

 betri banki

Risk Report

2023



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01

Introduction

1 Introduction

The aim of this risk report is to provide an insight into Betri Banki P/F's capital and risk management practices.

The report has been prepared in accordance with the disclosure requirements under Part 8 of the Capital Requirements Regulation (CRR) and the Executive Order for the Faroe Islands on Calculation of Risk Exposures, Own Funds and Solvency Need.

The information in this risk report relates to Betri Banki P/F.

The risk report is published annually when the bank's annual report is released. Further information pursuant to the CRR disclosure requirements is published in the document Additional Pillar 3 Disclosures on the bank's webpage (www.betri.fo/fo/banki/um-okkum/om-betri-banki).

The risk report has not been audited.

The risk report is also available in Faroese. In the event of any discrepancy between the Faroese and the English version, the Faroese version shall prevail.

02

Risk Management

2 Risk Management

Betri Banki assumes risk based on the business model and the strategic objectives set by the Board of Directors.

The Board of Directors approves risk policies for the various areas in the bank based on the business model and the strategic objectives; and provides the Executive Board with authorities within these risk areas.

The purpose of Betri Banki's risk management is to ensure that the bank does not take on more risks than stipulated by the Board of Directors, and that the risk profile is appropriate in relation to the bank's own funds.

2.1 Risks

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

Credit risk, defined as the risk of financial losses arising from counterparties or debtors failing to meet all or part of their payment obligations.

Market risk, defined as the risk of the market value of assets and liabilities, as well as off-balance items, being affected because of changes in market conditions. Betri Banki's market risk is divided into 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 flows in the bank.

Operational risk, defined as the risk of losses arising from inadequate or inefficient internal processes, human errors, IT-failures or from external events, including legal risks and risks from outsourcing.

2.2 Division of responsibility

The Board of Directors adopts risk policies for the various risk areas based on the business model and the strategic objectives of the bank. The Board of Directors also determines guidelines for management and control of risks in the bank.

The Board of Directors reviews the individual risk policies annually.

The Board of Directors is responsible for ensuring that the bank is organised appropriately, and risk policies and limits being established for all risk areas. In addition, all major credit facilities must be submitted to the Board of Directors for approval.

The Board of Directors receives regular reports, enabling it to check compliance with risk policies and pre-defined limits.

The Board of Directors regularly, and at least annually, makes an assessment of the bank's individual and overall risks. At the same time, it is also determined whether the risks are acceptable.

The bank's risk management arrangements are also discussed in the Risk Committee. The Risk Committee assesses the bank's current and future risk profile and strategy and ensures implementation of the risk strategy in the bank. The terms of reference of the Risk Committee is available on the bank's webpage.

The Executive Board is responsible for the day-to-day management of the bank and must ensure that the bank is managed according to adopted policies, guidelines and authorities that have been granted in relation to the different risk areas.

