group's Executive Board, the Country Manager in Denmark, Chief Investment Officer, Chief Financial Officer 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 Executive Board 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 organisational 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.

The Group implemented the risk appetite framework in its major business units in 2009. 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

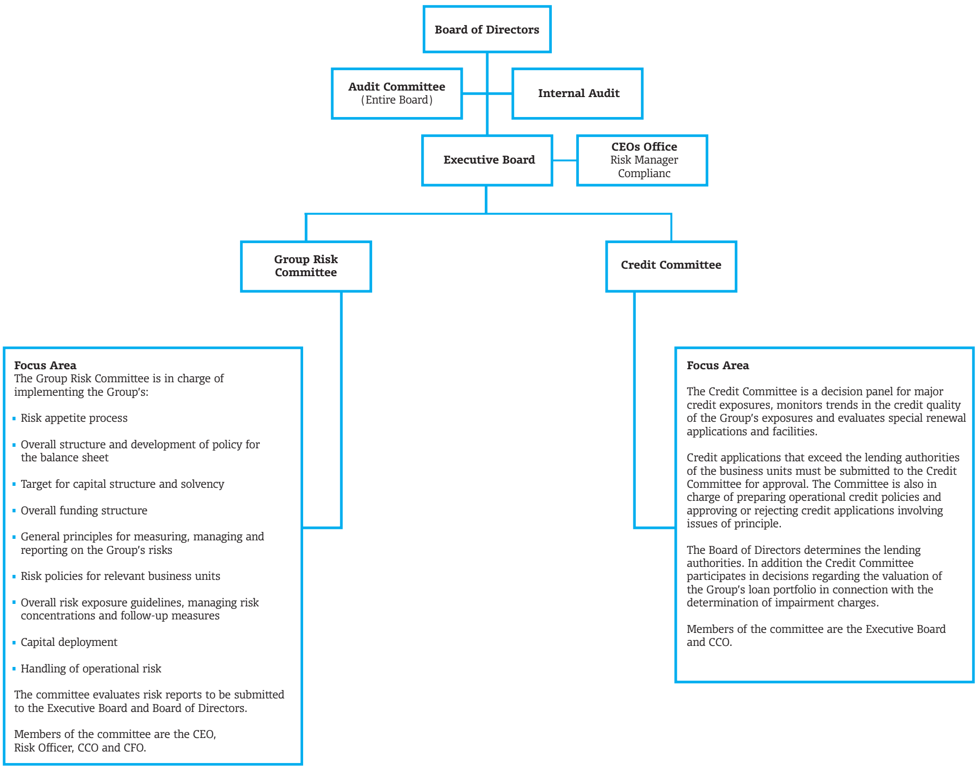
Other risk dimensions are incorporated at the Group and business unit levels where appropriate. They include insurance and concentration risk, financial strength, and earnings robustness. Specific risk instructions for the main business units are prepared on the basis of the overall risk policies and 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 organisation

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

The Board of Directors lays down overall policies, while the Executive Board is in charge of the Group's day-to-day management and reports to the Board of Directors. None of the Group's executive managers serve on the Board of Directors of the parent company. The risk and capital management functions are separate from the credit assessment and credit-granting functions, as shown in figure 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 in respect of the recommendations on Corporate Governance issued by the Icelandic Chamber of Commerce. These recommendations apply to companies listed on NASDAQ OMX Iceland.

The 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 the members of the Board of Directors.

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 organised. As part of this duty, it appoints the members of the Executive Board and the Group's Chief Internal Auditor.

The largest credit facilities are submitted to the Board of Directors for approval, and the Board defines overall limits for market risk and liquidity risk. Regular reporting enables the Board of Directors to monitor whether the overall risk policies and systems are being complied with and whether they meet the Group's needs. In addition, the Board of Directors reviews reports analysing the Group's portfolio, particularly information about industry concentrations, large exposures and 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 organised various subcommittees/functions for specific risk management areas such as asset and liability management and the management of risk parameters and models affecting the Group's capital and risk-weighted assets. The subcommittees consist mostly of members of the management team.

2.3.3 Risk Committee

The Risk Committee consists of:

- the Chief Executive Officer
- the Risk Officer
- the Chief Financial Officer and
- the Chief Credit Officer

The Risk Committee is in charge of identifying all main risks of the Group with the aim of optimising 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 members of the Executive Board and the CCO.

Credit applications that exceed the lending authorities of the Credit Department (personal customers) or to 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 and Accounting department oversees the Group's financial reporting, budgeting, liquidity and capital structure, and the performance and analytical tools used by the business units. It also has overall responsibility for the Group's compliance with the Capital Requirements Directive and 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 Executive Board Secretariat 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 utilisation of portfolio limits for industries and countries and of the quarterly process of calculating the impairment of exposures. It also keeps track of the credit quality of the Group's loan portfolio by monitoring trends in unauthorised overdrafts and overdue payments, new approvals to weak customers and other factors.

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

The CEO's office is in charge of analysing and monitoring strategic business risk and corporate governance. The Business Development unit is responsible for monitoring the Group's operational risk, and the Group's investor relations are handled by the Finance and Accounting department.

