



# Annual Report

2006

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# Annual Report 2006



**FØROYA BANKI**

# Management, Head Office and Branches

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## Board of Directors

**Jóhan Páll Joensen**, Chairman

**Jóhannus E. Hansen**, Vice-chairman

**Høgni Hansen**, Board member

**Graham D. Stewart**, Board member

**Olav Enomoto**, Employee Representative

**Sigmar Jacobsen**, Employee Representative

## Management

**Janus Petersen**, CEO

**Súni Schwartz Jacobsen**, Managing Director

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## Results 2006 for and Prospects for 2007

### Results

- Profit before tax is DKK 193 mill. compared to DKK 158 mill. in 2005. Interest on equity after tax in 2006 is 13.7%
- Lending has increased from DKK 4.1 bn to DKK 5.4 bn. The increase is 33%. Deposits have increased from DKK 4.5 bn to DKK 4.6 bn. or 3.1%
- Net interest margin has decreased from 4.2% to 3.9%
- Net interest and fee income has increased from DKK 255 mill. to DKK 275 mill. corresponding to 7.7%
- Fee and commission income increased from DKK 21 mill. to DKK 35 mill. This increase is 68%
- Operational expenses have increased from DKK 136 mill. to DKK 154 mill. or 13.4%. One main reason for these expenses are the Bank's centenary celebration
- The Bank's balance has increased from DKK 6.4 bn to DKK 7.2 bn or 13.2%
- The Bank's equity is DKK 1,246 mill. and the solvency ratio is 23.8%
- The Bank has decreased the credit risk primarily by reorganising companies in aquaculture and consequently, has reversed provisions of DKK 66 mill. in 2006
- The Bank started its own Corporate Finance department to provide advice in connection with the purchase and sale of businesses
- The Bank founded Skyn, a real estate brokerage, and the investment company Løkir, together with other investors, as well as Bakkafrost Holding, the largest aquaculture corporation on the Faroe Islands

### Prospects

- The Bank expects lending in 2007 to increase by approximately DKK 1 bn
- In 2007, net interest and fee income is expected to be in the range of DKK 290-310 mill.
- The Bank expects an annual result before tax in 2007 in the range of DKK 120-140 mill
- The Bank expects increased fee income from the growing investment activities among its customers in 2007
- In 2007, the Bank expects to sell Vestlax, the aquaculture corporation

## 5-years Summary in Figures

<b>Highlights</b> (DKK mill.)	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Income statement</b>					
Net interest and fee income	259	264	256	255	275
Value adjustments	33	-5	1	8	7
Other operating income	12	16	-2	2	-2
<b>Results from net financials</b>	<b>304</b>	<b>275</b>	<b>255</b>	<b>265</b>	<b>280</b>
Expenses	127	119	127	143	162
Provisions for poor and doubtful debts	-1	110	12	-34	-68
Value adjustments of investments	3	1	5	2	7
<b>Profit before tax</b>	<b>182</b>	<b>47</b>	<b>121</b>	<b>158</b>	<b>193</b>
Tax	36	9	24	30	34
<b>Net profit for the year</b>	<b>146</b>	<b>38</b>	<b>97</b>	<b>129</b>	<b>159</b>
<b>Balance sheet</b>					
Cash in hand and due from credit institutions, etc.	327	299	289	178	533
Loans	3,412	3,512	3,636	4,071	5,408
Bonds, shares and investments	1,688	1,493	1,560	2,013	1,147
Other assets	97	105	112	111	124
<b>Total assets</b>	<b>5,525</b>	<b>5,408</b>	<b>5,597</b>	<b>6,374</b>	<b>7,213</b>
Due to credit institutions	89	57	70	113	1,243
Deposits	3,832	3,780	3,870	4,507	4,647
Other liabilities	111	61	99	668	78
Equity, end of year	1,492	1,510	1,557	1,086	1,246
<b>Total liabilities and equity</b>	<b>5,525</b>	<b>5,408</b>	<b>5,597</b>	<b>6,374</b>	<b>7,213</b>
<b>Off-balance-sheet items</b>	<b>225</b>	<b>174</b>	<b>148</b>	<b>237</b>	<b>359</b>
<b>Dividends</b>	<b>73</b>	<b>20</b>	<b>50</b>	<b>600</b>	<b>0</b>
<b>Number of full-time employees at 31 December</b>	<b>210</b>	<b>199</b>	<b>196</b>	<b>191</b>	<b>221</b>

## Financial ratios

	2002	2003	2004	2005	2006
Solvency ratio	46.9	47.1	47.3	27.5	23.8
Core capital ratio	47.0	47.2	47.4	27.6	23.8
Return on equity before tax, pct.	12.5	3.2	7.9	12.0	16.6
Return on equity after tax, pct.	10.0	2.5	6.3	9.8	13.7
Income / cost ratio, DKK <sup>1)</sup>	2.42	2.32	2.04	1.87	1.77
Interest rate risk, pct.	2.1	1.5	1.4	3.4	1.1
Foreign exchange position, pct.	0.4	1.6	3.5	8.1	11.8
Foreign exchange risk, pct.	0.0	0.0	0.0	0.0	0.0
Loans, advances and provisions in relation to deposits, pct.	102.0	107.9	106.0	98.6	122.9
Excess cover relative to statutory liquidity requirements, pct.	297.3	260.3	261.2	244.9	132.2
Large exposures as a percentage of equity	33.1	27.9	30.6	51.1	126.5
Share of amounts with reduced interest rates, pct.	1.5	1.4	1.7	1.3	0.4
Provisioning ratio	12.2	13.5	11.0	7.9	5.0
Write-off and provisioning ratio	0.0	2.6	0.3	-0.7	-1.1
Annual growth on loans, pct.	1.5	2.9	3.5	12.0	32.8
Gearing of loans	2.3	2.3	2.3	3.7	4.3
<b>Shares</b>					
Number of shares, end of year (denomination DKK 100)	1,000,000	1,000,000	1,000,000	2,000,000	2,000,000
Book value per share	1,492	1,510	1,557	543	623

<sup>1)</sup> Provisions for poor and doubtful debts are not included in the calculation.

# 1. Strategy

The business foundation for FØROYA BANKI is to provide advice on financial services with the purpose of making it financially possible for our customers to achieve their full potential.

On the domestic market on the Faroe Islands, the Bank sees great potential for growth in its core business areas. In addition, the Bank sees a strong upside from introduction of new products and business areas to customers on both the Faroe Islands and abroad. Through a continued effort to maintain and build its high staff competence level, the Bank will actively seek to exploit such potential.

The Bank provides advice to its customers through its branch offices being as close to the customers as possible. Granting of loans is carried out in the branch offices and the Bank continuously develops its knowledge and competencies locally.

Advice on corporate business is provided through the regional branch offices. Furthermore, most of our branches around the country have recently been expanded with advisory sections covering real estate, investment and pensions. The environment surrounding the advisory service is continually improved by contemporary interiors of the branch offices, so that the customer may feel well received. With these expansions the Bank is able to offer sound advice closer to the customers than previously, despite the fact that the Bank has lowered the actual number of its local branches.

## Many Initiatives and New Activities

The Bank creates growth by establishing new relationships to our customers and supports this by arranging events that are beneficial for the customers. In 2006 the Bank hosted a variety of events about financial investments and corporate business consulting. Last year was also marked by the Bank's centenary, which came to a conclusion in October with grand celebrations in sports halls around the country.

The Bank continually provides its customers with more services. In collaboration with the Faroese Life Assurance Company, the bank now offers both life and disability insurances as supplements to the Bank's pension savings account. The Bank also founded *letpension*, a new pension company, together with several Danish banks. This company can potentially strengthen the Bank's pension account offers in the future.

## Vision, Mission and Values

In 2006 FØROYA BANKI expressed its vision and mission. This was done as part of the Bank's proactive growth plan.

Its vision is to be the leading bank on the Faroe Islands and internationally to provide its customers with selected financial services. Its mission is to make it financially possible for customers to achieve their full potential.

The Bank has also expressed its value foundation. The Bank is and wants to be characterised as Competent, Committed, and Proactive.



The Bank has founded Skyn, a real estate brokerage, which is a trendsetter in its aim for transparency and credibility on the real estate market. Together with the services from the insurance company Trygd, the bank now provides retail customers all services within real estate, pension and investment.