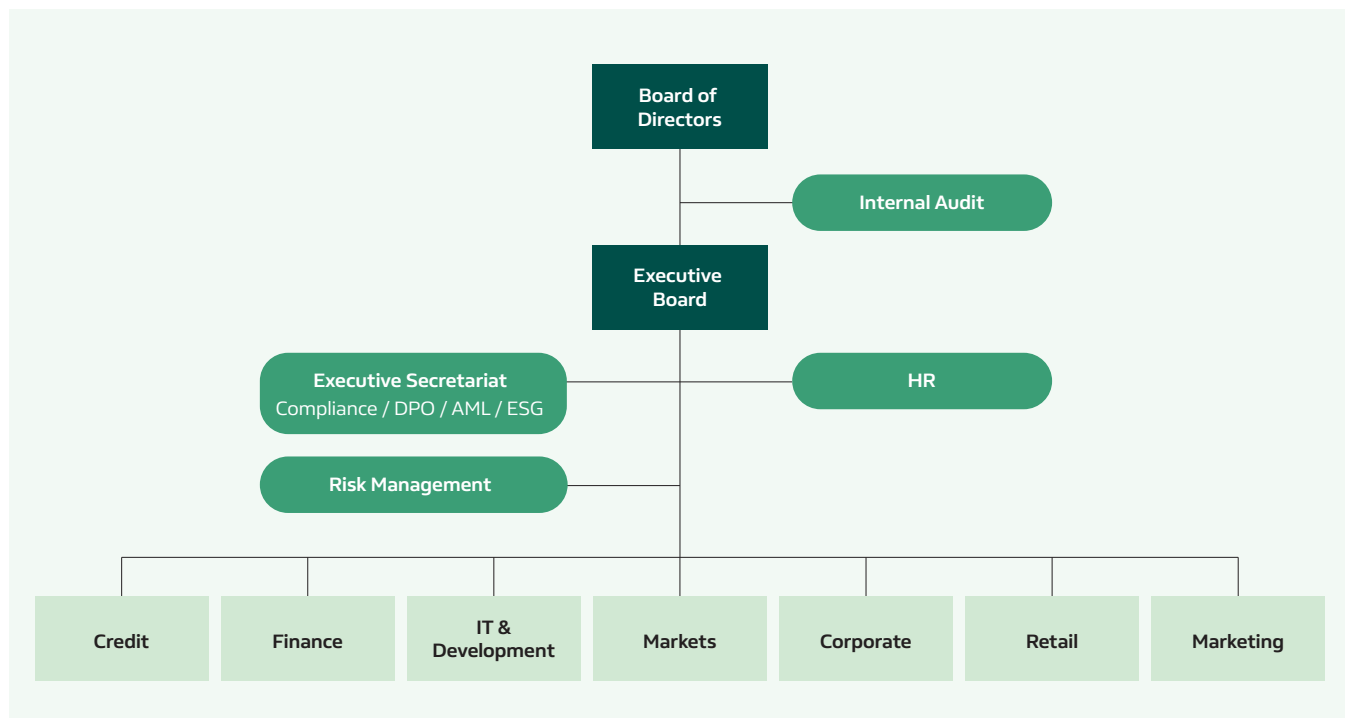
The Executive Board reports regularly to the Board of Directors on the development of risk exposures and pre-defined limits.

General management and control of risks is centralised with organised reporting to the Executive Board and Board of Directors. Daily management, control and reporting are carried out in separate business units in the bank.

Further information regarding governance arrangements pursuant to CRR Article 435 (2) and remuneration policy pursuant to CRR Article 450 can be found on page 18-19 and 22-26 in the bank's annual report and on the bank's webpage (www.betri.fo/fo/banki/um-okkum/om-betri-banki).

Betri Banki's organisational structure is illustrated below.

Organisational structure



2.3 Risk Management function

The bank has a separate risk management function. The Risk Manager heads the risk management function and reports to the Executive Board.

Risk Management monitors credit risk, market risk, liquidity risk, operational risk and IT risk on behalf of the Executive Board. This also includes monitoring risks across various risk areas and organisational units, in addition to risks deriving from outsourced functions. Risk monitoring is performed in accordance with the tasks of the risk management function as stipulated in the Executive Order for the Faroes on the management and control of banks etc.

Each year Risk Management prepares a plan for the coming year's activities. The annual plan is submitted to the Executive Board.

Risk Management reports to the Executive Board 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 and attends meetings in the Risk Committee. The Risk Committee held four meetings in 2023.

03

**Capital and solvency
requirement**

3 Capital and solvency requirement

Faroese credit institutions must comply with the European capital requirement rules that have been adopted in the Faroe Islands. These include the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) that are the European implementation of the Basel III framework.

Betri Banki has been identified as a systemically important financial institution (SIFI) in the Faroe Islands. SIFI institutions are subject to more rigorous supervision by the FSA. SIFI institutions are also subject to additional requirements, e.g. additional solvency requirements. Betri Banki must comply with a SIFI buffer requirement of 2%.

Banks in the Faroe Islands are also subject to a capital conservation buffer of 2.5%.

In addition to this, banks are required to reserve capital for countercyclical fluctuations in the economy, as well as requirements that enhance the banks' resilience to large fluctuations in the Faroese economy. To address fluctuations in the Faroese economy, the Danish Systemic Risk Council has, in consultation with Faroese authorities, imposed an additional systemic buffer of 2%. This systemic buffer applies to Faroese exposures.

