

Increase of the countercyclical capital buffer in the Faroe Islands

17 June 2026

*The Systemic Risk Council recommends that the Minister of Taxation and Economic Growth increases the countercyclical capital buffer rate in the Faroe Islands from 1 per cent to 2 per cent from **30 September 2027**.*

Føroya Váðaráð, the Faroese systemic risk council, supports this decision.

The Systemic Risk Council is tasked with identifying and overseeing systemic financial risks in the Faroe Islands and may recommend macroprudential measures relating to banks in the Faroe Islands.¹ The purpose of introducing a countercyclical capital buffer is to mitigate the real economic downturn that would otherwise arise if access to credit for households and corporations were tightened excessively during periods of stress in the financial system.

The Minister of Taxation and Economic Growth is responsible for setting capital buffer requirements in the Faroe Islands, including the countercyclical capital buffer rate. The higher buffer requirement will take effect 12 months after the Minister has announced an increase. Institutions therefore have time to adjust.

The Minister is required, within a period of three months, either to implement the recommendation or to provide an explanation stating why it is not implemented.

The Council assesses the countercyclical capital buffer rate based on an overall assessment of developments in the financial system.² In addition to a range of indicators for developments in the financial system, the Council also takes into account other relevant information, such as other policy measures and current and forthcoming requirements for institutions.

The Council's methodology aims to ensure that the buffer is built up before the financial system is potentially hit by a negative shock that could affect financial stability and the real economy. Gradual increases in the buffer are consistent with the Council's strategy that the buffer rate should be gradually raised to a level of **2.5 per cent**.

The Council is prepared to recommend an immediate reduction of the buffer rate if stress arises in the financial system with a risk of a sharp tightening of credit to households and corporations.

¹ In 2016, the Faroe Islands decided to set up a Faroese Systemic Risk Council. As regards the areas of responsibility controlled by Denmark in the financial area, the Faroese Systemic Risk Council may submit opinions to the Systemic Risk Council in Denmark.

² See the Council's method paper on setting the buffer rate ([link](#)).

To ensure a level playing field between Faroese and foreign credit institutions with exposures in the Faroe Islands, it is mandatory under legislation for EU Member States³ to recognise the countercyclical capital buffer rate of 2 per cent for Faroese exposures.⁴

Grounds for the recommendation

The Council assesses that cyclical systemic risks are building up in the financial system; see Appendix A for a detailed description.

Indicators for the activation and build-up of the countercyclical capital buffer suggest that the economy has been in a period of prolonged expansion with a very tight labour market, only briefly interrupted by the pandemic in 2020. House prices have risen over a number of years and price increases accelerated during 2025 in both Tórshavn and rural areas. Total credit growth has also increased since the beginning of 2025. Overall, the Council assesses that cyclical systemic risks have been building up over a long period and are at an elevated level.

Systemic risks typically build up during periods when the economy is performing well. Overall, this suggests that the economy is well into the financial cycle, implying a higher level of the countercyclical capital buffer. The objective is to ensure that the buffer is built up before the cycle turns, so that institutions are more resilient when risks materialise, for example if the financial system is hit by a negative shock. In such circumstances, the buffer should be released.

Institutions' earnings are high and the minimum requirements for eligible liabilities (MREL) will be fully phased in on 1 July 2026. The increase in the countercyclical capital buffer is not expected to affect institutions' lending capacity.

The buffer strengthens resilience and supports lending during periods of financial stress

The countercyclical capital buffer is a tool to make institutions more resilient by increasing their capital requirement in periods when risks are building up. If financial stress arises, the buffer can be reduced immediately, thereby releasing capital.

If institutions do not use the released capital to absorb losses, they can use it for new lending or to maintain excess capital adequacy. This improves the ability of credit institutions to sustain an appropriate level of lending during periods of stress. The buffer thus helps limit negative effects on the real economy.

Faroese banks can already meet a one percentage point increase in the buffer with their current capital. Continued strong profit in 2026 also supports further capital accumulation.

The countercyclical capital buffer is not a hard requirement. Institutions breaching it would therefore not lose their licence. Banks would instead have to submit a capital conservation plan to the Danish Financial Supervisory Authority. Restrictions may also apply to bonus and dividend distributions if the combined capital buffer requirements are not met.⁵

³ This also applies to countries with which the EU has entered into agreements in the financial area, including Norway and Iceland.