The Bank started a Corporate Finance department to provide advice on purchase and sale of companies. Already in the first year a number of deals have been finalised. The Bank has also, in collaboration with other investors, founded a new investment company called P/F Løkir.

#### **Employees Create Progress**

Emphasis is laid on attracting new employees to the Bank and retaining the Bank's skilful staff. Emphasis is also placed on developing their ability to provide financial advice. All of the Bank's financial advisors have been further educated in 2006, and there are now e.g. investment advisors in all of the Bank's service departments.

#### **A Large Increase in Loans**

The Bank's strategy was successful in 2006. The Bank has had a major increase in its activity level. Lending has increased by DKK 1.3 bn or 33%. Additionally, activities within asset management have also increased considerably. The increase in activities has also affected the Bank's expenses. The number of employees grew by 30, and extensive refurbishment has been carried out in the branch offices. The increase in expenses is the result of an investment made to facilitate the Bank's strategy and the Bank has now further strengthened its foundation for future growth. The Bank expects the growth in expenses to be more limited in the coming years.

#### **Financing International Activities**

During 2006, the Bank provided financial services abroad. Until now these projects have been funded from the Faroe Islands but the bank is investigating the possibilities for initiating activity abroad. It is the goal of the Bank to become an international provider of selected financial services. The Bank works toward putting local competencies to good use abroad, in addition to building new competencies abroad that may benefit the Bank's activities on the Faroe Islands.

Growth and internationalisation makes its demand on diligent risk management. The Bank funds the largest industrial corporations in the country and this requires that the bank have a sufficient equity. Currently this entails that the Bank's solvency is high. It places a certain pressure on the return on equity. However, according to the Bank's strategic growth plan, solvency will decrease in the years to come. The Bank is observant as to having a carefully balanced risk distribution between variable industries and countries.

The growth also places demand on liquidity and that is why the Bank, in 2007 and in the years to come, will strengthen liquidity by taking long-term loans abroad and increase deposits. The Bank's credit rating is sound and the Bank therefore expects to be given the liquidity needed at a competitive rate of interest.

### **Privatisation Approaches**

On 02 May 2006, Parliament adopted a proposal from the Minister of Finance proposing the selling of a majority of the shares currently held by the Financing Fund of 1992, which owns 99.4% of FØROYA BANKI. It is the objective of Parliament that FØROYA BANKI be privatised in 2007.

The privatisation process is well underway. In November 2006 the Financing Fund appointed Handelsbanken Capital Markets as main advisor for the process. The advisors are now preparing the sale together with the Fund and the Bank.

The privatisation will entail the listing of FØROYA BANKI on The Faroese stock Exchange/ICEX in Iceland and CSE in Denmark.

The Board and Management fully support the decision to sell the shares from The Financing Fund of 1992, and that the sale be conducted in the manner stipulated by Parliament.



## 2. Financial Statement

FØROYA BANKI made a profit before tax of DKK 193 mill. in 2006. This result is better than in 2005, when the profit before tax was DKK 158 mill. The result was DKK 159 mill. after tax. The return on equity was 13.7%.

### Result Better than Expected

In the 2005 Annual Report it was estimated that the result for 2006 would be below that of 2005. One of the reasons for this was that the banks, towards the end of 2005, lowered the interest on housing loans to a level below that of our neighbouring countries. The Bank assessed that the net interest margin had arrived at a level that did not cover the lending risk. In 2006 the interest rate on housing loans rose again. However, the low net interest margin in the beginning of 2006 meant that the annual average net interest margin fell from 4.2% to 3.9% in 2006.

Another reason for why the Bank expected a lower result was that the Bank paid a DKK 600 mill. dividend to its owners. Consequently, income fell by approximately DKK 15 mill. in 2006.

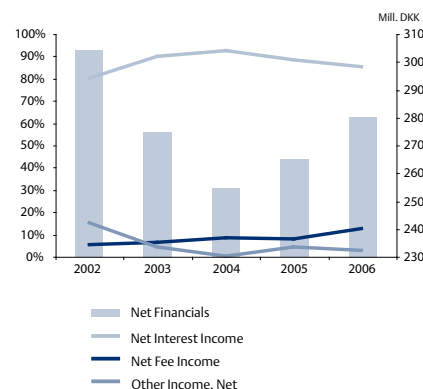
2006 proved to be better than predicted in 2005. In 2006, the Bank's net interest and fee income increased by DKK 20 mill. to DKK 275 mill. corresponding to a 7.7% growth. Value adjustments of securities and foreign exchange, etc. in 2006 was DKK 7.4 mill. In 2006 the result from net financials was DKK 280.4 mill. compared to DKK 265.1 mill. in 2005. This is an increase of 5.8%.

The main reason for the progress is that the Bank has increased lending considerably and has received greater income from fees and commissions that increased by DKK 14 mill. or 68% in 2006.

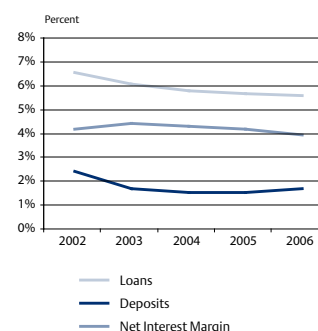
Furthermore, the Bank has together with new investors reorganised the aquaculture companies that the Bank temporarily took over in connection with the crisis in 2003. This has reduced the credit risk. The Bank has therefore carried-back provisions totalling DKK 66 mill. in 2006.

The Bank's operational expenses grew to DKK 154 mill. in 2006 from DKK 136 mill. in 2005, or 13.4%. Reasons for this increase are e.g. that the Bank celebrated its centenary in 2006 with grand events for customers and increased marketing expenses.

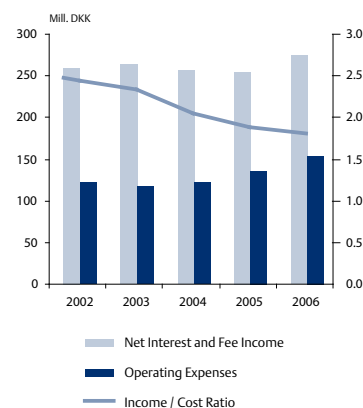
Composition of Net Financials



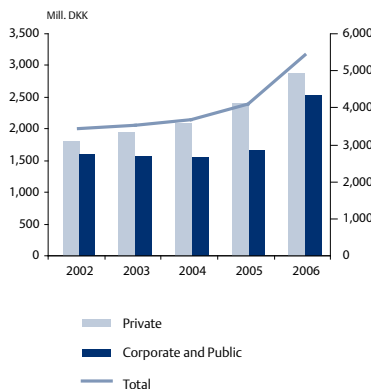
Net Interest Margin



Expenses



### Composition of Loans



Ultimately, the Bank deems the 2006 result to be satisfactory.

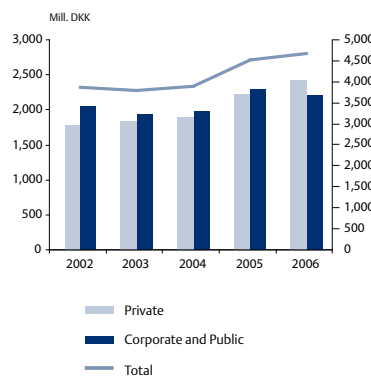
The Bank's equity is now DKK 1,246 mill. and the solvency ratio is 23.8%. The balance increased from DKK 6.4 bn in 2005 to DKK 7.2 bn in 2006. In addition, a number of guarantees that are not included in the balance rose by DKK 122 mill to DKK 359 mill. in 2006.

### Great Increase in Lending

The Bank's lending was DKK 5.4 bn at year-end 2006 compared to DKK 4.1 bn in 2005. This amounts to a 33% increase. Total increase is DKK 1.3 bn.

The deposits have increased by DKK 140 mill. from DKK 4.5 bn in 2005 to DKK 4.6 bn in 2006. A significant reason for the limited growth of 3.1% is that in 2006 many deposits were converted to investments.