The countercyclical buffer for the Faroes, which is fixed every quarter by the Danish Minister for Industry, Business and Financial Affairs, was 1% at year end 2023. Some of Betri Banki's risk weighted exposures are to the Danish market. At year end 2023, the countercyclical buffer for Danish exposures was 2.5%.

At year end 2023, Betri Banki was subject to a combined buffer requirement of 7.48%.

On 30 November 2023, Betri Banki received a notification regarding the MREL requirement per. 1 June 2026. The MREL requirement is set to 23.1% of total risk-weighted exposures. Thus, the requirement including buffers is 30.6% of the total risk-weighted exposures. The requirement is adjusted every year. The total requirement including the combined buffer requirement was 27.2% at year end 2023.

3.1 Own funds and solvency

Own funds are calculated in accordance with the Capital Requirements Regulation in addition to guidelines on adequate capital base and solvency requirement for credit institutions (Vejledning om tilstrækkeligt kapitalgrundlag og solvensbehov for kreditinstitutter) issued by the Danish FSA.

Solvency is calculated as own funds as a percentage of the risk-weighted assets. Own funds and the weighted assets are calculated in accordance with the Capital Requirements Regulation.

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.

Statement of Solvency as of 31.12.2023 (DKK 1,000)

Tier 1 Capital	2,262,389
Total capital	2,262,389

Weighted assets not included in trading portfolio including off balance items	5,398,378
Weighted items with market risk	494,849
Operational risk	577,496
Total risk weighted assets	6,470,722

Total capital ratio	35.0%
T1 Capital ratio	35.0%

Capital position

Core Capital before statutory deductions	2,304,846
Proposed dividend	40,000
Value adjustments due to the requirements for prudent valuation	2,456
Tier 1 Capital	2,262,389

Betri Banki P/F has not used the transitional arrangement in CRR Article 468 and unrealised gains and losses are therefore reflected in the calculation of the bank's own funds.

Betri Banki P/F has not used the transitional arrangement in CRR Article 473a and IFRS 9 impairments are therefore fully reflected in the calculation of the bank's own funds.

3.2 Solvency requirement

The bank's approach to assessing whether the capital is sufficient to support current and future activities (the solvency requirement) follows the bank's ICAAP (Internal Capital Adequacy Assessment Process).

The risks that the bank is exposed to are identified in the ICAAP, and the risk profile is assessed. When the risks are identified, an assessment is made of how they can be reduced, e.g. via processes, contingency plans etc. Finally, an assessment is made to determine which risks are to be covered by capital.

The solvency requirement is the bank's own assessment of the capital requirement attributable to the risks assumed by the bank. The Board of Directors has quarterly discussions to determine the solvency requirement to ensure that it is sufficient to support the bank's activities. The discussions are based on a recommendation from the Executive Board. The recommendation contains a proposal on the bank's solvency requirement.

In addition, the Board of Directors annually discusses the method of calculation of the bank's solvency requirement.

The solvency requirement is calculated using an 8+ approach, where capital is reserved within the risk areas: credit risk, market risk, operational risk, other risks and supplements due to statutory requirements. The solvency requirement is calculated using the bank's risk profile, capital position and considerations regarding the future, which can be of significance, including the budget.

The calculation of the bank's solvency requirement is based on a model developed by the Association of Local Banks (The Association of Local Banks, Savings Banks and Cooperative Banks in Denmark) and on guidelines on adequate capital base and solvency requirement for credit institutions issued by the Danish FSA.

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

Using the model developed by the Association of Local Banks and the guidelines issued by the Danish FSA, the bank considers the calculated solvency requirement to be fair.

