

Adequate own funds and solvency need

Q3 2024

Introduction

This annex to the risk report has been prepared in accordance with the provisions of the Executive Order on capital adequacy. The annex to the risk report is prepared on a quarterly basis in connection with the disclosure of the Bank's solvency need and is presented on the Bank's website. The entire risk report is published once annually in connection with the presentation of the Bank's annual report. The information provided has not been audited by the company's internal or independent auditors.

Adequate own funds and solvency need

The calculation of adequate own funds and individual solvency need is divided into the risk areas shown below. Føroya Banki has calculated its adequate own funds as of 30 September 2024 at DKK 688,497k and its solvency need at 9.8%.

The table below provides a breakdown of Føroya Banki's adequate own funds in terms of the risk areas the Bank is exposed to.

Capital and solvency adequacy assessment	30.9.2024		31.12.2023	
	Capital requirement	Solvency need ratio	Capital requirement	Solvency need ratio
DKK 1,000				
1) Basic Capital requirement, 8 % of RWA	559,433	8.0%	545,324	8.0%
+ 2) Earnings (capital for risk coverage due to weak earnings)	-	0.0%	-	0.0%
+ 3) Growth in lending (capital to cover organic growth in business)	-	0.0%	-	0.0%
+ 4) <i>Credit risk, of which:</i>	27,433	0.4%	67,156	1.0%
4 a) Credit risk on major customers in financial distress	1,937	0.0%	19,900	0.3%
4 b) Other credit risk	4,143	0.1%	4,153	0.1%
4 c) Concentration risk on individual exposures	20,484	0.3%	22,395	0.3%
4 d) Concentration risk on industries	-	0.0%	20,709	0.3%
4 e) NPE-backstop	870	0.0%	-	0.0%
+ 5) <i>Market risk, of which:</i>	45,687	0.7%	45,687	0.7%
5 a) Interest risk	25,687	0.4%	25,687	0.4%
5 b) Credit spread risk	20,000	0.3%	20,000	0.3%
5 c) Equity risk	-	0.0%	-	0.0%
5 d) Foreign exchange risk	-	0.0%	-	0.0%
+ 6) Liquidity risk (capital to cover more expensive liquidity)	-	0.0%	-	0.0%
+ 7) Operational risk (capital to cover operational risk in excess of	55,943	0.8%	40,899	0.6%
+ 8) Gearing (capital to cover risk due to gearing)	-	0.0%	-	0.0%
+ 9) Margins due to statutory requirements	-	0.0%	-	0.0%
Capital requirement and solvency requirement ratio	688,497	9.8%	699,067	10.3%

Pillar I requirement (8% of risk-weighted assets)

Føroya Banki is subject to section 124(2) of the Faroese Financial Business Act which requires solvency of at least 8% of risk-weighted assets. At 30 September 2024, the risk-weighted assets amounted to DKK 6,992,916k. The Pillar I requirement of 8% of the risk-weighted assets amounted to DKK 559,433k.

Income

The assessment of whether additional capital must be provided to withstand future credit losses is based on the Danish FSA's relevant benchmark guidelines. The core earnings have been assessed relative to total loans, advances and guarantees. In Føroya Banki's assessment, there is no need to make a reservation of capital to cover weak earnings.

Lending growth

The assessment of whether a provision of additional capital must be made to cover growth in lending is based on the Danish FSA's relevant benchmark guidelines. In Føroya Banki's assessment, there is currently no need to provide capital to cover growth in lending.

Credit risk

Credit risk covers the risk of losses from debtors or counterparties defaulting on their payment obligations, over and above what is covered by Pillar I, including large customers in financial difficulty, single name concentration risk and sector concentration risk. In Føroya Banki's assessment, there is a need to supplement the adequate own funds by a total of DKK 27,433k (0.4%) due to additional credit risk. The supplement needed due to additional credit risk is broken down into sub-groups set out below.