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 forward 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 3) 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 in relation to the Group LOPI methodology. The report contains the conclusions drawn from the stress testing and the effect of scenarios on expected losses and capital requirements.
Key figures for the credit portfolio	An overview of credit-quality indicators, classifications and trends in lending volumes.
Market risk	Analysis of the Group's current equity, fixed income and currency positions and report on the utilisation of Board approved limits since the preceding report.
Large exposures	An overview of exposures equal to or exceeding 10% of the Group capital base and the sum of these exposures, including the percentage of the Group's capital base 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 Basel II regulatory framework, which consists of three pillars.

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

3.2 Pillar I

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

3.2.1 Approach to solvency statement

The Bank's solvency statement was completed in accordance with the executive order on capital adequacy for the Faroe Islands of 25 May 2011.

Table 4 sets out the Bank's capital adequacy statement as of 31 December 2013, including the basis for calculating risk-weighted items, core capital, core capital after deductions, capital base, capital base 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 Capital Requirements Directive, 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.

Statement of capital - P/F BankNordik		Table 4
Solvency		
DKK 1,000	2013	2012
Core capital	1,468,569	1,537,748
Base capital	1,696,191	1,764,115
Risk-weighted items not included in the trading portfolio	8,900,568	9,644,767
Risk-weighted items with market risk etc.	1,294,186	1,172,371
Risk-weighted items with operational risk	1,316,520	1,084,613
Total risk-weighted items	11,511,274	11,901,750
Core capital rato, excl. hybrid core capital	10.6%	9.6%
Core capital ratio	12.8%	12.9%
Solvency ratio	14.7%	14.8%
Core Capital and Shareholders' eguity		
Share capital	200,000	200,000
Reserves	126,811	99,826
Net profit	92,396	103,099
Retained earnings, previous years	1,729,181	1,643,331
Shareholders' equity	**2,148,388**	**2,046,255**
Deduction of dividend	15,000	10,000
Deduction of Foreign currency translation reserve	29,348	18,443
Deduction of intangible assets	788,695	797,779
Deduction of deferred tax assets	31,773	26,333
Deduction of insurance subsidiaries	56,413	51,008
Core capital exclusive of hybrid core capital	**1,218,339**	**1,142,692**
Hybrid core capital	**250,230**	**395,055**
Core capital	**1,468,569**	**1,537,748**
Base capital		
Core capital	1,468,569	1,537,748
Addition of revaluation reserve	8,820	0
Subordinated loan capital	275,216	277,375
Deduction of insurance subsidiaries	56,413	51,008
Base capital	**1,696,191**	**1,764,115**

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. For credit calculation purposes this corresponds to applying the so called credit reservation approach applied by the Danish FSA when reviewing exposures during bank inspections. An 8+ approach means that a calculation 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 ongoing 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 general capital requirement (see the 8+ approach). The second part consists of seven underlying risk factors:

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

In addition to these seven risk factors, the Bank calculates potential premiums for special risks believed not to be covered by the calculation of general risk. See the calculation of the 8+ capital requirement above. If any other areas of special risk are identified that are not listed in the model set out above, the Bank must calculate 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 general 8+ capital requirement and any possible individual additional capital requirement constitute BankNordik's total individual capital requirement.

Table 5

Capital and solvency adequacy assesment pr. 31.12.2013 (DKK 1,000)		Capital requirement, 8% of RWA, 1,000 DKK	RWA Capital requirement, per cent
1) Pillar I requirement (8% of RWA)		920,902	8.0%
+ 2) Earnings (capital for risk coverage due to weak earnings)		-	0.0%
+ 3) Growth in lending (capital to cover organic growth in business volume)		-	0.0%
+ 4) Credit risk, of which:		70,789	0.6%
	4a) Credit risk on major customers in financial distress	28,030	0.2%
	4b) Other credit risk	12,527	0.1%
	4c) Concentration risk on individual exposures	30,233	0.3%
	4d)Concntration risk on industries	-	0.0%
+ 5) Market risk, of which:		29,481	0.3%
	5a) Interest risk	16,840	0.1%
	5b) Equity risk	-	0.0%
	5c) Foreign exchange risk	12,640	0.1%
+ 6) Liquidity risk (capital to cover more expensive liquidity)		4,610	0.0%
+ 7) Operational risk (capital to cover operational risk in excess of pillar I)		-	0.0%
+ 8) Margins due to statutoryrequirements		-	0.0%
Capital requirement and solvency ratio		**1,025,781**	**8.9%**

3.3.3 Group solvency requirement

The Group's solvency requirement has been calculated using the method illustrated above. At the end of December 2013, the solvency requirement was 8.9%, the risk-weighted items were DKK 11.5bn and the capital requirement was DKK 1,026m.