⁴ Read more about reciprocity of other countries' macroprudential requirements on the Systemic Risk Council's website.

⁵ In addition to the countercyclical capital buffer, the combined capital buffer requirement consists of the general systemic buffer, the capital conservation buffer and a SIFI buffer for systemically important institutions, the so-called SIFIs; see the Danish Financial Supervisory Authority's Executive Order on Calculation of the Combined Capital Buffer Requirement, etc., issued on 16 December 2014, and the related note, Provisions on Capital Conservation Plans and Calculation of the Maximum Distributable Amount, available on the Danish Financial Supervisory Authority's website.

Other capital requirements

The Council also considers other policy measures when assessing the countercyclical capital buffer rate, including both current and forthcoming requirements.

MREL requirement

The MREL is set by the Danish Financial Supervisory Authority⁶ and will be gradually phased in by July 1, 2026, for Faroese banks. The MREL ensures that institutions can absorb losses and be recapitalised in resolution.

Institutions can meet an additional one percentage point countercyclical capital buffer requirement on top of current MREL and buffer requirements. They are assessed to have sufficient time to retain earnings and/or issue MREL-eligible debt.



Christian Kettel Thomsen, Chairman of the Systemic Risk Council

Statements from the representatives of the ministries on the Council

“The representatives of the ministries and the Danish Financial Supervisory Authority do not have voting rights in relation to recommendations addressed to the Government. The Government will request an assessment of the recommendation from Government of the Faroe Islands in order to form an overall assessment of whether there is a basis for following the recommendation. On this basis, the Government will, within three months, decide on the recommendation from The Systemic Risk Council.”

⁶The purpose of the MREL requirement is to ensure that institutions can be restructured or resolved without the use of public funds and without resolution having a significant adverse effect on financial stability. This purpose differs from that of the countercyclical capital buffer, which is intended to strengthen the ability of credit institutions to maintain an appropriate level of lending during periods of stress in the financial system. The MREL requirement may be met using several types of capital and debt instruments, whereas capital buffer requirements may be met only with Common Equity Tier 1 capital.

Appendix A – Assessment of developments

In assessing the buffer rate, the Council takes into account a number of selected key indicators intended to capture the build-up of systemic risks at different stages of the financial cycle. Supplementary indicators and other relevant information are also included in the assessment in order to provide a more nuanced picture than that suggested by the key indicators alone.

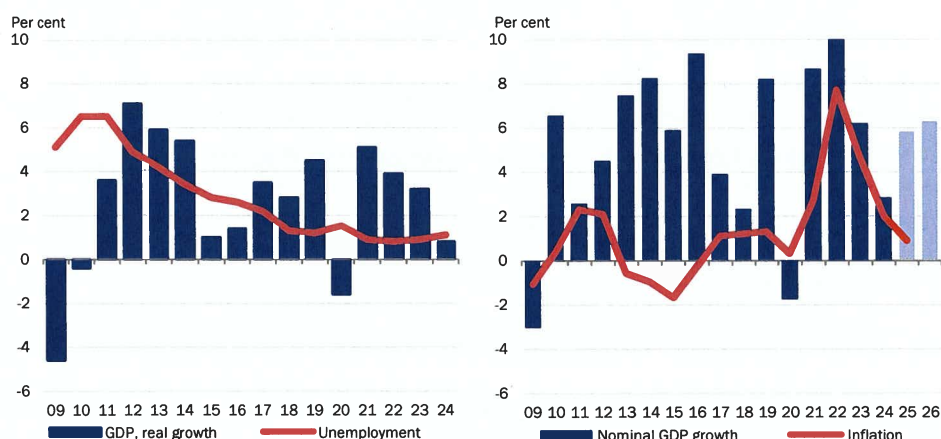
Economic developments

The economy has been in a period of prolonged expansion with very low unemployment, briefly interrupted by the pandemic in 2020, see chart A1, left. Growth has been driven by the primary and tertiary sectors. According to the Faroese Economic Council's latest projection (March 2026), growth remains strong, see chart A1, right. The Faroese economy is small and open, with a concentrated industrial structure in which the fisheries sector plays a highly prominent role. Large fluctuations in both fish prices and volumes may, in the short term, lead to lower GDP without necessarily indicating a broad-based decline in economic activity.