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

Solvency requirement based on the 8+ approach

1)	Pillar I requirement (8% of the risk-weighted items)
+ 2)	Earnings (capital for risk coverage 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 rate 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)	Leverage (capital to cover risk related to excessive leverage)
+ 9)	Possible supplement caused by regulatory maturity of capital instruments
+ 10)	Possible supplement due to statutory requirements
Total = Capital requirement/solvency requirement	
	- of which credit risk (4)
	- of which market risk (5)
	- of which operational risk (7)
	- of which other risks (2+3+6+8+9)
	- of which supplement due to statutory requirements (1+10)

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

In addition, the Board of Directors and management must assess whether own funds are adequate to support future activities. In Betri Banki, this assessment is part of the assessment of the solvency requirement.

The bank has reserved additional capital for credit risk, market risk and operational risk, which are not fully reflected in the Pillar I requirement of 8% of the risk-weighted items.

Credit risk: A supplement has been added to the Pillar I requirement (8%) to cover credit risk on major customers with financial problems, other credit risks and concentration risk on individual exposures.

Market risk: A supplement has been added to the Pillar I requirement (8%) to cover interest rate risk and credit spread risk.

Operational risk: A supplement has been added to the Pillar I requirement (8%) to cover potential operational risk.

The table below shows the bank's individual solvency requirement as of 31.12.2023.

Adequate own funds and solvency requirement

Risk area	Adequate own funds DKK 1,000	Solvency requirement
Statutory requirements	517,658	8.00%
Credit risk	35,081	0.54%
Market risk	86,652	1.34%
Operational risk	12,941	0.20%
Other risks	0	0.00%
Total	652,332	10.08%

3.3 Leverage ratio

The leverage ratio is calculated as the Tier 1 capital divided by the total unweighted exposures.

The CRR stipulates that banks must have a leverage ratio of at least 3%, which is equal to a maximum leverage of 33 times the Tier 1 capital.

The Board of Directors of Betri Banki has adopted a leverage policy, which includes main principles for handling and managing the risk of excessive leverage.

At year end 2023, the bank's leverage ratio was 18%, which is considerably higher than the minimum requirement in the CRR.

The leverage ratio is monitored and reported regularly to the Board of Directors.

04

Credit Risk

4 Credit Risk

Betri Banki offers loans, credits, guarantees and other services as part of its business model and thereby incurs credit risk. Credit risk is defined as the risk of financial losses arising from counterparties or debtors failing to meet all or part of their payment obligations.

4.1 Objective and risk policy

The Board of Directors of Betri Banki has adopted a credit policy, which is prepared in accordance with the Executive Order for the Faroes on the management and control of banks etc. The credit policy defines the main principles that apply to the bank's management of credit risks, taking into account the bank's business organisation, area of operation and legal requirements.

The credit policy defines the risks that the bank is willing to accept, in addition to principles for handling and managing credit risk. A main principle is that pricing (earnings) must always reflect the risks that the bank assumes.

The bank's market segment is Faroese retail, corporate and public sector customers with good repayment abilities.

The Board of Directors reviews the credit policy at least annually.

4.2 Authority and division of responsibility

Lending authorities are provided according to competence and needs, and with regard to the bank's risk profile. The Board of Directors has provided the CEO with lending authorities, which have, in part, been delegated to the Head of Credit, who delegates lending authorities to relevant employees.

Betri Banki's credit granting is overseen by the Credit Department, which regularly checks compliance with the credit policy and lending authorities.

The Credit Department is responsible for day-to-day credit granting. This includes developing credit assessment tools, such as rating of customers and drawing up procedures for credit granting and value assessment of collateral. The Credit Department must also ensure compliance with limits regarding e.g., customer concentration and industry concentration. The Credit Department oversees the bank's valuation of loans and impairment procedures, in addition to 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. This report is presented to the Board of Directors on a quarterly basis.

4.3 Credit management and control

Credits are granted based on the individual customer's financial situation with regard to the ability to repay the facilities. 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 the daily credit control.

Credit exposures above a certain size are renewed annually.

The quality of the overall loan portfolio is assessed by the Credit Department every quarter. Once a year, there is a review and analysis of individual exposures in connection with the annual review of assets. This review is presented to the Board of Directors.