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

DKK 1,000	31.12.2013	31.12.2012	Change
Total risk-weighted items	11,511,274	11,901,750	-390,476
Base capital	1,696,191	1,764,115	-67,924
Core capital	1,468,569	1,537,748	-69,179
Solvency ratio	14.7%	14.8%	-0.1%
Core capital ratio	12.8%	12.9%	-0.2%
Capital requirement	1,025,781	1,022,211	3,570
Solvency requirement	8.9%	8.6%	0.3%
Excess capital, DKK 1,000	670,410	741,904	-71,494
Excess capital ratio	5.8%	6.2%	-0.4%

4 Credit Risk

Credit risk is the most crucial risk facing the Group. BankNordik has loans and advances (exposures) of DKK 15,570m, 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.

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 branches (2010) and the healthy parts of 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 2013 in total DKK 410m was recorded on this account (see Table 15 and 16 for more details). Whether 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 credit instructions are submitted to the Credit Department (personal customers) or to the Group's Corporate Department (corporate customers) along with a credit recommendation.

Corporate Department: The central corporate departments in the Faroe Islands, Denmark and Greenland handle all of the Group's major corporate accounts. 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 that are 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 does not apply an automatic rating model that classifies customers into homogenous groups. However, the Group has implemented a behavioural credit scoring model for its private customers in Denmark and Greenland, and the Group has in recent years classified its customers in accordance with the methodology used by the Danish FSA, see table 7. Currently, about 91% 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 2013, 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.

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.

Quality of loan portfolio excl. financial institutions 2013 — Table 7

		> 7.5m	< 7.5m	Total
Portfolio without weakness (3, 2a5)	Exposure in DKKm	3,029	4,140	7,168
Portfolio with some weakness (2b15, 2b30)	Exposure in DKKm	1,338	3,527	4,865
Portfolio with weakness (2c50)	Exposure in DKKm	194	483	677
	Unsecured	73	275	347
Portfolio with OEI (1)	Exposure in DKKm	659	1,194	1,852
	Unsecured	355	799	1,153
	Impairments/provisions	153	338	491
Portfolio without individual classification	**Exposure in DKKm**	**0**	**1,351**	**1,351**
Total	**Exposure in DKKm**	**5,220**	**10,694**	**15,913**

Quality of loan portfolio excl. financial institutions 2012

		> 7.5m	< 7.5m	Total
Portfolio without weakness (3, 2a5)	Exposure in DKKm	3,356	3,650	7,006
Portfolio with some weakness (2b15, 2b30)	Exposure in DKKm	1,210	3,533	4,743
Portfolio with weakness (2c50)	Exposure in DKKm	189	534	723
	Unsecured	50	323	372
Portfolio with OEI (1)	Exposure in DKKm	551	553	1,105
	Unsecured	226	318	543
	Impairments/provisions	138	236	374
Portfolio without individual classification	**Exposure in DKKm**	**11**	**2,631**	**2,642**
Total	**Exposure in DKKm**	**5,317**	**10,903**	**16,219**

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 vast majority of the exposures will be in line with FSA's classification, requirements.

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.

The Danish FSA performed inspections in 2011 and 2012. The outcome of the inspection was an extra impairment of DKK 7.4m, which is an insignificant amount, and their conclusion was that BankNordik's portfolio was above average compared to similar Danish banks.

As shown in table 7, 91% of total exposures are individually classified. The unclassified part of the portfolio has been steadily decreasing.

The impairments from the acquired portfolio in Sparbank and Amagerbanken of DKK 410m is not included in the total exposure.

The classification gives some important insights to the credit quality of the portfolio. 83% of all classified 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 73m unsecured exposures and in exposures less than 7.5m there are DKK 275m 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. In special cases, such 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 base capital. The Group has a few customers with exposures exceeding 10% of the base capital all of which are classified 2a5 or 3.

Large exposures

Table 8

	2013	2012
Exposures > 10% of capital base (%)	52%	36%
Exposures > 10% of capital base (DKKm)	885	641
Base capital (DKKm)	1,701	1,764

Credit exposure by geographical area

Table 9

(DKKm)	2013				2012			
	Exposures	in%	Loan/Credits	Guarantees	Exposures	in%	Loan/Credits	Guarantees
Faroe Islands	7,344	46%	6,035	642	7,568	47%	6,220	582
Denmark	7,114	45%	4,476	641	7,112	44%	4,503	676
Greenland	1,455	9%	837	363	1,540	9%	954	444
Total	**15,913**	**100%**	**11,348**	**1,646**	**16,219**	**100%**	**11,677**	**1,702**

As can be seen from Table 10 no single industry exceeds 9% of total exposures.