Growth in GDP, low unemployment and moderate increase in consumer prices Chart A1

Prolonged economic expansion and low unemployment

The Faroese Economic Council expects continued GDP growth



Note: Left: The chart shows real GDP growth and unemployment. The latest data for GDP at constant prices are for 2024. Right: The chart shows growth in nominal GDP based on data from Hagstova Føroya. The figures for 2025 and 2026 are projections from the Faroese Economic Council published in March 2026.

Source: Hagstova Føroya, the Faroese Economic Council and own calculations.

Labour market conditions remain tight, with low unemployment and high employment. The increase in employment in recent years reflects a substantial expansion of the labour force, including the entry of a large number of foreign workers into the Faroese labour market. In the past couple of years, however, employment growth has slowed, and the contribution from foreign labour has declined markedly. This suggests that pressures in the labour market remain elevated, albeit somewhat less so than previously.

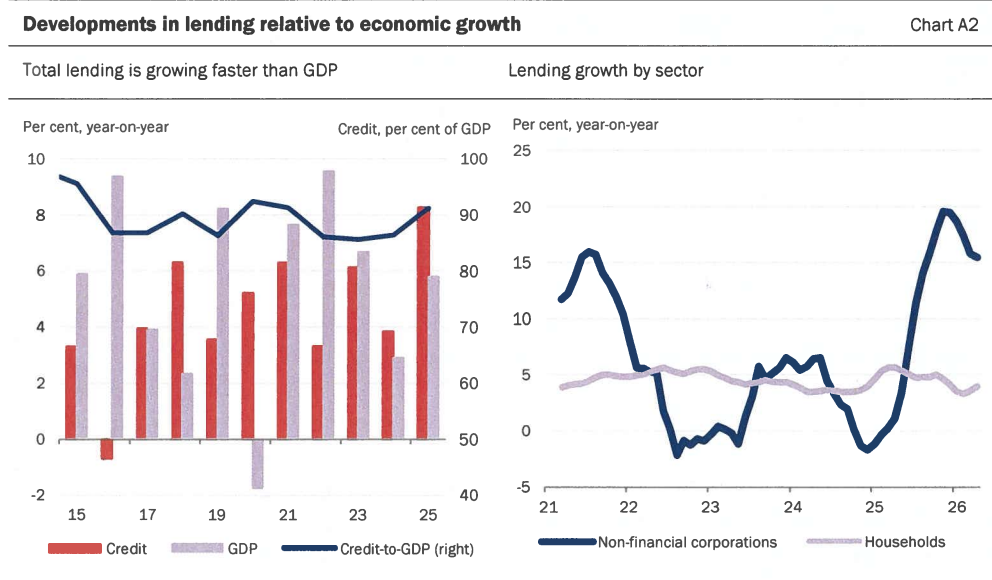
Real estate market

House prices in the Faroe Islands have risen sharply over a number of years, and the increase continued in 2025. This development should, inter alia, be seen in the light of positive economic developments, population growth, high wage increases and declining interest rates. The average annual increase in house prices in Tórshavn was approximately 9.6 per cent, while prices rose by just over 9 per cent in the larger settlement areas in the period

from 2024 to 2025.⁷ House prices in the smaller settlement areas have, on average, grown faster (measured in per cent) than in Tórshavn over the past 10 years.

Credit development^a

Credit growth in the Faroe Islands has picked up since the beginning of 2025 and stood at 9.8 per cent year-on-year at the end of April 2026. Credit growth also exceeds the growth in nominal GDP, see chart A2, left. The development has been driven in particular by growth in lending by Faroese and Danish credit institutions. Over the past year, the development has been driven by growth in credit to both non-financial corporations and households, see chart A2, right.



