CREDIT OPINION
6 November 2024

New Issue

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RATINGS

Foroya Banki

Domicile	Denmark
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Foroya Banki

Update following rating affirmation, outlook changed to negative

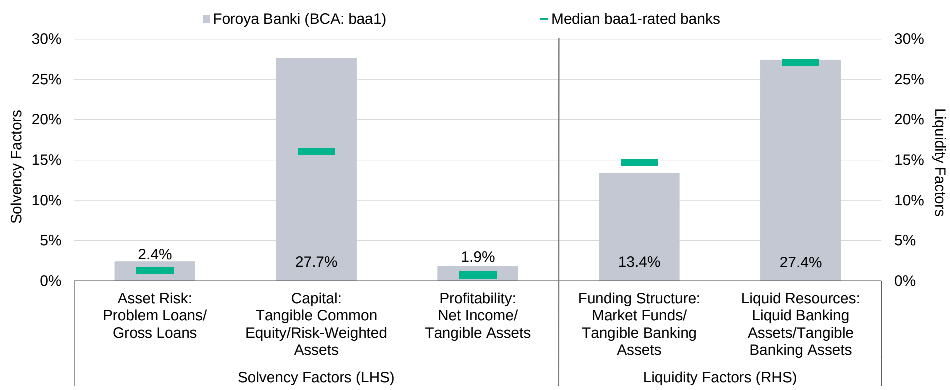
Summary

On 24 October we affirmed Foroya Banki's long term deposit and issuer ratings at A1 and changed the outlook to negative from stable.

Foroya Banki's A1 long-term deposit and issuer ratings reflect the baa1 Baseline Credit Assessment (BCA) and three notches uplift as indicated per our Advanced Loss Given Failure (LGF) analysis, which takes into account the risks faced by different liability classes should the bank enter into resolution.

Foroya Banki's baa1 BCA captures its low level of problem loans, strong capitalisation, sound profitability, and a diversified and stable depositor base, balanced against high geographical and sector concentrations as well as some single name reliance in its funding profile. The bank's position as one of the largest banks in the Faroe Islands (Aa2 stable) and Greenland, which are small and narrow sub-sovereign economies that depend on fishing industries, but benefit from ongoing support from the Government of Denmark (Aaa stable).

Exhibit 1
Rating Scorecard - Key financial ratios



The metrics presented in the exhibit are our Banks Methodology scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average or the latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end figures.
Source: Moody's Ratings

Credit strengths

» Very strong levels of capitalisation

» Strong recurring profitability

» Large liquidity buffer

Credit challenges

» Geographical concentration

» Dependence in economies on fishing industries increases the bank's asset risk

Outlook

The negative outlook on the long-term deposit and issuer ratings reflects Moody's Rating's view that due to the bank's build of capital and limited need to issue further MREL eligible debt in the coming periods, a continued balance sheet growth will lead to a lower share of loss absorbing liabilities to tangible banking assets. If the subordination for senior creditors according to Moody's Rating's Advanced LGF analysis falls under 8%, this may evolve into lower ratings uplift, while the strengthened capital base does not result in further uplift in the banks adjusted BCA due to the already very strong capitalisation assessment. Moody's Rating's estimates that the subordination was 8.2% after the Additional Tier 1 instruments were called, post end of June 2024.

Factors that could lead to an upgrade

While the constraints of the geographical and sectoral concentration risks, make an upgrade of the BCA less likely, a continued reduction in problem loans and prudent underwriting standards combined with strong capitalization, strong recurring profitability, and a stronger track record of accessing capital markets could exert upward pressure on the BCA, and consequently also on the other ratings and assessments.

The outlook could stabilize if the bank's balance sheet sees limited growth or if additional volumes of senior non-preferred debt or more subordinated instruments are issued.

Factors that could lead to a downgrade

Factors that could lead to a downgrade include a deterioration in earnings capacity, and significant deterioration in capitalization, or heightened macro risks relating to the bank's geographical location. A lower share of loss absorbing liabilities to tangible banking assets could lead to a downgrade in the ratings.