Having a strong position in the personal segment is a crucial priority for the Group. Personal loans account for about 56% 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

	2013		2012	
(DKKm)	DKKm	In %	DKKm	In %
Public authorities	578	3.6%	631	3.9%
Corporate sector:				
Agriculture and farming, others	115	0.7%	68	0.4%
Aquaculture	142	0.9%	146	0.9%
Fisheries	461	2.9%	469	2.9%
Manufacturing industries, etc.	567	3.6%	575	3.5%
Energy and utilities	322	2.0%	346	2.1%
Building and construction, etc.	521	3.3%	559	3.4%
Trade	1,361	8.6%	1,245	7.7%
Transport, mail and telecommunications	570	3.6%	616	3.8%
Hotels and restaurants	47	0.3%	24	0.1%
Information and communication	98	0.6%	173	1.1%
Property administration, etc.	1,202	7.6%	1,120	6.9%
Financing and insurance	416	2.6%	360	2.2%
Other industries	707	4.4%	850	5.2%
Total corporate sector	6,529	41.0%	6,550	40.4%
Personal customers	8,807	55.3%	9,038	55.7%
Total	**15,913**	**100.0%**	**16,219**	**100.0%**
Credit institutions and central banks	1,304		816	
Total incl. credit institutions and central banks	**17,217**		**17,035**	

Personal loans/guarantees balance distribution — Table 11

(in%)	2013	2012
Real estate	64%	64%
Car	5%	5%
Credits	10%	10%
Guarantees	10%	10%
Other	12%	12%
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 Danish 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.

Credit exposure and collateral for 2013

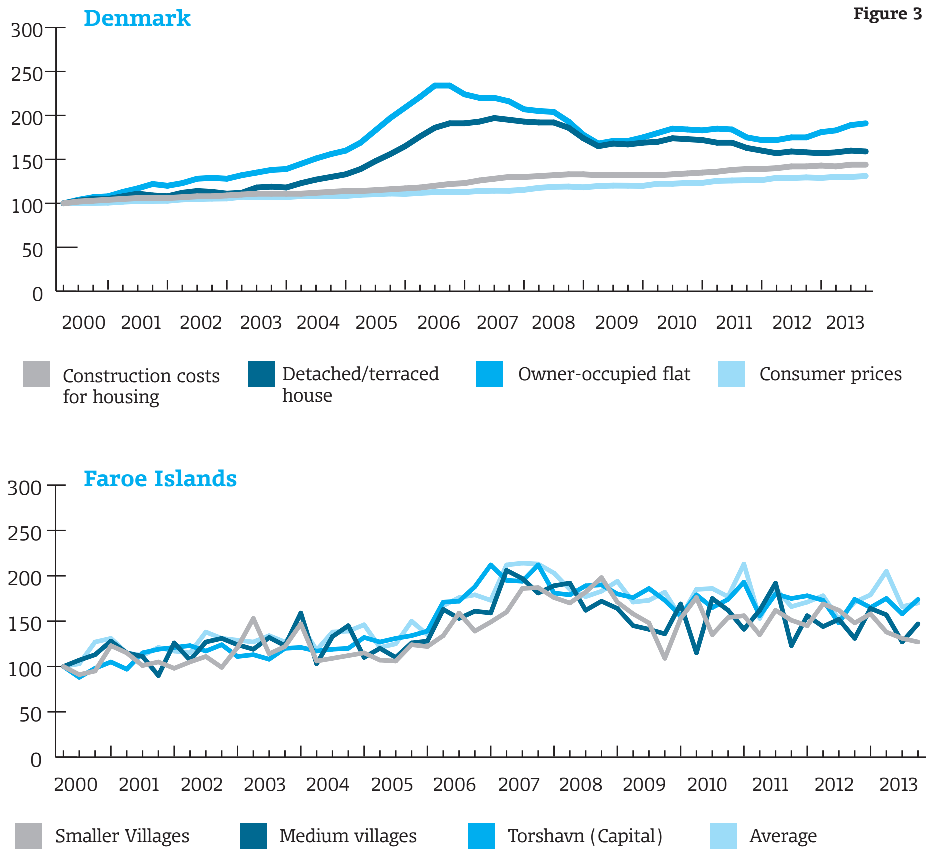
Table 12

(DKKm)	Personal	Corporates	Personal & Corporate	Public	Total
Exposure	8,807	6,529	15,336	578	15,913
Loan balance and guarantees	7,459	5,096	12,555	439	12,994
Collateral	4,680	3,683	8,363	47	8,410
Unsecured (of exposures)	4,127	2,846	6,973	530	7,503
Unsecured (loan balance and guarantees)	2,796	1,413	4,209	392	4,601
Unsecured ratio	47%	44%	45%	92%	47%
Unsecured ratio balance	37%	28%	34%	89%	35%

Credit exposure and collateral for 2012

(DKKm)	Personal	Corporates	Personal & Corporate	Public	Total
Exposure	9,038	6,550	15,588	631	16,219
Loan balance and guarantees	7,515	5,388	12,903	557	13,460
Collateral	5,398	3,771	9,169	185	9,354
Unsecured (of exposures)	3,640	2,779	6,419	446	6,865
Unsecured (loan balance and guarantees)	2,117	1,617	3,733	372	4,105
Unsecured ratio	40%	42%	41%	71%	42%
Unsecured ratio balance	28%	30%	29%	67%	31%

Figure 3



Source: Statistics Denmark and the Association of Danish Mortgage Banks Source: Own research

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%.

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.

After several years of rising property prices, Denmark experienced major decline in house prices in 2006-2008, after which the prices have stabilised at the same level as in 2000. In the same period there were moderate declines in the Faroe Islands.

Figure 3 illustrates the general price developments in the Faroe Islands and Denmark.