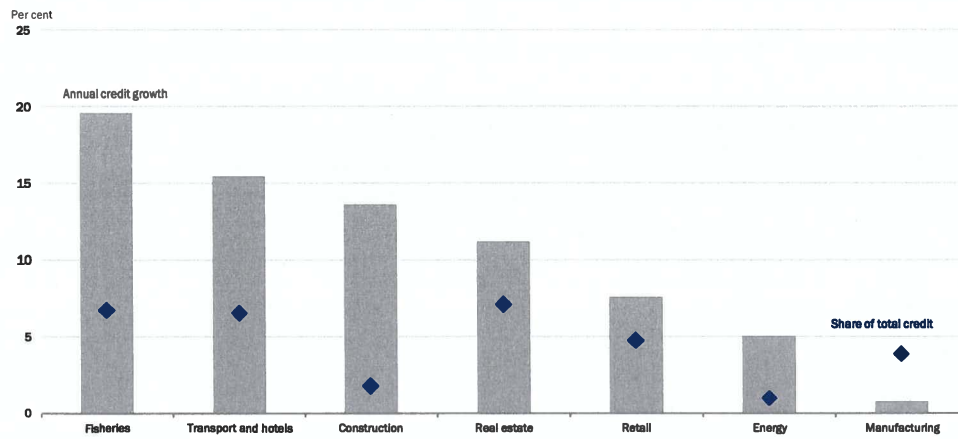
Note: Lending covers lending to Faroese residents (households, non-financial corporations and the public sector). Nominal GDP for 2025 is based on simple projections derived from the Faroese Economic Council's forecast for growth published in spring 2026. Right: The chart shows growth in nominal lending to Faroese non-financial corporations and households (including non-profit institutions) by Faroese, Danish and Greenlandic credit institutions. Non-financial corporations comprise private and public corporations. Lending growth is calculated as the annual growth rate of lending measured as a three-month moving average. Latest observation: April 2026.

Source: Danmarks Nationalbank, the Faroese Economic Council and own calculations.

Lending to non-financial corporations has shown particularly strong growth, which increased further during 2025. At the beginning of 2026, growth eased somewhat, and in April 2026 year-on-year growth in lending to non-financial corporations stood at just under 15 per cent, see chart A2.

⁷ The growth rate is based on the change in the average price in 2024 relative to the average price in 2025.

⁸ The credit developments referred to include lending by both Faroese, Danish and Greenlandic institutions. The description does not however take into account the developments in direct lending by Icelandic, Norwegian and Swedish institutions.



Note: The chart shows growth in lending by Faroese credit institutions to non-financial corporations in April 2026, broken down by sector. Lending growth is calculated as a three-month moving average.

Source: Danmarks Nationalbank.

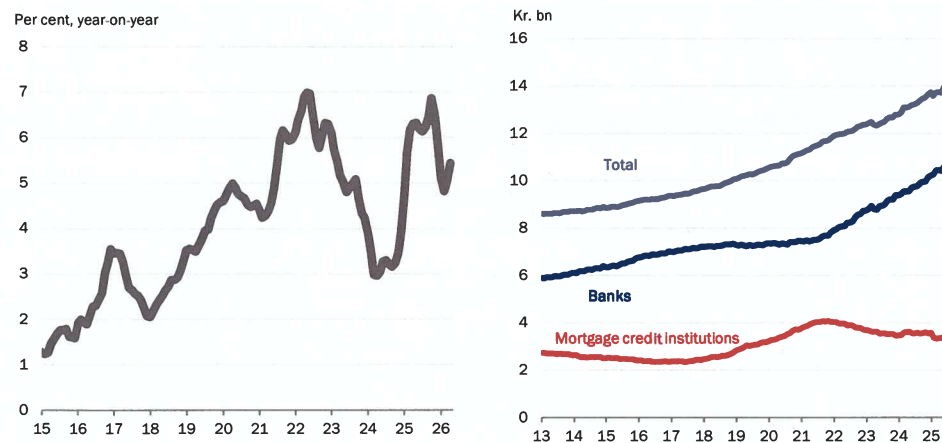
Growth in lending to non-financial corporations may fluctuate considerably. A breakdown of lending by sector shows that lending has grown strongly in several sectors, see chart A3. Growth has been particularly strong in lending to fisheries, transport and hotels, as well as construction.

While growth in total lending to households has remained moderate at close to 5 per cent, growth in housing lending picked up during 2025, see chart A4. The increase in house prices has not, in general, led to rising loan-to-value ratios among homebuyers. In smaller segments, however, for example among first-time buyers with the lowest loan-to-value ratios, there has been an increase. The majority of housing lending is amortising, which helps strengthen homeowners' resilience to shocks to the economy.