Key Indicators

Exhibit 2

Foroya Banki (Consolidated Financials) [1]

	06-24[2]	12-23[2]	12-22[2]	12-21[2]	12-20[3]	CAGR/Avg.[4]
Total Assets (DKK Million)	13,491.6	12,944.5	12,166.6	11,789.3	17,288.8	(6.8)[5]
Total Assets (USD Million)	1,938.9	1,918.2	1,746.1	1,796.4	2,841.9	(10.3)[5]
Tangible Common Equity (DKK Million)	1,896.8	1,841.3	1,782.5	2,027.5	2,260.8	(4.9)[5]
Tangible Common Equity (USD Million)	272.6	272.8	255.8	308.9	371.6	(8.5)[5]
Problem Loans / Gross Loans (%)	--	2.0	2.3	3.0	4.1	2.9[6]
Tangible Common Equity / Risk Weighted Assets (%)	27.7	27.0	24.8	29.6	23.1	26.4[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	--	9.0	9.5	10.5	12.7	10.4[6]
Net Interest Margin (%)	3.5	3.3	2.2	2.1	1.7	2.6[6]
PPI / Average RWA (%)	5.4	5.2	2.1	2.1	1.1	3.2[7]
Net Income / Tangible Assets (%)	2.1	2.4	1.3	1.6	0.9	1.7[6]
Cost / Income Ratio (%)	40.1	40.0	60.9	58.9	68.3	53.6[6]

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Market Funds / Tangible Banking Assets (%)	12.4	13.4	11.9	10.4	0.5	9.7[6]
Liquid Banking Assets / Tangible Banking Assets (%)	28.6	27.4	29.2	31.2	34.2	30.2[6]
Gross Loans / Due to Customers (%)	100.5	104.1	99.2	99.4	102.4	101.1[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] Basel I; IFRS. [4] May include rounding differences because of the scale of reported amounts. [5] Compound annual growth rate (%) based on the periods for the latest accounting regime. [6] Simple average of periods for the latest accounting regime. [7] Simple average of Basel III periods.
Sources: Moody's Ratings and company filings

Profile

Foroya Banki is a commercial bank established in 1906. It operates primarily in the Faroe Islands and has a presence in Greenland. It offers banking services that focus on retail customers and small to medium-sized corporates in the Faroe Islands and Greenland, as well as offers insurance products and acts as a real estate brokerage in the Faroe Islands only. In 2021, Foroya Banki sold its Danish arm to Spar Nord Bank A/S (A1 stable, baa1).

The bank held total assets of DKK13.5 billion as of June 2024 and had market shares of around 40% in terms of loans and deposits, respectively, in the Faroese banking system as of June 2024. It is listed on the Nasdaq OMX Copenhagen, while the Government of the Faroe Islands held a share of 35% as of December 2023.

Detailed credit considerations

Geographical and industry concentrations renders the bank's asset quality to downside risks

Foroya Banki's concentration to the narrow Faroese and Greenland economies, largely dependent on fishing industries, is reflected in a negative adjustment to business diversification. These levels have increased following the bank's withdrawal from the Danish market in February 2021. The direct exposure to the farming and fishing industry stood at 7% of the bank's corporate book as of June 2024. The Faroese economy continues to rely on the fishery and fish farming, which account for around 20% of national gross value-added product and more than 90% of the total export value of goods. Our assessment takes into account the historical volatility in the performance in the fishing industry. However, we acknowledge that the improvement in processes in the Faroese fishing industry since the beginning of the 2000's, because of consolidation and improved disease control in aquaculture

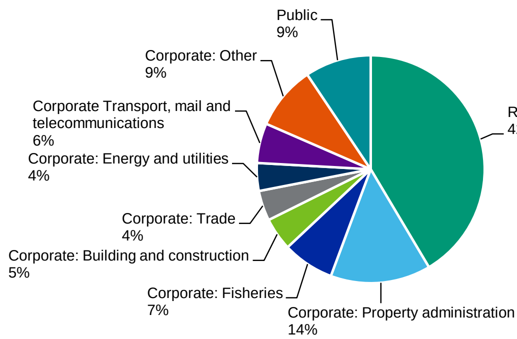
Asset quality improving, with some concentration risks

Our assessment of Foroya Banki's asset risk, captured in our baa2 Asset Risk score, reflects the bank's balanced loan portfolio across the Faroe Islands and Greenland.