There are no publicly available statistics illustrating developments in house prices in Greenland. The Group estimates that house prices are relatively stable at a high level. The Group offers fixed-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.

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.

Distrubution of past due amount — Table 13

(DKKm)	2013 Exposure	2013 Past due total	2013 Past due > 90 days	2013 Total balance with past due	2012 Exposure	2012 Past due total	2012 Past due > 90 days
Portfolio without weakness (3, 2a5)	7,168	30	2	1,535	7,006	73	2
Portfolio with some weakness (2b15, 2b30)	4,865	36	5	1,354	4,743	51	6
Portfolio with weakness (2c50)	677	8	2	275	723	14	4
Portfolio with impairment/provision (1)	1,852	42	9	752	1,105	37	18
Portfolio without individual classification	1,351	7	2	212	2,642	21	1
Total	**15,913**	**124**	**19**	**4,127**	**16,219**	**196**	**32**
Past due in % of exposure		0.78%	0.12%			1.21%	0.20%

As shown in table 13, DKK 19m is more than 90 days past due, which is a reduction of DKK 13m compared to 2012.

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 estimates the future cash flows on the basis of the most likely scenario. The Group tests the entire loan portfolio for impairment four times per year. Table 14 shows the Group's total losses by industry from 2000 to 2013. As the table shows, the average loss ratio during the overall period was 0.8% 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.

According to IAS 39 and Executive Order on Financial Reports for Credit Institutions and Investment Firms, etc. as valid in the Faroe Islands, OEI (Objective evidence of impairment) of a financial asset may appear before default, for example when a debtor is found to be in financial difficulty, likely to go bankrupt or enter into financial restructuring.

Historical losses — Table 14

Sector:	Weighted	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Personal	0.3%	0.4%	0.2%	0.3%	0.1%	0.1%	0.03%	0.1%	0.1%	0.2%	0.3%	0.3%	0.5%	0.7%	1.0%
Agriculture	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	10.3%	0.0%	0.0%
Aquaculture	4.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.00%	0.2%	0.0%	17.7%	31.5%	4.7%	0.5%	0.1%	0.0%
Fishing industry	2.0%	1.5%	6.6%	14.0%	2.8%	5.7%	0.00%	0.0%	0.0%	0.6%	0.0%	3.0%	0.3%	0.0%	0.1%
Manufacturing industries etc.	0.5%	0.2%	0.0%	0.3%	0.6%	0.0%	0.00%	1.9%	0.1%	5.6%	0.0%	0.0%	0.0%	0.1%	0.1%
Building and construction etc.	2.2%	0.2%	0.9%	0.3%	6.2%	16.0%	0.00%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Trade, hotels and restaurants	0.2%	0.1%	2.4%	0.0%	0.0%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Transport, mail and telephone	0.2%	0.1%	2.4%	0.0%	0.0%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Service	1.6%	0.4%	1.2%	3.0%	1.6%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Property adm., purchace and sale and business services	1.5%	2.5%	0.4%	0.5%	5.7%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.1%	1.0%	0.0%	
Personal other	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.00%	0.0%	0.3%	0.0%	0.0%	0.6%	0.7%	0.9%	0.4%
Public Autorities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**0.8%**	**0.7%**	**1.1%**	**0.9%**	**1.5%**	**1.1%**	**0.01%**	**0.2%**	**0.1%**	**1.3%**	**2.7%**	**0.9%**	**0.4%**	**0.4%**	**0.5%**

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

Exposures and individual impairments by sector — Table 15

(DKKm)	2013		2012	
	Exposure	Impairments./ Provisions	Exposure	Impairments./ Provisions
Public	578	-	631	0
Private	8,807	216	9,038	116
Corporate	6,529	275	6,550	260
Total	**15,913**	**491**	**16,219**	**376**

Specification of individual and collective impairments

Table 16

DKKm	2013 Individual impairments/provisions	2013 Impairments from acquired portfolio	2012 Individual impairments	2012 Impairments from acquired portfolio
Faroe Islands	202	-	178	0
Denmark	272	410	181	469
Greenland	17	0	18	3
Total individual impairments	491	410	376	471
Collective impairments:				
Faroe Islands	19		17	0
Denmark and Greenland	7	2	6	3
Total collective impairments	27	2	24	3
Total impairments	**518**	**412**	**400**	**474**

In addition to the individual impairment charges above, the Group is required to test the remaining loan portfolio collectively for impairment. Table 16 provides a breakdown of individual and collective impairment by geographical area.

In connection with the acquisition of Sparbank branches (2010) and the healthy parts of 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. DKK 476m of the impairments reflected in the table below are impairments recognised up to 12 months after the acquisition of the relevant exposure, see Table 16 second and fourth column.

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 real estate, excess liquidity and stable funding.