Growth in housing lending has picked up

Growth in housing lending has picked up

The development has been driven primarily by growth in lending by Faroese banks



Note: The charts show developments in lending for housing purposes to households in the Faroe Islands by Faroese, Danish and Greenlandic banks and Danish mortgage credit institutions. Lending growth is calculated as the annual growth rate of lending measured as a three-month moving average. Latest observation: April 2026.

Source: Danmarks Nationalbank.

House prices are also affected by the fact that there is no taxation of real property in the Faroe Islands and that subsidies are granted for interest expenses on housing loans. Both factors contribute to increasing fluctuations in house prices. In 2023, rules on lending for housing purposes were introduced corresponding to the Danish provisions on down payment requirements and debt-to-income ratios set out in the Executive Order on Good Practice for Housing Credit, see also box 1.

Rules on lending for housing purposes were introduced in the Faroe Islands in 2023.

The rules apply only to banks and therefore to loans granted by banks. Mortgage credit loans are not covered by the Executive Order. This is because the Executive Order provides legal authority only for laying down rules for banks, as the area of mortgage credit has been devolved to the Faroe Islands. The Executive Order therefore does not regulate, for example, Danish mortgage credit institutions.

The rules correspond to the Danish provisions on down payment requirements and debt-to-income ratios:

- Banks may grant loans only if the borrower is able to service a 30-year fixed-rate amortising loan. The rule applies to the part of the loan that falls within 80 per cent of the market value of the property.
- The borrower must make an appropriate down payment in connection with the raising of the loan.
- Risky mortgage-like loan agreements may not be entered into with borrowers with a high loan-to-value ratio if this simultaneously results in a high debt-to-income ratio.

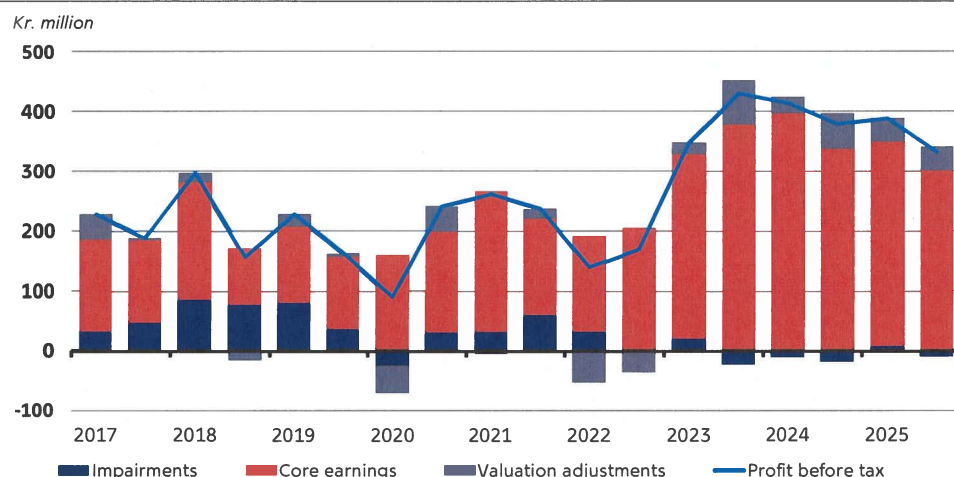
Source: Executive Order No. 1582 of 6 December 2023 for the Faroe Islands on good practice for financial institutions, sections 20-22.

Sector resilience

Faroese institutions have generally recorded high pre-tax profits over the past few years, see chart A5. At the same time, capital headroom above risk-based capital requirements increased during 2025. The higher capital headroom should also be seen in the light of institutions' requirements for eligible liabilities, which are being phased in by 1 July 2026. Institutions comply with the MREL requirement predominantly through Common Equity Tier 1 capital.

Earnings of Faroese institutions support capital accumulation

Chart A5



Note: *Left:* The chart shows Faroese institutions' results on a half-year basis. Core earnings comprise net interest and fee income, staff and administrative expenses, amortisation, depreciation and impairment losses on intangible and tangible assets, and other operating income and expenses. A positive value for impairment charges indicates that impairments have been reversed. Latest observation: Q4 2025.
Right: The chart shows Faroese institutions' capital headroom relative to the risk-based capital requirements (CET1 requirements under Pillar I and Pillar II, as well as capital buffers). The high capital headroom reflects the fact that institutions predominantly use CET1 capital to meet the MREL requirement.
 Latest observation: Q4 2025.