Foroya Banki's problem loans reached 2.0% of gross loans as of December 2023, down from 2.3% as of December 2022. Nonperforming loans (NPLs) were adequately covered by loan loss reserves at 99% as of December 2023, including a management estimate of DKK93 million booked to mitigate risks stemming from Russia's invasion of Ukraine, macroeconomic uncertanties and additional provision for expected losses. Although the NPL ratio is higher than that of its Nordic peers, reflecting the bank's focus on small and medium-sized enterprises (SMEs) and retail customers, we expect the ratio to continue declining over time, with the bank reducing its exposure to the high-risk SME segment.

In line with local credit trends, the bank has high exposure to the property administration and building and construction sectors at 19% of total loans, and to the fishery sector at 7%, as of December 2023 (see Exhibit 3), compared to 21% and 8%, respectively, in 2022.

Exhibit 3
Sectoral concentration of risk exposure as of year-end 2023



Source: Bank's financial reports

Very strong capitalisation

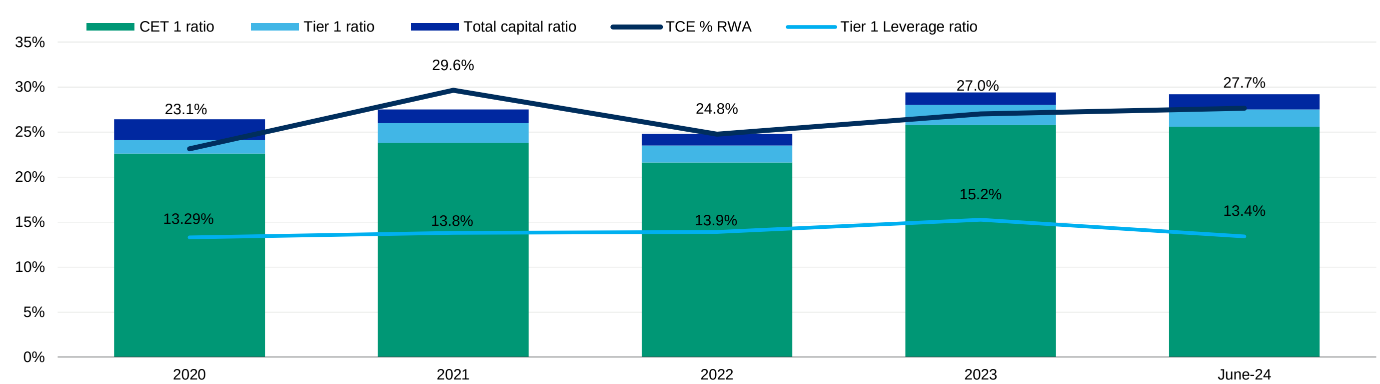
We expect Foroya Banki to maintain very strong capitalisation over the next 12-18 months, supporting the bank's standalone profile. The bank continued to strengthen its capitalization with tangible common equity (TCE) to risk weighted assets improving to 27.7% of risk-weighted assets (RWA) at the end of June 2024 from 27.0% at end of year 2023 and 24.8% a year earlier. The increase reflects strong retained earnings and lower RWA growth in H1 2024. We expect the bank to maintain a TCE to RWA ratio of above 20% during the outlook period. Foroya Banki's TCE/total assets remains high at 14.1% as of end of June 2024, considerably higher than that of its Danish and global peers. However, this ratio is expected to fall once the bank resumes its 70% dividend payout policy, compared to the YE2023 payout of 26%.

The bank's Common Equity Tier 1 (CET1) capital ratio of 25.6% (excluding H1 2024 profitability) and total capital ratio of 29.2% as of June 2024, were comfortably above the regulatory requirements. We expect capital ratios to remain at such high levels following the bank's revised CET1 target of 23% for 2026 from previous 20%. Since the bank uses the standardised approach to measure credit exposures, the lower capital target still entails a strong leverage ratio of more than 10% in the coming years.

The bank is recognized as a systemically important financial institution in the Faroe Islands, entailing a systemic risk requirement. The authorities decided to increase this buffer from 2% to 3% as of June 2025 on Faroes exposures.