The Supervisory Diamond

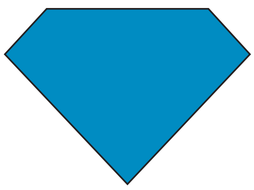
Figure 4

Sum of large exposures < 125%

2013	2012
52.0%	36.3%

Loan growth < 20%

2013	2012
-7.5%	-4.0%



Funding-ratio < 1.0

2013	2012
0.70	0.68

Property exposure < 25%

2013	2012
8.5%	7.9%

Excess liquidity > 50%

2013	2012
178.0%	153.2%

5 Market Risk

5.1 Organisation

The Bank has established an Investment Working Group to monitor the financial markets and continuously update its expectations for the financial markets. The Investment Working Group meets once a month to discuss the outlook for the financial markets and determine the Bank's official position on strategic asset allocation.

The Investment Group refers to the Executive Management. The decisions are communicated throughout the organisation and forms the basis for all advice provided to customers. Participants in the Investment Group are the CFO, the CIO, Treasury and the Head of Portfolio Management.

Markets monitors developments in the financial markets on a daily basis, and at least every two months the Bank's Investment Working Group receives an update containing a recommendation on strategic asset allocation on about a 12-month horizon.

Based on the recommendation, the Investment Working Group then decides whether to retain or revise the Bank's official Markets Update. If the Working Group decides to change the Markets Update, the recommendation is submitted to the Executive Board. Decisions are evaluated before they are announced internally 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 has 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. In 2013 corporate bonds are added to the bank's portfolio.

Market Risk Management — Table 18

Level	Board of Directors	Executive Board	CFO	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

	Change	2013	% of Base Capital	2012	% of Base Capital
Equity risk DKKm (+/-)	10%	33.5	2.0%	41.2	2.3%
Exchange risk DKKm (+/-) EUR	2.25%	0.1	0.0%	1.6	0.1%
Exchange risk DKKm (+/-) Other currencies	10%	22.2	1.3%	19.5	1.1%
Interest rate risk DKKm (parallel shift)	100 bp	68.2	4.0%	37.7	2.1%

- 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 calculation is based on all factors developing in an unfavourable direction for the Bank.

5.6 Interest rate risk

The Group's policy is to invest most of its excess liquidity in highly liquid bonds. As a consequence, BankNordik holds a large portfolio of bonds and most of the Group's interest rate risk stems from this portfolio. Furthermore, as can be seen from table 20, the credit quality of the bond portfolio is high.

BankNordik does not hold unlisted bonds.

Rating af bonds — Table 20

	2013	2012
AAA	72%	84%
AA1-A2	14%	13%
Other	14%	3%

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.

Interest rate risk broken down by currency — Table 21

(DKKm)	2013	2012
DKK	48	21
ISK	16	16
EUR	4	-
Other	0	1

Table 21 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. The exposure in ISK comes from the Group's Icelandic subsidiary.

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.

Foreign exchange position — Table 22

(DKKm)	2013	2012
Assets in foreign currency	229	265
Liabilities and equity in foreign currency	0	0
Exchange rate indicator 1	229	265

The Group's exchange rate risk mainly stems from:

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

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 23

DKKm	2013	2012
Shares/unit trust certificates listed on the Copenhagen Stock Exchange	57	70
Shares/unit trust certificates listed on other stock exchanges	101	171
Other shares at fair value based on the fair-value option	177	171
Total shares etc.	**335**	**412**

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.

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 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 unfavourable liquidity conditions.

Liquidity Management Table 24

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

6.2.1 Operational liquidity risk

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

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

6.2.2 Liquidity stress testing

BankNordik has incorporated a liquidity stress testing model. This model is used at least monthly to forecast developments in the Bank's liquidity on a 12-month horizon and to forecast whether, on a 6-month horizon, the Bank will comply with the Board of Directors' target that excess liquidity should equal at least 100% of the statutory requirement. The test is based on the business-as-usual situation with outflows from undrawn committed facilities and further stress measures. If the 6-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 2013, which were revised in December taking the market outlook into account.

Table 25

Remaining maturity, DKKm	0-1 month	1-3 months	3-12 months	More than 1 year	Without fixed maturity	Total
2013						
Cash in hand and demand deposits with central banks	480					480
Due from Credit institution	806			19		824
Loans and advances	728	905	1,437	7,389		10,460
Bonds	217	111	57	3,108		3,493
Shares					335	335
Derivatives		4	8	42		54
Other Assets	272	7	61	1,099		1,438
Total assets	**2,503**	**1,026**	**1,564**	**11,657**	**335**	**17,085**
Due to credit institutions						
and central banks	290			1,000		1,290
Deposits	8,292	1,650	430	1,820		12,193
Derivatives	3	9	57			69
Other liabilities						689
Provisions for liabilities	287	38	222	142		161
Subordinated debt				161		525
Equity					**2,156**	**2,156**
Total Liability	**8,872**	**1,698**	**709**	**3,399**	**2,406**	**17,085**
Off-balance sheet items						
Guarantees, etc.	1,727					1,727
Other commitments	185					185
Total	**1,912**					**1,912**
2012						
Cash in hand and demand deposits with central banks	632	12	1			644
Due from Credit institution	816	0	16	7		839
Loans and advances	116	873	1,414	8,900		11,303
Bonds	126	97	1,119	1,540		2,882
Shares					412	412
Derivatives				38		38
Other Assets	190	17	74	1,210		1,492
Total assets	**1,880**	**998**	**2,624**	**11,695**	**412**	**17,609**
Due to credit institutions						
and central banks	1,288					1,288
Deposits	8,729	1,990	212	1,815		12,746
Derivatives	3	9	57			69
Other liabilities						677
Provisions for liabilities	350	48	138	141		103
Subordinated debt				103		672
Equity					**2,053**	**2,053**
Total Liability	**10,370**	**2,047**	**407**	**2,337**	**2,448**	**17,609**
Off-balance sheet items						
Guarantees, etc.	1,780					1,780
Other commitments	130					130
Total	**1,910**					**1,910**

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 25 shows assets and liabilities by maturity structure.