### Composition of Deposits

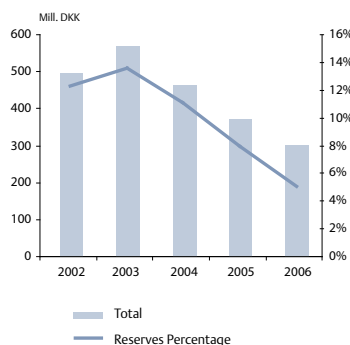


### Liquidity Still Good

FØROYA BANKI has a high liquidity. The liquidity in 2006 was 132.2% relative to statutory liquidity requirements. The bulk of the liquidity is placed in bonds. In the last few years the Bank has also allocated a part of the liquidity to shares.

The limited growth in deposits puts a strain on the Bank's liquidity and the Bank will in 2007 approach the international market to obtain funding for the increased lending activities.

### Reserves



### Subsidiaries

FØROYA BANKI holds 100% in the insurance company P/F Trygd, which in 2006 provided a result of DKK 5.7 mill. after tax. This is the best result Trygd has had during the time since FØROYA BANKI resurrected the dormant company in 1998.

Additionally, FØROYA BANKI holds shares in aquaculture that the Bank temporarily took over in connection with financial reorganisations of the companies, following the crisis in the industry in 2003. The Bank intends to sell the shares in the companies.

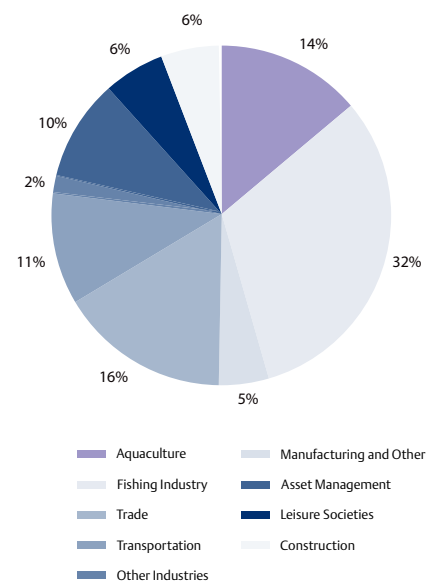
A subsidiary of the Bank, P/F FB Holding was the temporary owner of the Vestlax Corporation, the Faroe Salmon Corporation and the company

P/F 15. juni 2004. By year-end 2006 a structural change has occurred between the Bank and P/F FB Holding, as during 2006 it proved successful in restructuring the Faroe Salmon Corporation and East Salmon together with other investors. This means that FØROYA BANKI's share hold has changed from respectively 100% and 60% to 35.9% in the merged and restructured company Bakkafrost Holding.

FØROYA BANKI has acquired all shares from P/F FB Holding in December 2006 and as of 31 December 2006 P/F FB Holding holds no shares. Consequently, FØROYA BANKI now owns 100% of the shares in P/F Vestlax.

FØROYA BANKI focuses on making these aquaculture companies into interesting investment objects. The Bank's new Corporate Finance department is in charge of the selling of the Vestlax Corporation.

**Composition of Corporate  
Loan portfolio**





### 3. Initiatives and Activities

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One of the main objectives in the Bank's strategic growth plan is to introduce new business areas. This process accelerated in 2006.

In February 2006 FØROYA BANKI together with many other banks invested in *letpension*, the new Danish pension provider company. The purpose of the company is to provide all the Bank's customers with competitive pension offers in a manner that is easy to understand.

In February and March, 900 customers made investments worth DKK 240 mill. in structured products, whose return is linked to the Japanese Stock Exchange index, TOPIX.

In 2005 FØROYA BANKI launched Skáalán, a new real estate loan with more flexible repayment schedule. Reception of Skáalán is good. In spring of 2006 the Bank launched long-term convertible fixed interest loans, Fastlán and Rentuloft that have the same qualities as mortgage loans. Demand for these types of loans is growing continuously, perhaps particularly because of the 2006 increase in interest rate.

In June FØROYA BANKI became a member of OMX, Nordic Exchange in Iceland, to which the Faroese Stock Exchange is affiliated. Through its membership the Bank may function as broker on the market and provide ancillary business services.

In July FØROYA BANKI together with P/F Havsbrún and P/F Bakkafrost participated in the foundation of Bakkafrost Holding, the largest aquaculture corporation on the Faroe Islands. This merger was the result of FØROYA BANKI's intention to reduce its shares in the aquaculture companies that the bank acquired due to the crisis in the aquaculture industry in 2003. The Bank owns 35.9% in this corporation.

In August the new Corporate Finance department at FØROYA BANKI began its activities. The bank started this department to satisfy the need for advisory services in connection with the buying and selling of companies. The department is currently in charge of selling Vestlax, the aquaculture corporation. The Corporate Finance department has also brokered the deal regarding the local IT company Farodane, see below.

Four investment evening events targeted at women were held in August and all were fully booked. These evening events were meant to raise awareness about investment possibilities, pension plans and financial matters in general. The Bank has concluded that such informative events are good for customer support.

On 27 October FØROYA BANKI together with P/F Krúnborg and P/F Tjaldur founded the investment company Løkir. The founders placed a total of DKK 60 mill. in the company. Løkir's objective is to acquire companies with growth potential. Examples are companies opting for privatisation, companies on the verge of a generational change or companies in need of capital for growth. The first concrete step Løkir made was to acquire 76.3% of the shares in Farodane.

On 17 November 2007 FØROYA BANKI founded P/F Skyn, a real estate brokerage. The Bank holds all the shares in the company. Skyn brokers houses, industrial buildings and building sites. The company's goal is to increase transparency and credibility on the property market. For instance, the company commissions an independent status report of the properties in connection with all deals. Previously not a common practice on the Faroese housing market.

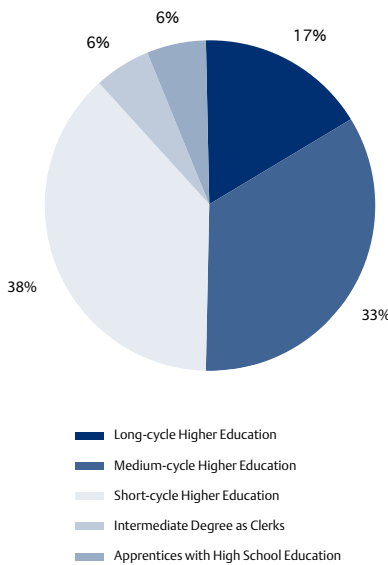
In December FØROYA BANKI launched an advertising campaign for the purpose of reminding people to save for their pensions. This campaign was fruitful. Despite the fact that it was launched in the month of Christmas, tens of millions were placed in pension accounts in the Bank. The advertising campaign itself received the best reviews from advertisement experts for its clear and original message.

In 2006 the Bank funded several ventures abroad for Faroese companies, among them the ventures of the trawl manufacturer P/F Vónin in Greenland and Iceland and part of the activities of P/F Thor in Hósvík, which today is one of the fastest growing Faroese company abroad. Similarly the bank funded half of the largest new investment in a Faroese fishing vessel ever, Norðborg, which is being built in Chile.



## 4. Employees

### Employees

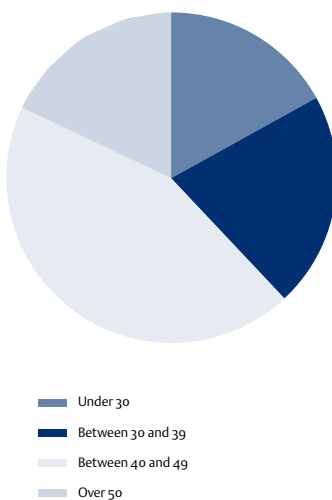


FØROYA BANKI has 19 branch offices on the Faroe Islands in addition to the head office in Tórshavn. By year-end 2006, 257 people were employed by the bank. This corresponds to 221 full-time jobs. At year-end 2005 the number of full-time jobs was 191. Thus the growth in the Bank's activities is visible in the number of employees.

The hardened competition between financial institutions on the Faroe Islands is accompanied by a competition over staff. It is a delight to conclude that interest in working for FØROYA BANKI has grown much since the Bank announced its new growth plan in June 2005. The Bank is continually receiving inquiries from highly educated people about employment.

FØROYA BANKI's diverse activities demand employees with a variety of skills. The Bank needs both educated and experienced bank employees, employees with academic educations and people with marketing skills. Similarly, people with specialised knowledge within various other areas are of high value to the Bank. Together these people create a competent and proactive bank.