There is independent internal control of all significant activities in the credit area. The Credit Department is responsible for internal controls (1st line control) and prepares a biannual report on the controls. The bank's compliance officer ensures that the procedures for internal controls are independent, and the risk manager ensures that necessary control procedures are implemented (2nd line control).

4.4 Risk concentration

In order to ensure diversification 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 own funds. Additionally, the total amount of the 20 largest exposures must not exceed 175% of own funds.

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, except for local authorities and the public sector where the limit is 20%.

4.5 Circumstances that are considered when granting credit

The bank considers credit applications based on an assessment of the individual customer's financial situation.

Retail customers: Credit granting is based on the customer's personal income and assets, in addition to disposable income, debt factor etc.

Corporate customers: Credit granting is based, among other things, on the company's revenues, solidity, state of collateral, in addition to the owner's experience.

Jyske Realkredit: Betri Banki collaborates with Jyske Realkredit providing mortgage credit loans for Faroese homeowners. The agreement stipulates that Betri Banki handles all customer communication, conducts customer ratings and forwards loan applications to Jyske Realkredit. The bank also provides supplementary collateral for all loans from Jyske Realkredit. Jyske Realkredit provides financing for up to 80% of the market value of properties.

4.6 Rating of customers

The bank uses the rating scale provided by the Danish FSA to describe the credit quality of individual customers. The rating scale 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)

4.7 Collaterals

To reduce credit risk the bank requires collaterals. The types of collateral most frequently provided are real estate, company charge, ships, financial collateral 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 determined from the price that would be obtained in a sale.

The bank's agreements with customers on collateral ensure that the bank can realise the collateral in the event of customers defaulting on their payment obligations.

The bank uses the financial collateral comprehensive method as its credit risk mitigation technique for computing its capital ratio. This means that the bank can reduce a commitment's strain on the capital by accepting certain financial items as collateral.

The CRR specifies which items are eligible as collateral under the financial collateral comprehensive method. To be eligible the financial collateral must be issued by a company or country with a particularly good rating.

Under the limitations of the CRR, the bank accepts the following main categories of financial collateral: deposits, bonds/debt securities and equities.

The bank uses neither on- nor off-balance sheet netting.

4.8 Impairments

Impairment charges are calculated in accordance with the IFRS 9 accounting standard. According to IFRS 9, expected credit losses on all financial assets recognized at amortized cost are impaired, and provisions are made according to the same rules for expected credit losses on unutilized credit lines, loan commitments and financial guarantees.

A description of the impairment method used by the bank can be found in the section on impairments in "Significant accounting policies" in the bank's annual report.

4.9 Counterparty risk - derivatives

Counterparty risk is the risk of loss resulting from a financial counterparty defaulting on its obligations under a financial contract before the final settlement of the transaction's cash flows.

Betri Banki uses the standardised approach for calculating capital requirements for counterparty risk for derivative instruments (SA-CCR).

When Betri Banki enters into an agreement with a counterparty regarding derivatives, credit limits must be observed.

The limits to financial contracts for commitments with customers in the exposure groups, corporate and retail customers, are treated in accordance with the bank's standard credit rating principles.

No extra capital has been allocated to cover counterparty risk in the calculation of adequate own funds except for what is included in the Pillar I requirement under the 8+ model.

4.10 ECAI

Betri Banki has selected Standard & Poor's Ratings Services as its external credit assessment institution (ECAI). The bank uses Skandinavisk Data Center (SDC), which receives external credit ratings from Standard & Poor's Ratings Services via SIX Financial. Regular IT updates are undertaken in relation to the credit ratings from Standard & Poor's Ratings Services.

SDC has converted Standard & Poor's Ratings Services' credit rating classes to credit quality steps using the conversion table from the Danish FSA. Each individual credit quality

step is given a weight to be applied to the exposures in the individual steps when calculating risk-weighted exposures according to the standard approach for credit risk pursuant to Articles 111-134 of the CRR.

The table below shows the Danish FSA's conversion of Standard & Poor's Ratings Services' credit assessment categories to credit quality steps.