In order to minimise liquidity risk, BankNordik's 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.

In 2013 the bank has made early repayment of Subordinated debt of 141m. For further information see note 31 in the annual report 2013.

6.3 Collateral provided by the Group

BankNordik has entered into ISDA and CSA agreements with derivatives counterparties. These agreements commit both parties to provide collateral for negative market values. As a consequence of these arguments BankNordik at year-end 2013 had pledged bonds and cash deposits valued at DKK 43m under these agreements.

BankNordik also provides collateral to the Danish central bank to give the Bank access to the intra-day draft facility with the central bank as part of the Danish clearing services for securities. At year-end 2013, this collateral amounted to DKK 289m.

In September 2012 the bank obtained a loan from the Danish Central bank of DKK 1bn. As security for this loan, the bank has pledged loans for the value of DKK1.4bn and bonds for the value of DKK 44m.

7 Operational Risk

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

7.1 Definition

According to the Basel Committee, operational risk is defined as follows:
"Risk of loss resulting from inadequate or faulty internal procedures, human errors and system errors, or because of external events, including legal risks."

Operational risk is thus often associated with specific and 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 tooptimise 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 insurance 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 in Capital Adequacy 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 two non-life insurance companies: Trygd and Vörður, both wholly owned. Vörður holds a 100 %-stake in life insurance company Vörður Life.

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 consentration 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, TRYGD's and Vörður'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 and Vörður 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 and Vörður is well diversified in personal and commercial lines, see table 26.

Distrubution of portfolio of Vörður and Trygd — Table 26

(in %)	2013	2012
Commercial lines	40%	41%
Personal lines	60%	59%

8.1 Insurance risk

The companies cover the insurance liabilities through a portfolio of securities and investment assets exposed to market risk.

Financial assets linked to insurance risk — Table 27

(mDKK)	2013	2012
Listed securities on stock exchange	239	218
Accounts receivable (total technical provisions)	65	65
Cash and cash equivalents	151	150
Total	**455**	**432**
Incurance contracts, short term, net	373	326

The companies have invested in investment securities and cash and cash equivalents in the effort to balance the exposure to market and currency risk.

Likely effects from changes in markets value	Change	2013	2012
			Table 28
Equity risk DKKm (+/-)	10%	5.1	12.7
Exchange risk DKKm (+/-) in euro	2.25%	0	0
Exchange risk DKKm (+/-) others currency	10%	0	0
Interest rate risk DKKm (parallel shift) - Trygd	100 bp	0.9	0.9
Interest rate risk DKKm (parallel shift) - Vörður Lif	100 bp	1.6	1.1
Interest rate risk DKKm (parallel shift) - Vörður	100 bp	14.2	15.1
Interest rate risk DKKm (parallel shift) Total	**100 bp**	**16.7**	**17.1**

The Bank reviews its market risk exposure on a regular basis, and the likely effect of market changes on the Bank's results. The likely changes are revised on an ongoing basis and may be assessed in the context of historic or anticipated market fluctuations.

Market risk

Market risk is the risk of changes in market prices, such as foreign exchange rates, interest rates and equity prices affecting the Company´s income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

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

Trygd holds shares, bonds and cash in DKK only and Vörður is only exposed in ISK.

8.2 Trygd insurance

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

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.

Run-off gains/losses in Trygd (mDKK) — Table 29

Sector:	2013	2012	2011	2010	2009
Industry	-1.31	-4.9	1.66	0.92	-1.35
Private	0.96	0.48	0.63	-0.59	-0.04
Accidents	-0.10	0	0.02	-0.09	0.01
Automobile	0.86	2.8	2.54	1.30	-1.00
Total	**0.41**	**-1.62**	**4.84**	**1.53**	**-2.38**

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.

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

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.

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 15m. The reinsurance program is reviewed once a year and approved by the Board of Directors. Trygd uses reputable reinsurance companies with good ratings and strong 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 business is done in DKK.

8.3 Vörður insurance

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

Run-off gains/losses in Vörður (DKKm) — Table 30

Sector:	2013	2012	2011	2010	2009
Automobile	2.43	-2.38	4.85	-3.54	-12.29
Other sectors	3.72	3.16	-2.98	-9.75	-7.95
Total	**6.15**	**0.78**	**1.87**	**-13.29**	**-20.23**

Risk exposure and sensitivity analysis

Careful analysis of insurance risk exposure is performed annually in connection with reinsurance renewals. The objective of this analysis is to identify possible worst case scenarios, especially in relation to property and marine risks with regards to known and unknown accumulation of risks which might involve a loss from a single event. Reinsurance placements are tailored to meet those risks. The company purchases "Clashes of Retention" reinsurance to meet possible worst case scenarios such as a major storm, affecting many different classes of insurance. Another factor of risk exposure is the number of risks underwritten by the company within different portfolios of insurance classes. These numbers are monitored and reported monthly to the management team.