The aa1 Capital score reflects the continued very strong capitalisation and our expectation that the bank will maintain high capital ratios despite a higher dividend payout ratio in the coming years.

Exhibit 4
Foroya Banki's capitalisation will decline but remain strong



Source: Bank's financial reports and Moody's Ratings

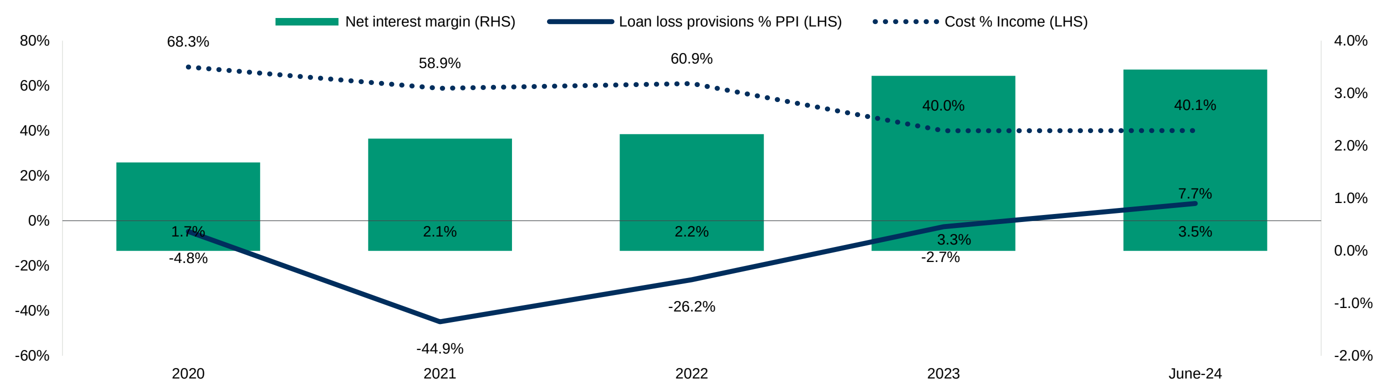
Strong but volatile profitability, constrained by growth limitation

Foroya Banki's strong profitability reflects its entrenched position in the Faore Islands and Greenland, but earnings have been volatile historically. We expect the bank's profitability to continue to benefit from higher for longer interest rates and good economic activity in its local economies. In June 2024, the bank reporting record profit of DKK142 million (compared to a net income of DKK131 million in H1 2023), resulting in an adjusted net income/tangible assets of 2.1% in June 2024. The year-on-year improvement was driven by higher net interest income, which increased by 17% year-on-year, mainly driven by higher interest rates, increased lending and a 3% decrease in operating expenses. The bank expects a full-year net income of DKK275 million-DKK300 million for 2024, indicating a profitability ratio above 1%.

Despite limited potential for additional balance-sheet growth in the existing geographical areas of its banking operations, Foroya Banki is expanding its insurance business and mortgage lending via partners, which will allow the bank to continue to increase its net income over time. The bank's cost-to-income ratio improved to 40.1% in June 2024 from 49.8% in June 2023 despite ongoing investments in IT.

The assigned score of a2 reflects the expected profitability, with the net income-to-tangible assets ratio likely to remain above 1% and historic volatility.