Large customers in financial difficulty

For large customers in financial difficulty, an assessment is made of a conservatively estimated loss on each exposure. Customers in financial difficulty are categorised as follows:

- Customers with objective evidence of impairment (OEI), financial standing category 1
- Customers with material signs of weakness, but without OEI, financial standing category 2c.

Large customers in financial difficulty are exposures representing at least 2% of own funds.

The conservative loss estimate indicates the "net loss risk" in a conservative and forward-looking assessment, if major exposures with customers in financial difficulty is wound up for reasons of default.

In Føroya Banki's assessment, there is a need to supplement adequate own funds by DKK 1,937k (0.0%) due to large customers in financial difficulty.

Other credit risks

An assessment is made of whether there are other special credit risks in the credit portfolio that are not covered by the Pillar I requirement and not grouped under *Large customers in financial difficulty*. In Føroya Banki's assessment, there is a need to provide a supplement of DKK 4,143k (0.1 %) for such exposures.

Concentration risk on individual exposures

Concentration risk on individual exposures covers the risk related to the distribution of exposure amounts in the lending portfolio. The calculation of the supplement to concentration risk on individual exposures is based on the Danish FSA's Guidelines on adequate own funds and solvency need for credit institutions. According to those guidelines, a supplement should be provided if the sum of the twenty largest exposures exceeds 4% of the portfolio of exposures.

The twenty largest exposures make up 31.0% of the total portfolio of exposures, and a supplement must therefore be provided. The Bank has calculated a supplement of DKK 20,484k (0.3%) in respect of concentration risk on individual exposures.

Concentration risk by industry

Concentration risk by industry covers the risk related to having exposures distributed on relatively few industries. The calculation of the supplement for concentration risk by industry is based on the Danish FSA's Guidelines on adequate own funds and solvency need for credit institutions. According to those guidelines, the Herfindahl-Hirschman index (HHI) must be applied to measure the degree of concentration by industry. According to the guidelines, a concentration rate of less than 20% does not require a supplement to adequate own funds. A concentration rate of more than 20% will incrementally require a supplement to adequate own funds.

According to Føroya Banki's calculations, the Bank has an HHI index concentration rate of 19.5%. Accordingly, no supplement has been calculated.

Non-performing exposures (NPE backstop)

The Bank's calculations show that non-performing exposures will increase by DKK 870k within the next twelve months. Accordingly, this amount has been added in the calculation of adequate own funds.

Market risk

Market risk is the risk of losses resulting from potential changes in interest rates, share prices and exchange rates other than as covered by Pillar I. Calculations are based on the maximum risks Føroya Banki is permitted to accept within the limits the Board of Directors has defined for the Executive Board's powers to accept market risk pursuant to section 70 of the Faroese Financial Business Act.

The assessment of whether all market risks have been adequately covered by Pillar I is based on the Danish FSA's benchmark guidelines for interest rate risk, credit spread risk, equity risk and currency risk. In Føroya Banki's assessment, there is a need for a supplement due to special market risks for a total amount of DKK 45,687k (0.7%).

This supplement for special market risk includes special interest rate risk in the amount of DKK 25,687k (0.4%) and credit spread risk in the amount of DKK 20,000k (0.3%). In Føroya Banki's assessment, no further supplement is needed to the adequate own funds due to special equity risk or special currency risk.

Liquidity risk

The assessment of whether capital should be provided because procuring liquidity is expected to involve additional costs is based on the Bank's LCR ratio, which at the end of September was calculated at 302.2%, the liquidity indicator calculated at 266.4% at the end of the period and on the NSFR ratio which was 156.6% at the end of the period.

In light of the comfortable excess liquidity coverage relative to the statutory requirements and in the liquidity stress test, Føroya Banki assesses that there is no need for a supplement to adequate own funds in respect of special liquidity risk. The Bank has also assessed that its internal liquidity adequacy assessment process (ILAAP) does not require a supplement to adequate own funds.