Conversion table from the Danish FSA

Credit quality step	Credit rating categories	Exposure to corporates	Exposure to central governments or central banks
1	AAA to AA-	20%	0%
2	A+ to A-	50%	20%
3	BBB+ to BBB-	100%	50%
4	BB+ to BB-	100%	100%
5	B+ to B-	150%	100%
6	CCC+ and lower	150%	150%

05

Market Risk

5 Market Risk

Market risk is defined as the risk of the market value of assets and liabilities, as well as off-balance items, being affected because of changes in market conditions.

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

5.1 Objective and risk policy

The Board of Directors of Betri Banki has adopted a market risk policy, which is prepared in accordance with the Executive Order for the Faroes on the management and control of banks etc. The policy defines the main principles that apply to the bank's management of market risks, taking into account the bank's business organisation, area of operation and legal requirements.

The market risk policy defines the risks that the bank is willing to accept, in addition to principles for handling and managing market risk.

The bank uses derivatives to hedge and manage market risk, if the bank wants to reduce the market risk, which the bank has assumed.

The market risk policy and the limits defined in the policy are reviewed at least annually.

5.1.1 Interest rate risk

Interest rate risk is the risk of loss caused by changes in market rates.

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 managed within certain limits in relation to the interest rate outlook.

5.1.2 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.

5.1.3 Foreign exchange risk

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

Foreign exchange risk is calculated according to the Danish FSA's currency indicator 1 and currency indicator 2.

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

5.1.4 Other price risks

Other price risks is the risk of loss caused by fluctuating market prices of other assets than those mentioned above, e.g. changes in commodity prices.

At year end 2023, Betri Banki had no risks in this category.

5.2 Reporting and division of responsibility

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

The Board of Directors and Executive Board regularly receive reports regarding market risk and compliance with the limits defined in the policy and instructions from the Board of Directors to the Executive Board. The Finance Department is responsible for these reports.

Betri Markets has day-to-day responsibility for the bank's liquidity, securities portfolio and foreign exchange deposits, on behalf of the Executive Board. Thus, Betri Markets is also responsible for ensuring that the market risk is within the limits that are specified in the instructions from the Board of Directors to the Executive Board. This is conducted by regularly calculating the interest rate risk on the bank's bond portfolio, a statement of 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 Executive Board and the authorisation provided to Betri Markets in this area.

The Finance Department is responsible for checking that market risk is always within the limits specified in the policy, instructions to the Executive Board and delegated authorities. If limits are exceeded, the Executive Board is informed. If the Executive Board exceeds its limits, the Board of Directors is informed.

5.3 Exposures in securities not included in the trading book

The bank has acquired shares in a number of sector companies in partnership with other banks. The purpose of these sector companies is to support financial institutions within IT, payment services, etc. The bank does not intend to sell these shares, as participation in these sector companies is considered necessary for a bank's operations.

In several of the sector companies, the shares are redistributed to the effect that the ownership interest of the respective institution reflects its business volume with the sector company.

The shares are typically redistributed on the basis of the sector company's equity value. The bank adjusts the recognised value of these shares when new information is available that warrants a change of fair value measurement. In other sector companies, the shares are not redistributed, but are measured based on a fair value corresponding to the net asset value or another recognised valuation method.

Unrealised gains/losses are included in the income statement and are therefore included in the Tier 1 capital.

5.4 Interest rate risk not included in the trading book

Interest rate risk not included in the trading book is primarily derived from fixed-interest loans and deposits.

Interest rate risk or the modified duration is measured as the expected capital loss, when the interest rate curve is shifted by one percentage point.

The market risk policy includes limits for interest rate risk not included in the trading book.

Interest rate risk is calculated regularly and is included in the report to the Executive Board and the Board of Directors on market risk.

In the bank's solvency requirement process (ICAAP) an assessment is made of whether additional funds should be allocated due to interest rate risk. This includes stressing the interest rate risk not included in the trading book in accordance with guidelines issued by the Danish FSA.

06

Liquidity Risk

6 Liquidity Risk

Betri Banki's liquidity risk is defined as the risk that arises from differences in scheduled outgoing and incoming cash flows.