### Age Composition in FØROYA BANKI



These last years, FØROYA BANKI has placed great emphasis on improving employee benefits and facilities and to provide the employees with further opportunities to develop their professional skills. Satisfied employees that develop their abilities are a prerequisite for the Bank as a company to maintain satisfied customers and to continue growing.

Employee satisfaction studies being carried out biannually show that employee satisfaction is growing. The employees were more satisfied with personal and professional development opportunities in 2006 compared to the previous study from 2004. Furthermore, they also said that the work seems more challenging in 2006 than in 2004, that greater care was shown them professionally and that job security, which is a prerequisite for job satisfaction, has increased.

## 5. Customer Satisfaction

FØROYA BANKI is constantly monitoring whether customers are satisfied with the services offered by the Bank. This is done in order to continually be able to provide the best service.

In 2006 FØROYA BANKI asked what the customers think as regards cooperation with the bank and how satisfied they are with this cooperation.

The main questions are based on customers' assessment of the reputation and expectations to the Bank, products and personal service.

Below, the result of the 2006 survey is compared to results from Danish banks. The highest rating possible is 100.

<b>Corporate Customers</b>	<b>FØROYA BANKI</b>	<b>Danish Banks</b>
Bank's Reputation	78	78
Expectations to the Bank	86	81
Products	81	78
Personal Service	84	82
<b>Retail Customers</b>		
Bank's Reputation	79	82
Expectations to the Bank	87	83
Products	81	82
Personal Service	84	85

Throughout its existence, the Bank has always sought to maintain good relations to its customers, particularly with regard to personal service. In the corporate area the Bank is better placed than Danish banking institutions and in the retail area the Bank maintains approximately the same position as Danish banks.

## 6. Board and Management Changes

Prior to the General Meeting in March 2006 the Bank's employees elected two representatives to the Board of Directors. Sigmar Jacobsen was re-elected and elected for the first time was Olav Enomoto, hence replacing Jóhan Elkjær Hansen.

The Board composition changed in November, when Rúni Hansen left the Board of Directors at the extraordinary General Meeting. Graham D. Stewart, CEO of Faroe Petroleum was elected to the Board in his place. After this rearrangement Jóhannus Egholm Hansen was elected Vice-chairman.

**In the back row from the left:** Sigmar Jacobsen, Employee Representative, Høgni Hansen, Board member, Jóhannus E. Hansen, Vice-chairman, Graham D. Stewart, Board member, Olav Enomoto, Employee Representative **In the front row from the left:** Janus Petersen, CEO, Jóhan Páll Joensen, Chairman, Súni Schwartz Jacobsen, Managing Director



## 7. Corporate Governance

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FØROYA BANKI emphasises ensuring investors detailed information about the company. Therefore management follows the main points in the recommendations from “Recommendations for good corporate governance in Denmark – Corporate Governance in Denmark” These recommendations are beneficial for the Bank, its investors and its partners. The Bank follows most of the recommendations. Where the Bank does not comply, the reasons are explained according to the guidelines set in the recommendations.

FØROYA BANKI aims for openness and strengthens communication with its partners by posting relevant and updated material to its website [www.foroyabanki.fo](http://www.foroyabanki.fo).

The Board of Directors comprises six members, of which the staff elects two. The Board of Directors is elected at the General Meeting. Election of Board members among the staff is conducted in accordance to relevant legislation.

The Board of Directors convenes at regular Board Meetings at least 10 times a year. In addition to this a strategy seminar is conducted annually.

It is important that all Board members have the necessary prerequisites for active membership in the Board. Rather than aiming for a specific number of board members, the Board of Directors prioritises the level of commitment from individual board members.

Age limit for election and re-election to the Board is set to 67 years.

In accordance to the Bank’s Articles of Association, members of the Board of Directors are elected for a 3-year term maximum with the possibility for re-election. The tenures are staggered so that one member is elected annually and two members every three years. This process is however set to be changed by an amendment to the Articles of Association at the coming General Meeting so that the entire Board is elected at every General Meeting.

FØROYA BANKI does not make use of councils and sub-committees, because the Board of Directors deems that the frequency of their sessions enables a full Board of Directors to make all the necessary decisions.

Currently, the Board of Directors does not see the need for regular assessments of Board of Directors or management and the cooperation between them. Through regular meetings and close collaboration, including working with management, the Board feels that it can have the necessary discussions about the achieved results.

The Board of Directors is compensated with a fixed fee, which is reflected in the Annual Report. The Board of Directors is not compensated with a profit related pay. FØROYA BANKI does not comply to the recommendations regarding transparency in compensation and severance agreements, as the Board of Directors regard such information sensitive.

It is believed that circumstances regarding appointment to management, including severance conditions, follow standard practice on the area and this is reassessed on a regular basis. Retirement assurances for management are already indicated in the financial statement. The management is not compensated with a performance related pay.

The Board of Directors always gives the Bank's risk their full attention and follows up on the risks regularly.

The Board of Directors maintains a steady and close cooperation with the Bank's auditors.





## 8. Risk Management

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FØROYA BANKI defines risk as any matter, which may have a negative influence on the Bank's possibilities to achieve its business objectives. Several types of risks may appear and the Bank controls and monitors these risks closely. The most important are credit risk, liquidity risk and market risks.

The credit department has over-all responsibility for the bank's risk management. That is where risk management systems, notices and corrective procedures are arranged.

In connection with the forthcoming listing of the Bank, a new compliance unit will be formed in the credit department, which will be responsible for ensuring that the Bank continues to comply with relevant legislation and internal guidelines set by the Bank itself.

### **Credit Risk**

The bank attaches importance to increasing lending in a way that generates greater profit in the long-term by taking on suitable credit risks. It works diligently to distribute risk evenly in all its lending activities.

The Bank is working on developing systems that can divide customers into credit risk groups to ensure the Bank a satisfactory monitoring process of credit, to facilitate the future plans of the Bank.

The Bank's monitoring of credit risk is to a certain extent delegated to those persons, who have the daily corporate responsibility of operating the lending departments.

Corporate customers are asked on a regular basis for insight into their financial status and generally the Bank receives copies of monthly or quarterly financial statements from larger corporations, where the Bank has a certain credit risk. Close communication between customer and the Bank, which dedicates itself to meeting the customers on the site where the activity is placed, ensuring the Bank updated information about the customers' financial status.

The Bank's credit department keeps check on the branches making sure that they follow-up on credit risks. If a customer's financial course is less than satisfactory, a conference is needed with the credit department and management about how the Bank must protect itself in the future, and a plan is devised regarding communication with the customer.

The Bank monitors all large exposures closely. The Bank's corporate business department in Tórshavn has the over-all responsibility of all business loans and the department stays in regular contact with all local corporate business advisors in the Bank's branch offices, where the course for each individual corporate business is discussed.

All corporate business exposures greater than DKK 2.5 mill. are evaluated annually in the credit department and management together with the relevant regional manager to assess the solidity of the exposures. It is assessed whether there is a need for special follow-up procedures and if the bank should rethink its position.

Credit meetings are conducted on a regular basis, where management, credit department and corporate business department discuss large corporate business loans.

### **The Bank's Loans and Guarantees**

The Bank's lending has increased by 33% in 2006. The most substantial growth is on loans to corporate and public activities, which is 50%. Within these sectors the biggest increases have been within the construction industry and the fishing industry. The Bank's increased funding within construction is in great part due to housing construction in the capital area. And the increase in the fishing industry is mainly for the building of new vessels and for acquisitions and consolidation of current fishery shipping companies on the Faroe Islands. The Bank's lending to companies in offshore activities increased significantly in 2006 and this is a step in the direction to divide the credit risk in corporate business loans.

The Bank's loans to individuals have increased by approximately 20% in 2006 and the increase stems mostly from funding for houses toward security in the property.

The Bank's large exposures, which are greater than 10% of the bank's equity are divided in a variety of risk groups. The exposures amount to approximately DKK 1,6 bn. Hereof 27% are granted to the public sector, 20% to aquaculture, and approximately 35% are granted to the construction, fishing and offshore industries. 18% are granted to other sectors.



The Bank's guarantees have increased by more than 50% and this specifically concerns labour guarantees as well as some larger collaterals in connection with the construction of ships.

### **Weak Loans**

The Bank keeps a watchful eye on those exposures where the state is considerably worse than expected. The Bank's branch offices have the daily responsibility of this process under the supervision of the credit department and management.