Operational risk

Operational risk comprises the risk of loss resulting from inadequate or failed internal processes, human error or system error or from external events and including legal risks other than as covered under Pillar I.

An assessment of the need for a supplement for operational risk considers these risk areas, including the Bank's organisation, IT security and IT operations as well as the Bank's business model. From the review it is concluded that a supplement to the adequate own funds of DKK 55,943k (0.8%) is needed to cover special operational risk.

Statutory requirements

The Danish FSA has not stipulated an individual solvency requirement for Føroya Banki.

Own funds, capital requirement and excess cover

Excess capital relative to adequacy requirements			
DKK 1,000	30-09-2024	31-12-2023	Change
Total risk-weighted items	6,992,916	6,818,861	174,055
Total capital, incl. MREL capital	2,647,492	2,805,762	-158,270
Total capital	1,853,398	2,007,537	-154,139
Tier 1 capital	1,753,643	1,907,887	-154,244
CET 1 capital	1,753,643	1,758,043	-4,400
Total capital ratio, incl. MREL capital	37.9%	41.1%	-3.3%
Total capital ratio	26.5%	29.4%	-2.9%
Tier 1 capital ratio	25.1%	28.0%	-2.9%
CET 1 capital ratio	25.1%	25.8%	-0.7%
Own funds requirement	688,497	699,275	-10,778
Solvency requirement	9.8%	10.3%	-0.4%
Excess Subordinated and additional Tier 1 capital (> 2% / > 1,5% of RWA), DKK	-	-10,915	10,915
Excess Subordinated and additional Tier 1 capital (> 2% / > 1,5% of RWA), %	0.0%	-0.2%	0.2%
Excess capital, DKK 1,000	1,164,900	1,297,347	-132,447
Excess capital ratio	16.7%	19.0%	-2.4%

The above table shows Føroya Banki to have a Total capital ratio of 26.5% and a solvency need of 9.8% at 30 September 2024. The excess coverage in relation to the individual solvency need is a comfortable 16.7 percentage points (2023: 19.0%) The Total capital ratio, including MREL capital, is 37.9%, a 3.3 percentage point decline since 31 December 2023 (41.1%) mainly due to the repayment of hybrid capital amounting to DKK 150m and secondly due to growth in the risk-weighted items. In relation to the calculation of capital ratios it should be noted that the Bank has not included the net profit for Q1-Q3 2024 of DKK 238,084k.

Excess capital relative to total capital requirements		
DKK 1,000	30-09-2024	31-12-2023
Total risk-weighted items	6,992,916	6,818,861
Total individual solvency requirement	9.8%	10.3%
Combined buffer requirement	6.8%	6.8%
Total requirements	16.7%	17.1%
Total requirements	1,164,785	1,163,708
Total capital ratio	26.5%	29.4%
Total capital	1,853,398	2,007,537
Excess capital	9.8%	12.4%
Excess capital	688,613	843,830

As can be seen from the table above, Føroya Banki had comfortable excess coverage of 9.8% (12.4%) relative to the total capital requirement of 16.7% (17.1%). The excess capital amounts to DKK 688,613k (DKK 843,830).

Excess capital relative to total MREL capital requirements		
DKK 1,000	30-09-2024	31-12-2023
Total risk-weighted items	6,992,916	6,818,861
Total MREL requirements	28.6%	23.3%
Total MREL requirements	1,998,867	1,588,795
Total capital ratio, incl. MREL capital	37.9%	41.1%
Total capital, incl. MREL capital	2,647,492	2,805,762
Excess capital	9.3%	17.8%
Excess capital	648,625	1,216,967

As can be seen from the table above, Føroya Banki had comfortable excess cover of 9.3% (17.8%) relative to the total capital requirement, including MREL capital, of 28.6% (23.3%). The excess capital amounts to DKK 648,625k (DKK 1,216,967k).