Liquidity risk can arise from significant increases in funding expenses, a lack of funding preventing the bank from maintaining its approved business model or the bank being unable to fulfil its payment obligations due to a lack of funding.

6.1 Objective and risk policy

The Board of Directors of Betri Banki has adopted a liquidity risk policy, which is prepared in accordance with the Executive Order for the Faroes on the management and control of banks etc. The policy defines the main principles that apply to the bank's management of liquidity risks, taking into account the bank's business organisation, area of operation and legal requirements.

The liquidity risk policy defines the risks that the bank is willing to accept, in addition to principles for handling and managing liquidity risks.

The bank has a contingency plan for funding, which has been prepared in accordance with the Executive Order for the Faroes on the management and control of banks etc. The contingency plan lists initiatives to be taken to improve liquidity – including expected effect and timeframe.

The contingency plan for funding is tested annually and is applied if the bank has difficulties complying with requirements in the liquidity risk policy.

6.2 Reporting and division of responsibility

The liquidity policy and the Board of Directors' instructions to the Executive Board stipulate the division of responsibility regarding risk taking, control and reporting to the Executive Board and the Board of Directors.

Betri Markets has been given day-to-day responsibility for liquidity on behalf of the Executive Board. Betri 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.

The Finance Department prepares a report on the bank's liquidity situation for all regular board meetings. The report to the Board of Directors also contains a statement on liquidity, liquidity indicators and the results from stress tests. Every month the Finance Department makes a 12-month projection of the liquidity under normal market conditions and a 12-month projection of the liquidity under stressed conditions.

6.3 LCR

At year end 2023, Betri Banki had a LCR of 210%, which is comfortably above the statutory minimum of 100% and the internal limit of 125% defined in the liquidity policy.

The bank has not changed the underlying principles for the calculation of LCR in the last four quarters.

The bank's lending is funded by deposits and equity. The deposits largely originate from retail customers and small corporate customers. Thus, the bank is not dependant on individual deposits from large customers. The bank considers deposits to be stable.

The liquidity reserve according to LCR mainly consists of central bank reserves and government debt (Level 1A assets) and mortgage bonds (Level 1B assets). Level 1 assets make up most of the liquidity reserve. The bank's mortgage bond portfolio makes up more than half of the liquidity reserve.

The bank has no total liabilities in a currency other than Danish kroner that exceeds 5 pct. of the total liabilities or branches in countries that use currencies other than Danish kroner. As a result, the bank must only meet the LCR legal requirement in Danish kroner.

The bank does not have other items in the LCR calculation that are not captured in the LCR disclosure template, which the bank considers relevant for its liquidity profile.

6.4 NSFR

The Net Stable Funding Ratio (NSFR) aims to ensure that financial institutions have sufficient long-term funding for their activities. The NSFR is calculated in percent as the ratio of total available stable funding to total required stable funding. The statutory requirement is that the ratio must exceed 100%.

The NSFR requirement became effective for Faroese institutions on 1 June 2023, when CRR2 entered into force.

At year end 2023, the bank's NSFR was 156.5%, which is comfortably above the statutory minimum requirement of 100%.

6.5 Liquidity indicator

The liquidity indicator of the Danish FSA, which is part of the Supervisory Diamond, is based on a projected version of LCR using an adjusted calculation of the liquidity resources, while the time horizon for the liquidity requirement is extended to cover a 3-month period.

At year end 2023, the bank's liquidity indicator was 221.9%, which is well above the 100% requirement.

6.6 Encumbered assets

Betri Banki has, to a certain extent, encumbered assets in connection with collateral agreements with other financial institutions, including the Danish Central Bank in connection with clearing and settlement.

For more information on encumbered assets see the Additional Pillar 3 Disclosures 2023 (templates AE1, AE2 and AE3) on the bank's webpage.

07

Operational Risk

7 Rakstrarváði

Operational risk is defined as the risk of losses arising from inadequate or inefficient internal processes, human errors, IT-failures or from external events, including legal risks and risks from outsourcing.

Risks arising from outsourcing are risks of loss directly or indirectly attributable to the operational handling of the bank or supplier in connection with the outsourcing of processes, services or activities to a supplier.