The Bank has few exposures where the interest is not calculated.

### **Provisions**

The Bank conducts a cautious policy regarding provisions. At year's end 2006, the Bank's provisions were DKK 301.5 mill. a total of DKK 66 mill. were carried-back in 2006.

The main cause of the carrying-back of provisions was reorganisations in the aquaculture in 2006.

A close assessment of the Bank's need for reversals is conducted quarterly, and all important exposures are examined annually by the credit department and management in connection with the financial statement. The conclusions from these examinations are presented to the Board of Directors for approval.

### **Liquidity Risk**

The Bank's liquidity is set in accordance with statutory requirements. In general, the bank aims for a composition of the balance to ensure a satisfactory and stable liquidity. The Bank's continuous goal is to have a liquidity that is 100% in excess of statutory requirement. Management receives daily reports on the liquidity.

In 2006 the Bank had a considerably higher increase in lending than in deposits. This, together with the DKK 600 mill. dividend paid in 2005, led to a great increase in the Bank's lending from financial institutions. Lending has increased from a DKK 113 mill. deficit in 2005 to DKK 1,243 mill. in 2006. To ensure a stable liquidity the Bank aims to divide the loans in relation to creditor and repayment period.

In 2006 the liquidity was 132.2% in excess of statutory requirements.

The Bank works to increase deposits as much as possible in addition to acquiring funding from other financial institutions to ensure a satisfactory liquidity.

### **Market Risk**

FØROYA BANKI controls the market risks in accordance with fixed limits to various risks. The Accounting Department and the Investment and Treasury Department prepare specifications, supervision and management reports. Management and Board of Directors receive reports on the monthly market risks.

### **Interest Risk**

The Bank's interest risk is set according to the demands from the Danish Financial Supervisory Authority. The interest risk is defined, as the complete risk should the interest change by one percent.

The Bank's total interest risk was DKK 13.2 mill. in the end of 2006 or 1.1% in relation to core capital. In 2005 the interest risk was DKK 37 mill. or 3.4% in relation to core capital. This decrease in interest risk stems from a decrease in the Bank's portfolio of bonds.

### **Currency Risk**

The Bank's currency market risk is measured by two key figures, Currency position and Currency risk respectively. The key figures are calculated according to the demands from the Danish Financial Supervisory Authority.

The currency position is an account of total value of the currency in relation to core capital. The currency risk shows the size of the loss that the Bank may receive from currency.

The Bank's currency position in 2006 was DKK 146.2 mill. while the currency risk in 2006 was DKK 0.3 mill. or 0.0% in relation to core capital. The reason for the low currency risk is that the majority of the Bank's currency is in EUR. In 2005 the currency was also 0.0%.

### **Equity Risk**

The share risk is calculated as share price of the Bank's total hold of shares. At year's end 2006 the Bank held listed shares worth DKK 122 mill. In 2005 the Bank held DKK 81 mill.

The increase in the Bank's shareholding is a step in the process spreading the risk profile of the bond portfolio. In addition to this the Bank divides the risk in its shareholding by buying shares from different countries and industries.

## 9. Prospects for 2007

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It is estimated that net interest and fee income for 2007 will be in the range of DKK 290 - 310 mill. The increase in net interest income stems mainly from an expected net increase in lending of approximately DKK 1 bn. Since the competition on the Faroese financial market is still fierce, an increase in interest margin is not expected.

Awareness on investments in bonds, shares and mutual funds among the Faroese population has increased significantly in the last years. FØROYA BANKI emphasizes providing advice on purchase and sale of securities. The Bank expects increased fee and commission income from this activity in 2007.

In 2006, several measures were taken as steps in the Bank's growth strategy, thus increasing expenses. Numerous employees were hired, which raised total number of employees by more than 30 people. It is expected that staff expenses will increase somewhat in 2007, because the increase in employees does not take full effect before 2007. This is an investment deemed necessary to implement the Bank's growth plan and to further enhance customer relations. Nevertheless the Bank expects its income-to-cost ratio to increase.

As mentioned earlier the annual result for 2006 is significantly influenced by carry-backs of provisions of loans. In 2007, the Bank expects provisions to be normalised.

In conclusion, FØROYA BANKI expects a result in the range of DKK 120 - 140 mill. before tax in 2007.



ets  
**total assets**  
ovnar / Due to credit institutions  
s  
Other liabilities  
lok / Equity, end of year  
ilities and equity

## The Centenary Celebrations Attended by 4,500 Guests



On 01 March 2006 one hundred years had passed since FØROYA BANKI started in a small house in Niels Finsensgøta in Tórshavn. This was celebrated in various ways during the Anniversary year. The Bank had a special centenary logo prepared, which was used in connection with most of the events and the advertisement campaign. The Bank also published a new book, *Føroyar and the Banks in a Hundred Years* written by Jørn Astrup Hansen, former CEO of FØROYA BANKI, and Jóan Pauli Joensen, professor and Vice-chancellor of the Faroese University. The book was delivered to every household on the Faroe Islands in December 2006.



Largest among the Bank's birthday events were five admission-free gala evenings in October for the bank's customers. The invitation process for the gala evening was organised in such a way that 10,000 customers received a letter urging them to sign up for the evenings. The first 3,500 applicants were given invitations. The remaining 1,000 seats were offered to the public and customers who were not invited in the first round. These invitations were given away in just 30 minutes.



The gala evenings took place in five assembly halls in Tórshavn, Klaksvík, Tvøroyri and Skála in the days between the 22 and 26 October. Every evening Janus Petersen, the CEO of FØROYA BANKI, welcomed the guest by e.g. calling attention to the fact that the Bank wants as many customers as possible to buy shares in FØROYA BANKI when the sale of shares begins.



The guests enjoyed themselves throughout the two and a half hour event with entertainment from the Danish masters of comedy Jacob Haugaard and Finn Nørbygaard and many more professional performances from Faroese artists. On the program were choir singing, drum dancing, pop music, a film about the Bank's history and a meal prepared by Hotel Føroyar, the country's biggest hotel. The evenings were the talk of the town for days, and people particularly commented on how well they were organised.

During the last gala evening the Bank handed a check worth DKK 1.5 mill. to Herbergjið, the Salvation Army's homeless shelter. Jóhan Páll Joensen, the Chairman of the Board of Directors handed the gift, which was a check and a preliminary construction blueprint made free of charge by MAP-arkitektur, a local architectural firm, to representatives for the Salvation Army. The plan is to rebuild and expand Herbergjið so that it can accommodate more occupants.





# Income Statement

DKK 1,000

		2006	2005
5	Interest income, etc.	327,427	298,279
6	Interest expenses, etc.	88,692	64,066
	<b>Net interest income</b>	<b>238,736</b>	<b>234,213</b>
7	Dividends from shares and other investments	1,548	516
	Fee and commission income, etc.	34,964	20,802
	Fees and commissions paid	280	254
	<b>Net interest and fee income</b>	<b>274,968</b>	<b>255,277</b>
8	Value adjustments of securities and foreign exchange, etc.	7,432	7,636
9	Other operating income	-1,991	2,235
	<b>Results from net financials</b>	<b>280,409</b>	<b>265,148</b>
10	Employee and administrative expenses	154,353	136,105
21	Amortisation and depreciations	7,606	6,444
	Other operating expenses	14	0
29	Provisions for poor and doubtful debts (net)	-67,969	-34,341
11 20	Income from groups and associates	7,046	1,511
	<b>Profit from ordinary activities before tax</b>	<b>193,451</b>	<b>158,451</b>
12	Tax	34,042	29,543
	<b>Net profit for the year</b>	<b>159,409</b>	<b>128,908</b>
<b>Allocation of profit</b>			
	Net profit for the year	159,409	128,908
	Brought forward from previous years	890,317	1,447,800
	<b>Amount to be allocated</b>	<b>1,049,726</b>	<b>1,576,708</b>
	Dividends	0	600,000
	Adjustment of revaluation reserve under equity method	7,046	1,511
	Increase of share capital by premium share issue	0	100,000
	Retained profit	1,042,680	875,197
	<b>Total</b>	<b>1,049,726</b>	<b>1,576,708</b>