Source: The Danish Financial Supervisory Authority.

Føroya Banki distributed 70 per cent of its profit in 2025, while the corresponding share was approximately 18 per cent for Betri Bank. Overall, all institutions appear to have sufficient capacity to accommodate an increase in the countercyclical capital buffer from 1 per cent to 2 per cent.

Model-based indicators

Estimates of the financial cycle in the Faroe Islands suggest that financial developments are either on the upswing of the financial cycle or have levelled off at a high level. The estimates should be interpreted with caution, as they do not provide an exact picture of the

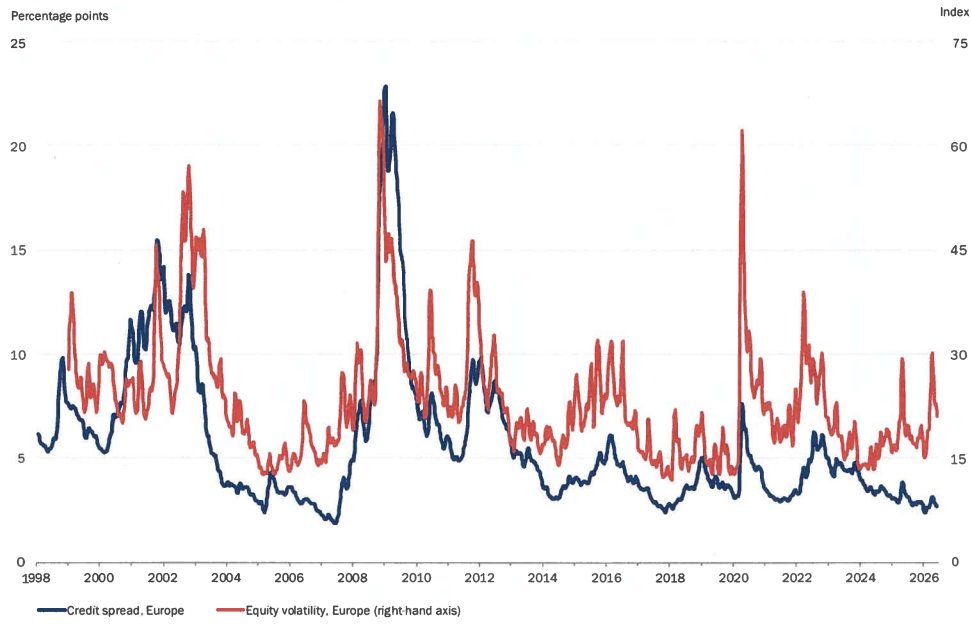
current financial cycle. Among other things, there is uncertainty at the end of the data period, the so-called end-point problem.⁹ Since 2021, for example, the estimates have indicated that developments in the economy and the financial sector were about to turn. This has, however, not proved to be the case, and the expansion in economic activity has continued while house prices have risen markedly. There has also been uncertainty regarding the effects on the economy of a number of external shocks (including Russia's invasion of Ukraine and higher interest rates), which has further complicated the interpretation of the estimates. The estimates therefore cannot necessarily be used to interpret the current situation or the direction of developments going forward. Rather, they may be used as an indicator of the overall level of cyclical systemic risks. Information on developments in the economy as a whole is therefore also included in the overall assessment.

⁹ See the appendix on page 54 of Grinderslev et al., *Financial Cycles: What are they and what do they look like in Denmark?*, Danmarks Nationalbank Working Paper, No. 115, June 2017. The analysis shows that the financial cycle is driven primarily by fluctuations in house prices and credit, with house prices tending to move ahead of credit.