Exhibit 5
Profitability drivers



Sources: Bank's financial reports and Moody's Ratings

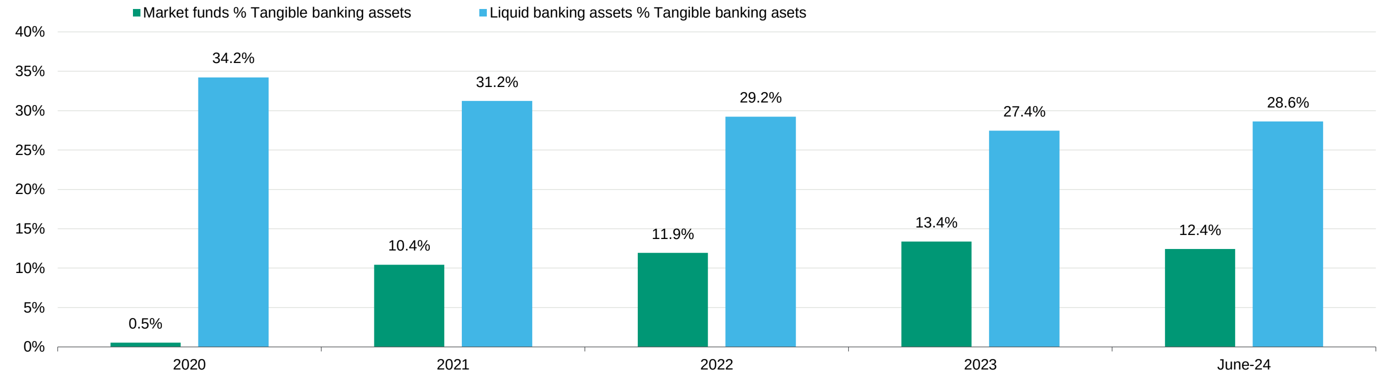
Stable funding, supported by deposits

Foroya Banki's funding structure is stable, with deposits comprising the largest part of the bank's funding, accounting for 68% of total assets as of June 2024, but single name reliance in both deposits and wholesale funding increases refinancing risks. At the same time, the bank's reliance on confidence sensitive market funding, which has been historically low, stood at 12.4% of tangible banking assets in June 2024 (see Exhibit 6), following the issuance of senior debt.

The bank fulfills its Minimum Requirements on own funds and Eligible Liabilities (MREL) of 32.5%. The bank's own funds and MREL eligible debt amounted to 40.8% of total REA at the end of June 2024 and therefore there is limited need for further issuances.

Foroya Banki has a large liquidity reserve, with liquid banking assets making up 29% of tangible banking assets as of June 2024, up from 27% as of year-end 2023. The bank reported a leverage coverage ratio of 286% as of June, comfortably above the 100% regulatory requirement.

Exhibit 6
Funding and liquidity scorecard metrics



Sources: Bank's financial reports and Moody's Ratings

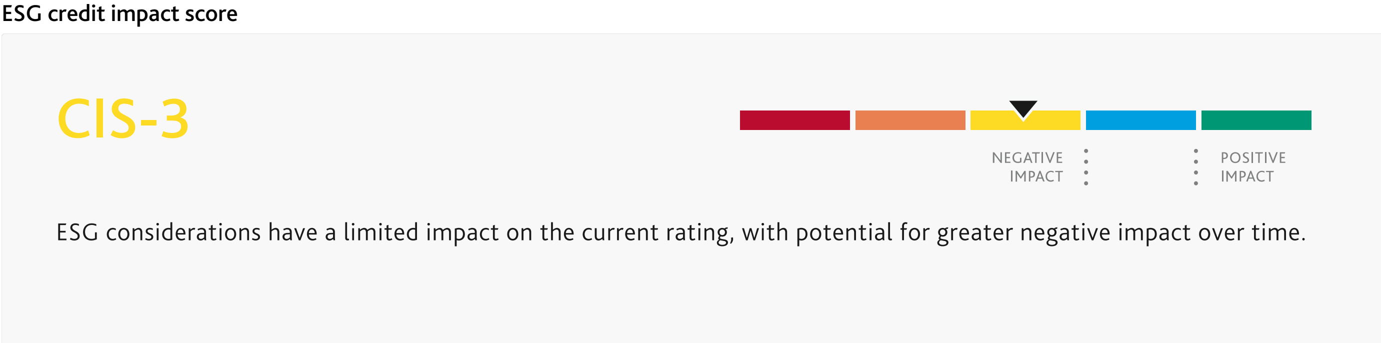
Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 8 April 2024.