# Balance Sheet at 31 December

DKK 1,000

			<b>2006</b>	<b>2005</b>
<b>Assets</b>				
		Cash in hand and demand deposits with central banks	201,877	73,747
16	32	Due from credit institutions, etc.	331,612	104,263
29	33	Loans	5,408,119	4,071,455
17		Bonds, etc.	864,119	1,802,928
18		Shares, etc.	134,813	83,306
20		Investments in associates	35,026	4,713
20		Investments in group enterprises	113,416	122,358
21		Tangible assets	60,762	62,487
22		Treasury shares	0	0
		Other assets	57,115	43,561
		Prepayments	6,016	5,217
		<b>Total assets</b>	<b>7,212,876</b>	<b>6,374,034</b>
<b>Liabilities and equity</b>				
23	34	Due to credit institutions and central banks	1,243,066	113,499
24	35	Deposits	4,646,731	4,506,532
		Other liabilities	74,462	664,338
		Deferred income	0	0
25		Provisions for commitments	3,099	3,556
1	2	<b>Equity</b>		
		Share capital	200,000	200,000
		Reserves	2,839	10,912
		Brought forward from previous years	890,317	875,197
		Retained profit for the year	152,363	0
		Total equity	1,245,519	1,086,110
		<b>Total liabilities and equity</b>	<b>7,212,876</b>	<b>6,374,034</b>
<b>Off-balance-sheet items</b>				
3		Guarantees, etc.	359,081	236,885
4		Other commitments	0	0
		<b>Total</b>	<b>359,081</b>	<b>236,885</b>



# Notes to the Financial Statements

DKK 1,000

	2006	2005
<b>1</b>	<b>Changes in capital</b>	
	200,000	100,000
	200,000	200,000
	10,912	9,402
	7,046	1,511
	15,119	0
	2,839	10,912
	875,197	1,447,800
	15,119	0
	152,363	-572,603
	1,042,680	875,197
	<b>1,245,519</b>	<b>1,086,110</b>
<b>2</b>	<b>Calculation of capital adequacy</b>	
	1,242,836	1,081,795
	1,239,836	1,078,795
	4,672,973	3,214,255
	540,894	703,569
	5,213,867	3,917,824
	23.8	27.6
	23.8	27.5
	The solvency ratio is calculated in accordance with the Danish Financial Supervisory Authority's executive order on the rules of capital adequacy for banks and certain credit institutions. The solvency ratio is 8 pct.	
<b>3</b>	<b>Off-balance-sheet items</b>	
	<b>Guarantees, etc.</b>	
	11,301	10,235
	347,780	226,650
	<b>359,081</b>	<b>236,885</b>

DKK 1,000

	<b>2006</b>	<b>2005</b>
<b>4 Other commitments</b>		
Irrevocable loan commitments	0	0
Other commitments	0	0
<b>Total other commitments</b>	<b>0</b>	<b>0</b>
<b>5 Interest income and premiums on forwards</b>		
Credit institutions and central banks	5,209	6,358
Loans	280,723	230,675
Bonds	43,999	65,134
Total financial instruments	-2,513	-3,955
Of which:		
Currency contracts	119	201
Interest rate contracts	-2,633	-4,156
Other transactions	0	0
Miscellaneous	9	66
<b>Total interest income</b>	<b>327,427</b>	<b>298,279</b>
Of which accounted for by income from genuine sale and repurchase transactions	0	0

## Notes to the Financial Statements

DKK 1,000

		2006	2005
6	<b>Interest expenses</b>		
	Credit institutions and central banks	10,548	547
	Deposits	78,144	63,519
	<b>Total interest expenses</b>	<b>88,692</b>	<b>64,066</b>
	Of which interest expenses on genuine sale and repurchase transactions are carried under:		
	Credit institutions and central banks	0	10
7	<b>Dividends</b>		
	Shares	1,548	516
	<b>Total</b>	<b>1,548</b>	<b>516</b>
8	<b>Value adjustments</b>		
	Bonds	-2,270	-8,870
	Shares	5,978	11,282
	Foreign exchange	3,665	5,009
	Total financial instruments	59	215
	<b>Total value adjustments</b>	<b>7,432</b>	<b>7,636</b>
	Of which:		
	Currency contracts	490	-9
	Interest rate contracts	-431	224
	Other contracts	0	0
	<b>Total</b>	<b>59</b>	<b>215</b>
9	<b>Other operating income</b>		
	Internal rental income	4,283	4,419
	Repairs and maintenance of properties	-6,509	-2,916
	Proceeds from sale of properties	235	731
	<b>Total</b>	<b>-1,991</b>	<b>2,235</b>

DKK 1,000

		<b>2006</b>	<b>2005</b>
10	<b>Employee and administrative expenses</b>		
	Executive Board	2,970	3,507
	Board of Directors	1,125	692
	<b>Total</b>	<b>4,095</b>	<b>4,199</b>
	<b>Employee expenses:</b>		
	Salaries	68,938	68,903
	Pensions	6,033	5,414
	Social security expense	5,452	4,499
	<b>Total</b>	<b>80,423</b>	<b>78,816</b>
	<b>Other administrative expenses</b>	<b>69,835</b>	<b>53,090</b>
	<b>Total employee and administrative expenses</b>	<b>154,353</b>	<b>136,105</b>
11	<b>Profit (loss) on investments in associates and group enterprises</b>		
	Associates	313	-209
	Group enterprises	6,733	1,719
	<b>Total</b>	<b>7,046</b>	<b>1,511</b>
12	<b>Tax</b>		
	Estimated tax charge on the profit for the year	32,748	32,808
	Adjustment of tax assets	1,246	-1,435
	Adjustment of previous year tax charge	48	-1,830
	<b>Total</b>	<b>34,042</b>	<b>29,543</b>
	<b>Breakdown of tax liability:</b>		
	Estimated tax (18%) on profit (loss) from ordinary activities before tax	34,821	31,690
	Tax value of non-taxable income	-1,533	-999
	Tax value of non-deductible expenses	-541	2,116
	Adjustment of tax assets	1,246	-1,435
	Adjustment of previous year tax charge	48	-1,830
	<b>Tax charged to the income statement</b>	<b>34,042</b>	<b>29,543</b>
	Effective tax rate (tax charged to the income statement relative to profit (loss) from ordinary activities before tax)	17.6%	18.6%

## Notes to the Financial Statements

DKK 1,000

	2006	2005
<b>13 Executive Board and Board of Directors</b>		
Size of loans, pledges, sureties or guarantees and related collateral provided to the members of the Executive Board and Board of Directors specified below:		
<b>Executive Board</b>		
Loans	910	945
Collateral	910	1,000
<b>Board of Directors</b>		
Loans	1,653	1,664
Collateral	1,332	1,400
<b>14 Auditors fee</b>		
Total fees for the accountancy firms elected by the annual general meeting to perform the statutory audit	1,070	989
Of which fees for non-audit services	100	0
<b>15 Number of employees</b>		
Average number of full-time employees for the accounting year	207,2	195,0
<b>16 Due from credit institutions and central banks</b>		
Deposits at notice with central banks	0	0
Due from credit institutions	331,612	104,263
<b>Total</b>	<b>331,612</b>	<b>104,263</b>
<b>17 Bonds</b>		
Listed	864,119	1,802,928
<b>Total</b>	<b>864,119</b>	<b>1,802,928</b>
The Bank has deposited bonds at a total market value of DKK 51 million with Danmarks Nationalbank (central bank) in connection with clearing.		
<b>18 Shares</b>		
Listed shares	76,908	61,659
Other shares	45,141	19,320
Other investments	12,764	2,327
<b>Total</b>	<b>134,813</b>	<b>83,306</b>

DKK 1,000

	<b>2006</b>	<b>2005</b>
<b>19 Financial current assets</b>		
Financial current assets valued at market value	986,169	1,883,907
The difference between the cost of financial current assets and the higher market value at the time of reporting	13,362	11,457
Financial current assets not valued at market value	0	0