Insurance risk

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

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

The reserving for outstanding losses is based on a case-by-case assessment of the final cost of each claim, supplemented by statistical and historical analysis and actuarial calculations. Reserves are adjusted individually as new information is gathered and the claim develops. In addition, a complete review is performed at least twice a year and by the end of each year an actuarial calculation is performed. A monthly report is issued and presented to the Board of Directors of all outstanding default premiums. Accordingly, the default rate is carefully monitored. In addition, a procedure has been applied to ensure that the company gets off risk if premiums are not paid within 90 days of the due date.

Natural disaster risk

Vörður tryggingar hf. does write a few policies which include natural disaster risk, mainly storm. In Iceland, there is, however, a separate government-owned insurance company, the Icelandic Natural Catastrophe Fund, which insures most property in Iceland against natural disasters such as earthquakes, volcanic eruption, avalanches, landslides and floods. However, the NatCat fund does not cover all property against the aforementioned disasters, the most notable category being ships. Therefor Vörður covers ships against natural catastrophes but that exposure is fully and specifically reinsured with a maximum exposure of approx. ISK 50 m.

As for storm coverage in relation to possible exposure, Vörður's standard property reinsurance with a limit of ISK 2,000 m is deemed sufficient to cover possible loss from a major storm, whereas the MPL (Maximum Probable Loss) is less than ISK 200m for such incidents based on current reinsurance contracts.

Market risk:

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

The current investment strategy is largely based on investments in bonds which are likely to give stable and reliable returns, such as government-, municipalities and mortgage bonds with high ratings or deposits. Furthermore the company applies prudent operational planning as regards expected investment income.

Fluctuations in marketprices affect the value of the portfolio. The company's objective Is to practisise a cautious investment policy in order to minimize the value changes of the portfolio as well as focus on listed securities with emphasis on the liquidity of assets.

Currency risk:

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

Liquidity risk:

The current investment policy ensures that sufficient funds are available . The aim is for two months´expenses, claims and costs to be available at all times. In addition, large share of investments are highly liquid market securities.

Contractual maturity for the insurance segment — Tabel 31

2013	On demand	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets						
Securities	308,338	16,341			32,845	357,524
Reinsurance assets		5,818	2,351			8,169
Accounts receivables		66,980				66,980
Restricted cash		25,640	50			25,690
Cash and cash equivalents	157,070					157,070
Total financial assets	**465,408**	**114,780**	**2,400**		**32,845**	**615,433**
Liabilities						
Technical provision		221,530	141,281	8,171		370,983
Account payable		22,455				22,455
Total financial liabilities		**243,985**	**141,281**	**8,171**		**393,438**
Assets - liabilities	**465,408**	**-129,206**	**-138,881**	**-8,171**	**32,845**	**221,995**

2012	On demand	0-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets						
Securities	269,378		72		29,573	299,022
Reinsurance assets		15,311	6,791			22,101
Accounts receivables		65,029				65,029
Restricted cash		14,438	7,896			22,334
Cash and cash equivalents	149,779					149,779
Total financial assets	**419,157**	**94,778**	**14,758**		**29,573**	**558,266**
Liabilities						
Technical provision		246,741	101,945	4,057		352,744
Account payable		21,511				21,511
Total financial liabilities		**268,252**	**101,945**	**4,057**		**374,254**
Assets - liabilities	**419,157**	**-173,474**	**-87,187**	**-4,057**	**29,573**	**184,012**

Contractual maturity of assets and expected maturity of liabilities, excluding interests, from insurance activities are shown in table 31. The table also illustrates the expected cash flow from insurance provisions.

Counterpary- / Consentration risk:
Vörður only deals with reinsurance companies with an S&P A-rating or better for long-tail business and at least BBB or better for short tail business. Current reinsurers of the company are all A rated or better with the exception for one small marine line for which the reinsurer is rated BBB. The risk of each reinsurance treaty is also spread on 2-10 different reinsurance companies according to the capacity of the treaty, spreading the risk of reinsurance default. The company sends quarterly reports of assets to the Icelandic Financial Supervisory Authority as required.

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

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

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

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

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

8.4 Vörður Life
Vörður Liftryggingar hf. is a small life insurance company established in 2007. The company began operations in early 2008. The company is 100% owned by Vörður tryggingar hf.

Vörður Liftryggingar hf. conducts regular life and critical illness business in the Icelandic market. The insurance portfolio has grown slowly but steadily and the number of issued policies is now at just over 3,000. Traditionally, life insurance is a very stable business as the underlying risks are statistically very well known and calculated. All life insurance companies operate with mortality rates derived from the entire population and calculated by qualified actuaries.

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

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