Operational risk also includes model risk, which is the risk of losses resulting from decisions that are primarily based on results from internal models, due to errors in the development, implementation or use of such models.

7.1 Objective and risk policy

The Board of Directors of Betri Banki has adopted a policy for operational risks, which is prepared in accordance with the Executive Order for the Faroes on the management and control of banks etc. The policy defines the main principles that apply to the bank's management of operational risks, taking into account the bank's business organisation, area of operation and legal requirements.

The Board of Directors has also adopted an IT security policy, an AML risk management policy and a data protection policy.

All activities in the bank are associated with operational risks and therefore a key task is to limit the operational risk level as much as possible.

The operational risk policy defines the risks that the bank is willing to accept, in addition to principles for handling and managing operational risks.

Operational risks are assessed on the basis of the likelihood of the risk materialising into an operational event, and the consequences this might entail.

The operational risk policy also describes how it is ensured that the Board of Directors and the Executive Board are informed about operational risks and loss events.

7.2 Reporting and division of responsibility

The operational risk policy stipulates procedures, registration and reporting obligations.

Operational risk is managed through business procedures and internal control measures. Operational risks are reduced by among other things separating the execution and control of activities.

The bank has procedures for recording and reporting operational events. Employees are responsible for reporting operational events to their nearest manager and Risk Management. Risk Management registers and categorises events and informs the Executive Board about the events every quarter. Risk Management also reports to the Board of Directors on operational events.

Operational risk can be limited but not eliminated. Regular processes are in place to check for risks that may have a negative impact on Betri Banki. 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.

7.3 Capital to cover operational risk

The capital needed to cover Betri Banki's operational risk is calculated using the basic indicator approach. At year end 2023, operational risk was DKK 577 million, which amounts to a capital requirement of DKK 46 million.

The bank assesses the capital requirement for operational risks on a regular basis. If the requirement is assessed to be higher than stated above, this will be taken into account in the assessment of the solvency requirement (ICAAP).

OS

Risk Statement

8 Risk Statement

The Board of Directors approved Betri Banki's risk report on 29 February 2024.

The Board of Directors finds that Betri Banki's risk management complies with current regulations and is appropriate in relation to the bank's business model and business strategy.

The Board of Directors also believes that the description of the bank's overall risk profile, in conjunction with the business model, business strategy and key figures provides a fair representation of the risk management in the bank.

The statement from the Board of Directors is based on the business model, material and reports submitted to it by the Executive Board, Internal Audit, Risk Manager and Compliance Officer, as well as supplementary information or statements obtained by the Board of Directors.

A review of the business model and policies shows that the overall requirements for the individual risk areas are reflected in policies and instructions from the Board of Directors to the Executive Board.

The bank's main activity is to be a full-service bank for the people of the Faroe Islands, which includes offering financial services to the Faroese market serving retail, corporate and public customers, as well as providing advice on deposits, loans, mortgage credit, payment services, investments, etc. Sensible risk management and healthy business operations are important factors in managing the bank soundly. The Board of Directors wants growth to be steady in order to manage risks on sustainable and safe foundations. Risk diversification ensures that risks are not concentrated on individual customers or branches.

Betri Banki wants to maintain safe and robust own funds that support the business model and ensure independence at all times. At year end 2023, the bank's solvency ratio was 35%.

The risk appetite determined by the Board of Directors is managed via the limits specified in individual policies, as well as limits in the instructions to the Executive Board.

The Board of Directors also addresses the limits set in the supervisory diamond from the Danish FSA. The table below shows the maximum limit values of the supervisory diamond and the bank's compliance at year end 2023.

Supervisory diamond

	Threshold value	Betri Banki
Sum of large exposures	< 175%	114.3%
Lending growth	< 20%	11.2%
Commercial property exposure	< 25%	7.7%
Liquidity requirement – Supervisory Diamond	> 100%	221.9%

The review also shows that the actual risks are within the limits laid down in policies and delegated authorities, and based on this the Board of Directors finds that there is consistency between the business model, policies, guidelines and the actual risks within the individual areas.