## Notes to the Financial Statements

DKK 1,000

	2006	2005	2006	2005	2006	2005
	Group enterprises		Associates		Other investments	
<b>20 Financial fixed assets</b>						
Cost, beginning of year	113,972	113,972	2,300	2,300	2,762	1,460
Additions	14,325	0	30,000	0	12,163	8,792
Disposals	0	0	0	0	1,677	7,490
<b>Total cost, end of year</b>	<b>128,297</b>	<b>113,972</b>	<b>32,300</b>	<b>2,300</b>	<b>13,249</b>	<b>2,762</b>
Revaluations and writedowns,						
beginning of year	8,386	6,780	2,413	2,621	-435	-358
Profit	6,733	1,606	313	0	0	0
Other changes in capital	-30,000	0	0	0	0	0
Revaluations and writedowns for the year	0	0	0	0	0	122
Reversal of revaluations and writedowns	0	0	0	209	50	200
<b>Revaluations and writedowns, end of year</b>	<b>-14,881</b>	<b>8,386</b>	<b>2,726</b>	<b>2,413</b>	<b>-485</b>	<b>-435</b>
<b>Book value, end of year</b>	<b>113,416</b>	<b>122,358</b>	<b>35,026</b>	<b>4,713</b>	<b>12,764</b>	<b>2,327</b>
Of which credit institutions	0	0	0	0	0	0

DKK 1,000

	2006	2005	2006	2005	2006	2005
	Land and buildings		Machinery and equipment		Total	
<b>21 Tangible assets</b>						
Cost, beginning of year	171,461	172,675	20,130	19,099	191,591	191,774
Additions	49	1,996	3,441	1,570	3,490	3,566
Disposals	1,012	3,210	269	539	1,281	3,749
<b>Total cost, end of year</b>	<b>170,498</b>	<b>171,461</b>	<b>23,302</b>	<b>20,130</b>	<b>193,800</b>	<b>191,591</b>
Depreciation and writedowns,						
beginning of year	113,262	111,285	15,842	14,903	129,104	126,187
Depreciation during the year	2,743	2,743	1,447	1,093	4,191	3,837
Reversal of depreciation and writedowns	0	766	257	154	257	920
<b>Depreciation and writedowns, end of year</b>	<b>116,006</b>	<b>113,262</b>	<b>17,032</b>	<b>15,842</b>	<b>133,037</b>	<b>129,104</b>
<b>Book value, end of year</b>	<b>54,492</b>	<b>58,198</b>	<b>6,270</b>	<b>4,289</b>	<b>60,762</b>	<b>62,487</b>
Full writeoff for the year	0	0	3,415	2,608	3,415	2,608

### 22 Treasury shares

The Bank's holding of treasury shares totals 144 shares of DKK 100 each.

No value has been assigned to these shares in the financial statements.

DKK 1,000

	<b>2006</b>	<b>2005</b>
<b>23 Due to credit institutions and central banks</b>		
Due to central banks	0	0
Due to credit institutions	1,243,066	113,499
<b>Total</b>	<b>1,243,066</b>	<b>113,499</b>
<b>24 Deposits</b>		
On demand	2,355,005	2,131,371
At notice	1,452,313	1,643,219
Time deposits	390,315	233,344
Special deposits	449,097	498,598
<b>Total</b>	<b>4,646,731</b>	<b>4,506,532</b>
<b>25 Provisions for obligations</b>		
Provisions for pensions and similar commitments	3,099	3,556
Provisions for deferred tax	0	0
Other provisions for commitments	0	0
<b>Total</b>	<b>3,099</b>	<b>3,556</b>
<b>26 Outstandings with group enterprises and associates, etc.</b>		
<b>Associates:</b>		
Assets:		
Loans	37,810	9,646
Liabilities:		
Deposits	60,761	761
<b>Group enterprises:</b>		
Assets:		
Loans	58,619	15,506
Liabilities:		
Deposits	72,128	116,966



## Notes to the Financial Statements

DKK 1,000

	2006	2005
27	<b>Credit risks:</b>	
	Loans and guarantees by sector and industry, percentage, end of year:	
	<b>6</b>	<b>7</b>
	<b>Public authorities</b>	
	Corporate sector:	
	13	9
	Fishing industry	
	5	5
	Manufacturing industries, etc.	
	2	2
	Building and construction, etc.	
	7	5
	Trade, hotels and restaurants	
	4	5
	Transport, mail and telephone	
	4	4
	Property administration, purchase and sale and business services	
	6	5
	Other industries	
	<b>41</b>	<b>34</b>
	<b>Total corporate sector</b>	
	<b>53</b>	<b>59</b>
	<b>Retail customers</b>	
	<b>100</b>	<b>100</b>
	<b>Total</b>	
28	<b>Credit risk on financial instruments</b>	
	Positive market value after netting	
	0	0
	Counterpart with risk weighting 0 pct.	
	320	196
	Counterpart with risk weighting 20 pct.	
	1,878	83
	Counterpart with risk weighting 100 pct.	
29	<b>Accumulated provisions</b>	
	301,537	371,869
	Provisions end of year against loans and guarantees	
	0	0
	Provisions end of year against due from credit institutions and other items involving a credit risk	
	301,537	371,869
	Total accumulated provisions	
	Accumulated provisions end of year against loans and guarantees as a percentage of loans and guarantees	
	5,0	7,9
	Non-accrual amounts due end of year	
	21,564	58,307

DKK 1,000

	<b>2006</b>	<b>2005</b>
<b>30 Foreign exchange risk</b>		
Assets in foreign currency	138,927	33,733
Liabilities and equity in foreign currency	266,943	16,746
Exchange rate indicator 1	146,193	87,360
Exchange rate indicator 1 as a percentage of core capital after statutory deductions	11,8	8,1
Exchange rate indicator 2	337	270
Exchange rate indicator 2 as a percentage of core capital after statutory deductions	0,0	0,0
<b>31 Interest rate risk</b>		
Interest rate risk	13,220	36,973
Interest rate risk broken down by the institution's currency with largest interest rate risk		
DKK	11,765	34,298
EUR	1,453	2,651
USD	2	0
GBP	0	24
<b>Maturity distribution by remaining life</b>		
<b>32 Due from institutions and central banks</b>		
On demand	85,612	36,263
3 months and below	246,000	68,000
<b>Total</b>	<b>331,612</b>	<b>104,263</b>
<b>33 Loans</b>		
On demand	56,481	39,013
3 months and below	194,302	167,039
3 months to 1 year	451,093	416,352
Over 1 year to 5 years	1,655,767	1,420,183
Over 5 years	3,050,477	2,028,867
<b>Total</b>	<b>5,408,119</b>	<b>4,071,455</b>

# Notes to the Financial Statements

DKK 1,000

	2006	2005
<b>34 Due to credit institutions and central banks</b>		
On demand	297,566	113,499
3 months and below	945,500	0
<b>Total</b>	<b>1,243,066</b>	<b>113,499</b>

	2006	2005
<b>35 Deposits</b>		
On demand	2,354,807	2,131,317
At notice:		
3 months and below	2,118,150	2,165,080
3 months to 1 year	6,173	6,007
Over 1 year to 5 years	167,371	204,126
Over 5 years	229	2
<b>Total</b>	<b>4,646,731</b>	<b>4,506,532</b>

	2006	2005	2006	2005
	Nominal		Net market value	
<b>36 Financial instruments</b>				
<b>Maturity distribution by remaining life</b>				
<b>3 months and below</b>				
Currency contracts:				
Forwards/futures, bought	260,875	14,977	-1,110	33
Forwards/futures, sold	40,246	18,486	1,415	89
Options, bought	2,265	0	0	0
Options, written	1,132	0	0	0
Interest rate contracts:				
Forwards/futures, bought	0	50,000	0	8

DKK 1,000

36	<b>Financial instruments</b>	2006	2005	2006	2005
		Nominal		Net market value	
<b>3 months to 1 year</b>					
Currency contracts:					
	Forwards/futures, bought	30,005	0	-213	0
	Forwards/futures, sold	29,638	0	239	0
<b>1 year to 5 years</b>					
Currency contracts:					
	Forwards/futures, bought	31,138	0	-154	0
	Forwards/futures, sold	31,138	0	185	0
Interest rate contracts:					
	Swaps	25,000	0	-602	0
<b>Over 5 years</b>					
Interest rate contracts:					
	Swaps	14,200	0	164	0
<b>Total</b>					
Currency contracts:					
	Forwards/futures, bought	322,018	14,977	-1,477	33
	Forwards/futures, sold	101,022	18,486	1,838	89
	Options, bought	2,265	0	0	0
	Options, written	1,132	0	0	0
Interest rate contracts:					
	Forwards/futures, bought	0	50,000	0	8
	Swaps	39,200	0	-439	0
<b>Total net market value</b>				<b>-77</b>	<b>129</b>