ESG considerations

Foroya Banki's ESG credit impact score is CIS-3

Exhibit 7
ESG credit impact score

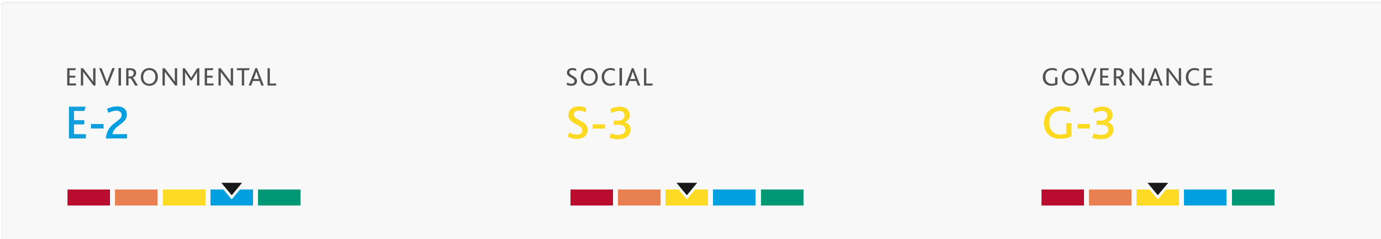


Source: Moody's Ratings

CIS-3 indicates limited impact of ESG considerations on the current credit rating with potential for greater negative impact over time, mainly because of governance considerations following some management turnover with limited track record of the current management team.

Exhibit 8

ESG issuer profile scores



Source: Moody's Ratings

Environmental

Foroya Banki faces low environmental risks. Foroya Banki faces lower carbon transition risk than peers due to the Faroe Islands having a high and increasing share of renewable energy sources. Over 50% of the island's electricity is derived from renewable energy sources. Furthermore, Foroya Banki is developing policies and frameworks to mitigate environmental risks.

Social

Foroya Banki faces social risks related to regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by the bank's developed policies and procedures. High cyber and personal data risks are mitigated by the bank's strong IT framework. As one of the largest banks on the Faroe Islands and Greenland, Foroya Banki has exposure to customer relations risks in terms of data privacy and cyber attacks, which is mitigated by strong IT framework, supported by their provider SDC in Denmark.

Governance

Foroya Banki faces moderate governance risks. These include a limited track record of the current management following turnover of key managers. The bank is a dominant market participant in both the Faroese Islands and Greenland and the concentrated nature of its operations compared to its small size can give rise to governance failures. In particular, the Danish Financial Supervisory inspections have highlighted as key risks the ongoing management change at the bank, and the level of credit risk skills, given the relatively complex group exposures the bank has. In response, the bank has addressed these key issues and has very strong capital buffers to absorb credit losses. Furthermore, although Moody's considers a concentrated ownership as increasing the risks of governance failures, the degree of control of the Faroese Government, with its 35% ownership stake, over Foroya Banki is limited by the articles of association that caps its voting power to 10% of total share capital. The Board of Directors consists of 9 members, of which 6 are independent and 3 are employee representatives.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

Foroya Banki is subject to the European Union's Bank Recovery and Resolution Directive (BRRD), which is an operational resolution regime. Therefore, in accordance with our Banks methodology, we apply our Advanced LGF analysis to Foroya Banki's liabilities, considering the risk exposures of the different debt and deposit classes across its liability structure if the group enters resolution.

Our Advanced LGF analysis is applied to Foroya Banki's consolidated group, in line with the Danish FSA's single-point-of-entry resolution strategy. In our Advanced LGF analysis, we use our standard assumptions and assume a residual TCE of 3% and post-failure losses of 8% of tangible banking assets. We also assume a 25% run-off in junior wholesale deposits and a 5% runoff in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt.

For Foroya Banki's A1 deposit and issuer ratings, our LGF analysis indicates an extremely low loss given failure, leading to three notches of rating uplift from the entity's baa1 Adjusted BCA. The three notches of rating uplift to the bank's the long-term deposit and issuer ratings reflects the volumes of loss absorbing debt obligations that Foroya Banki has issued to comply with Minimum Requirements for own funds and Eligible Liabilities (MREL), adding additional protection against losses at failure for junior depositors and senior creditors, as indicated by Moody's Advanced LGF analysis.

Government support considerations
We consider a low probability of support from the Government of Denmark for Foroya Banki, resulting in no uplift incorporated in its A1 long-term deposit ratings. This reflects that, although Foroya Banki is of systemic importance in the Faroese banking system with a very high market share of 40% in deposits as of June 2024, the bank is small in the context of the Danish banking system. Because Denmark previously let smaller banks fail, it is likely that Foroya Banki would not receive government support in case of failure.