Appendix B - Indicators

Credit spreads and volatility

Chart 1

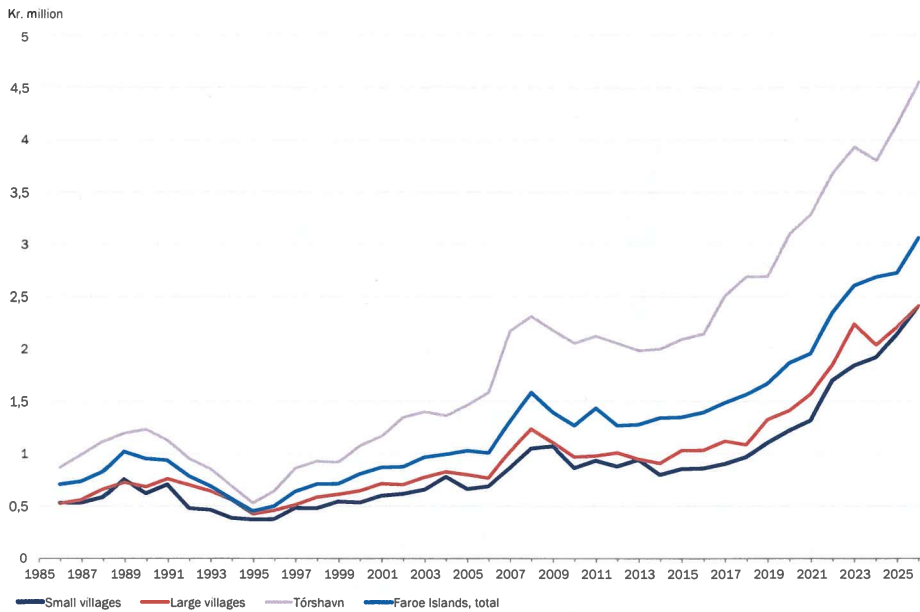


Note: Credit spreads are measured as the yield spread between euro-denominated high-yield corporate bonds and government bonds. Equity volatility is measured by the implied volatility of options on the Stoxx Europe 600, VSTOXX. Latest observation: 2 June 2026.

Source: Federal Reserve Bank of St. Louis og Bloomberg.

Average transaction prices for houses in the Faroe Islands

Chart 2

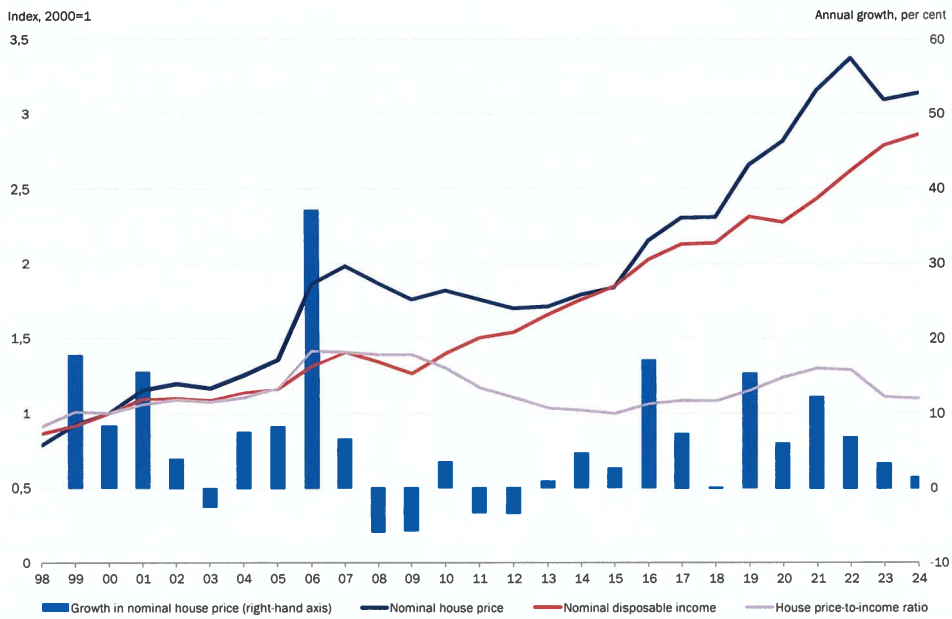


Note: The chart shows average house prices for each year. The figure for 2026 is based on house prices for 2025 projected using the growth in Føroya Banki's preliminary house price data for the second quarter of 2026.

Source: Hagstova Føroya, Føroya Banki, Danmarks Nationalbank and own calculations.