# Notes to the Financial Statements

DKK 1,000

	2006	2005	2006	2005
	Positive	Positive	Negative	Negative
37 <b>Financial instruments</b>				
<b>Maturity distribution by remaining life</b>				
<b>Market value:</b>				
Currency contracts:				
Forwards/futures, bought	108	94	1,585	61
Forwards/futures, sold	1,926	177	88	89
Interest rate contracts:				
Forwards/futures, bought	0	8	0	0
Swaps	164	0	602	0
<b>Market value of non-guaranteed contracts</b>				
Currency contracts:				
Forwards/futures, bought	108	94	1,585	61
Forwards/futures, sold	1,926	177	88	89
Interest rate contracts:				
Forwards/futures, bought	0	8	0	0
Swaps	164	0	602	0
<b>Total</b>	<b>2,198</b>	<b>279</b>	<b>2,275</b>	<b>149</b>
<b>Total after netting</b>	<b>-77</b>	<b>129</b>		

DKK 1,000

		2006	2005
38	<b>Number of branches in addition to the Head Office</b>	19	20
39	<b>Share capital</b>		
	Fíggjargrunnurin frá 1992 owns 99,4% of the share capital. The share capital, which is not divided into share classes, is distributed on 2,000,000 shares of DKK 100 each.		
40	<b>Subsidiaries</b>		
	The Bank has the following subsidiaries, which are not consolidated in the Bank's financial statements.		
		<b>Activity</b>	<b>Proportion of share capital</b>
	P/F Trygd	insurance company	100%
	P/F Vestlax	aquaculture	100%
	P/F FB Holding	no activity	100%
	P/F Skyn	real estate	100%
41	<b>Associates</b>		
		<b>Activity</b>	<b>Proportion of share capital</b>
	P/F Bakkafrost Holding	aquaculture	36%
	P/F Løkir	investment company	33%
	P/F Elektron	IT services	34%

# Statement by the Executive Board and Board of Directors on the Annual Report

The Executive Board and Board of Directors have today discussed and adopted the financial statements of P/F FØROYA BANKI for the financial year 2006.

The financial statements have been prepared in accordance with applicable Danish law and the Bank's Articles of Association.

In our opinion, the financial statements give a true and fair view of the Bank's assets and liabilities, financial position, net profit and cash flows.

We recommend that the financial statements be adopted by the annual General Meeting.

Tórshavn, 16 February 2007

## **Executive Board**

Janus Petersen

Súni Schwartz Jacobsen

## **Board of Directors**

Jóhan Páll Joensen

Jóhannus Egholm Hansen

Høgni Hansen

Graham D. Stewart

Olav Enomoto

Sigmar Jacobsen



# Auditor's Report

We have audited the financial statements of P/F FØROYA BANKI for the financial year 2006, presented by the Executive Board and Board of Directors.

## **Basis of opinion**

We conducted our audit in accordance with the executive order of the Danish Financial Supervisory Authority on auditing of financial enterprises and in accordance with generally accepted auditing standards. Based on an evaluation of materiality and risk we assessed, during the audit, business procedures applied and tested the basis of amounts and other disclosures in the financial statements.

Our audit did not result in any qualification

## **Opinion**

In our opinion, the financial statements have been presented in accordance with statutory accounting provisions and the financial statements give a true and fair view of assets and liabilities, financial position and net profit.

Tórshavn, 16 February 2007

**Petur A. Johannesen**

Chief Auditor

# Auditor's Report

We have audited the financial statements of P/F FØROYA BANKI for the financial year 2006, presented by the Executive Board and Board of Directors.

## **Basis of Opinion**

We planned and conducted our audit in accordance with generally accepted auditing standards to obtain reasonable assurance that the financial statements are free of material misstatement or errors. Based on an assessment of materiality and risk, we tested, during the audit, the basis and documentation for the amounts and other disclosures of the financial statements. We also assessed the accounting policies applied and the estimates made by the Executive Board and Board of Directors and we evaluated the overall presentation of the financial information included in the financial statements.

Our audit did not result in any qualification.

## **Opinion**

In our opinion, the financial statements have been prepared in accordance with statutory accounting provisions and give a true and fair view of the Bank's assets and liabilities, financial position and net profit.

Tórshavn, 16 February 2007

### **SPEKT**

Statsaut. revisorar Sp/f

### **Rasmussen & Weihe, P/F**

Statsaut. grannskoðarafelag

### **Finnbjørn Zachariassen**

State Authorised Public Accountant

### **Klaus Rasmussen**

State Authorised Public Accountant

### **Jákupa Mikkelsen**

MSc in Business Administration  
and Auditing

### **Ole Guldborg Nielsen**

MSc in Business Administration  
and Auditing

# Accounting Policies

The financial statements of P/F FØROYA BANKI have been prepared in accordance with the Danish Banking Act and with the executive order and guidelines of the Danish Financial Supervisory Authority on presentation of financial statements by banks.

The accounting policies are unchanged relative to last year.

All income and expenses are accrued and included in the income statement only at the amounts relevant to the financial year.

## **Consolidated Financial Statement**

The Bank has four subsidiaries: P/F Trygd, which conducts activities within general insurance and P/F Skyn, which is a real estate brokerage. In addition, the Bank acquired the shares in P/F Vestlax, for the purpose of restructuring the company, and P/F Holding, which has no activity.

The consolidated account has not been prepared.

## **Interest and commission**

Interest income and interest expenses and current commissions are accrued. Interest receivable and payable are carried in the balance sheet under Other assets / Other liabilities to the extent that they have not been added to the respective accounts. Dividends are booked at the time of payment. Fees and one-off commission are booked on an ongoing basis.

## **Foreign currency**

Assets and liabilities in foreign currency are booked at the exchange rates prevailing at the balance sheet date. Forward exchange transactions are booked at the forward rate on 31 December.

## **Bonds, shares and mortgages**

Listed securities are booked at the officially listed exchange rates prevailing at the balance sheet date. Unlisted securities are included at their estimated value.

## **Loans, guarantees and amounts due from credit institutions**

The Bank's loans and guarantees are subject to evaluation to identify risks of losses. Doubtful debts are written off and provisions are made against risk claims. Fixed-rate amounts due to the Bank are stated at their current outstanding amounts or the market value at the balance sheet date,

whichever one is lower. Value adjustment of fixed-rate loans and advances is incorporated in the income statement.

### **Investments in group enterprises and associates**

Investments in group enterprises and associates are recognised in the financial statements' balance sheet by use of the equity method. However, companies acquired with a financial restructuring as an objective, are recognised in the balance sheet at cost.

### **Tangible assets**

Land and buildings are stated at cost or market value, subject to a specific, individual assessment. From and including the financial year 1996, systematic depreciation has been provided for the Bank's buildings used for commercial purposes.

Machinery and equipment are stated at cost less depreciation. Depreciation is provided on a straight-line basis, based on the estimated useful lives of the assets.

The estimated useful lives are:

Buildings	20 to 30 years.
Machinery and equipment	3 to 5 years.

Acquisitions below DKK 20,000 are written off immediately.

### **Financial instruments**

Forward exchange transactions and options used for hedging purposes are stated at the market value at the end of the financial year. The transactions are included in the income statement under the item Value adjustment of other financial instruments and are booked in the balance sheet under the related assets or under Other assets / Other liabilities.

Interest rate swaps used to hedge interest rate risks are not value adjusted, they are mentioned in the notes only.

Interest on interest rate swaps is accrued and included as a net interest amount under other interest income in the income statement and in the item Other assets / Other liabilities in the balance sheet.

Genuine sale and repurchase transactions are included in the item Due to other credit institutions.

### **Other assets**

This entry, comprising interest due, positive market value of financial instruments and deposits, among other things, is booked at nominal value.

### **Prepayments**

This entry, comprising mainly prepaid payroll costs, is booked at nominal value.

### **Due to credit institutions and central banks**

Amounts due are included at nominal value.

### **Deposits**

All deposits are included at nominal value.

### **Tax**

The tax calculated on the taxable profit for the year is expensed in the income statement along with the year's change in provisions for deferred tax.

Provisions are made for tax assets, respectively deferred tax, at 18% of the difference between the values for tax and for accounting purposes.



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