Counterparty Risk Ratings (CRRs)
Foroya Banki's CRRs are positioned at A1/Prime-1

The CRR, before government support, is three notches above the Adjusted BCA of baa1, reflecting an extremely low loss given failure from the volume of instruments that will be subordinated to CRR liabilities. Furthermore, Foroya Banki's CRR does not benefit from any rating uplift based on government support, in line with our support assumptions on senior debt.

Counterparty Risk (CR) Assessment
Foroya Banki's CR Assessment is positioned at A1(cr)/Prime-1(cr)

For Foroya Banki, the preliminary CR Assessment is three notches above the bank's baa1 Adjusted BCA, reflecting the buffer against default provided to more junior obligations represented by the CR Assessment. To determine the CR Assessment, we focus purely on subordination, taking no account of the volume of the instrument class. Finally, the bank's CR Assessment does not benefit from any government support uplift.

Methodology and scorecard

About Moody's Bank Scorecard
Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 9

Rating Factors

MACRO FACTORS		
WEIGHTED MACRO PROFILE	STRONG +	100%

FACTOR	HISTORIC RATIO	INITIAL SCORE	EXPECTED TREND	ASSIGNED SCORE	KEY DRIVER #1	KEY DRIVER #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.4%	a2	$\leftrightarrow$	baa2	Sector concentration	Long-run loss performance
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	27.7%	aa1	$\leftrightarrow$	aa1	Expected trend	
Profitability						
Net Income / Tangible Assets	1.9%	aa3	$\leftrightarrow$	a2	Earnings quality	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	13.4%	a2	$\leftrightarrow$	baa2	Market funding quality	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	27.4%	a3	$\leftrightarrow$	baa1	Expected trend	
Combined Liquidity Score		a2		baa2		
Financial Profile				a3		
Qualitative Adjustments				Adjustment		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

BALANCE SHEET	IN-SCOPE (DKK MILLION)	% IN-SCOPE	AT-FAILURE (DKK MILLION)	% AT-FAILURE
Other liabilities	2,614	19.5%	3,549	26.4%
Deposits	9,173	68.3%	8,238	61.4%
Preferred deposits	6,788	50.6%	6,449	48.0%
Junior deposits	2,385	17.8%	1,789	13.3%
Senior unsecured bank debt	390	2.9%	390	2.9%
Junior senior unsecured bank debt	597	4.4%	597	4.4%
Dated subordinated bank debt	100	0.7%	100	0.7%
Preference shares (bank)	150	1.1%	150	1.1%
Equity	403	3.0%	403	3.0%
Total Tangible Banking Assets	13,427	100.0%	13,427	100.0%

DEBT CLASS	DE JURE WATERFALL		DE FACTO WATERFALL		NOTCHING		LGF NOTCHING GUIDANCE VS. ADJUSTED BCA	ASSIGNED LGF NOTCHING	ADDITIONAL NOTCHING	PRELIMINARY RATING ASSESSMENT
	INSTRUMENT VOLUME + SUBORDINATION	SUB-ORDINATION	INSTRUMENT VOLUME + SUBORDINATION	SUB-ORDINATION	DE JURE	DE FACTO				
Counterparty Risk Rating	25.5%	25.5%	25.5%	25.5%	3	3	3	3	0	a1
Counterparty Risk Assessment	25.5%	25.5%	25.5%	25.5%	3	3	3	3	0	a1 (cr)
Deposits	25.5%	9.3%	25.5%	12.2%	3	3	3	3	0	a1
Senior unsecured bank debt	25.5%	9.3%	12.2%	9.3%	3	2	3	-	-	-

INSTRUMENT CLASS	LOSS GIVEN FAILURE NOTCHING	ADDITIONAL NOTCHING	PRELIMINARY RATING ASSESSMENT	GOVERNMENT SUPPORT NOTCHING	LOCAL CURRENCY RATING	FOREIGN CURRENCY RATING
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	-	-	-	0	A1	A1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Ratings

Ratings

Exhibit 10

Category	Moody's Rating
FOROYA BANKI	
Outlook	Negative
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1

Source: Moody's Ratings

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