House prices and income

Chart 3

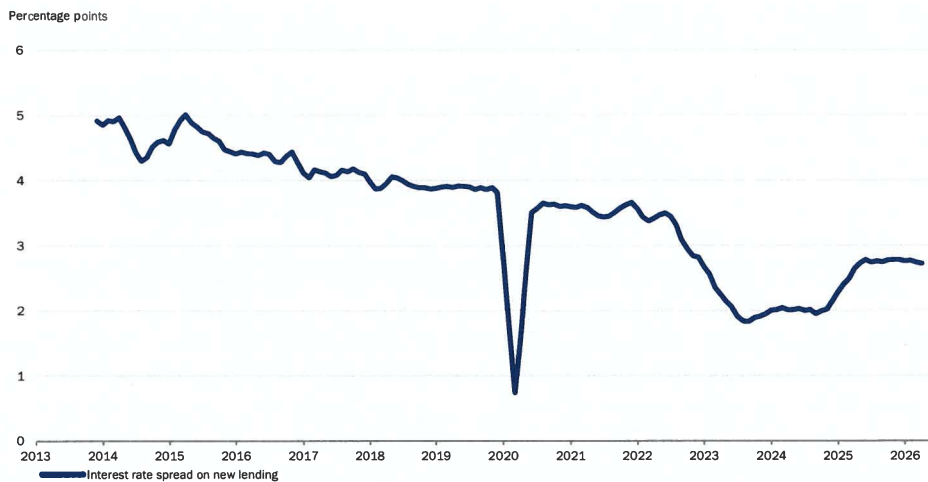


Note: The house price is the average annual house price in Tórshavn. Income is gross disposable national income. Latest observation: 2024.

Source: Hagstova Føroya.

Interest rate spread on new lending

Chart 4

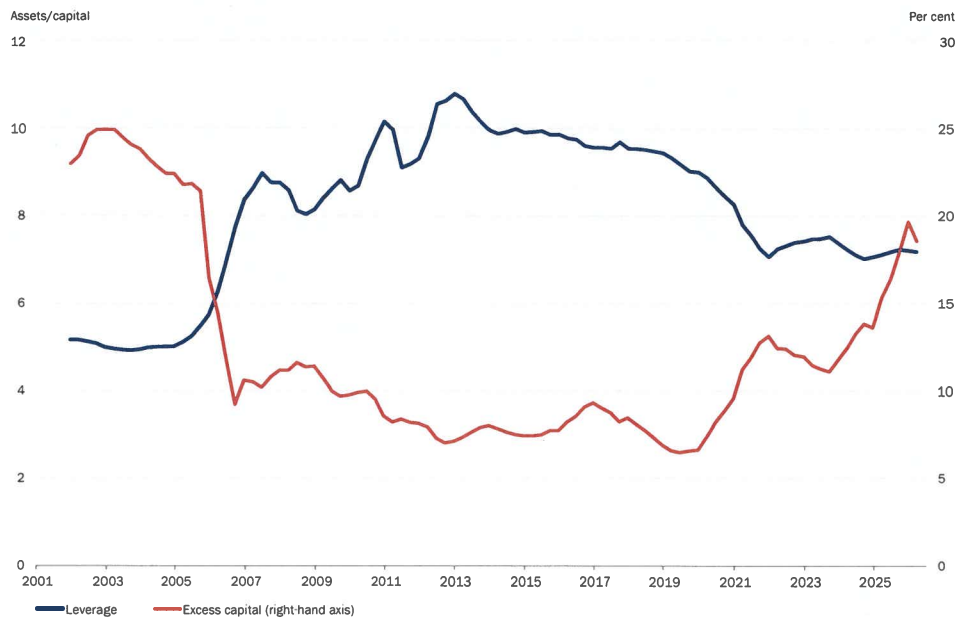


Note: Three-month moving average. The interest rate spread is defined as banks' interest rate on new lending, excluding overdrafts, relative to Danmarks Nationalbank's key policy rate (currently the rate on certificates of deposit). Banks' lending rate is a weighted average of interest rates on new lending by Danish and Faroese banks. Developments in the rate on new lending reflect movements in the general level of interest rates, but are also influenced to a considerable extent by the composition of new lending in a given month. For example, a higher share of secured lending will, in isolation, reduce the aggregate rate. Latest observation: April 2026.

Source: Danmarks Nationalbank.

Banks' leverage and capital headroom

Chart 5

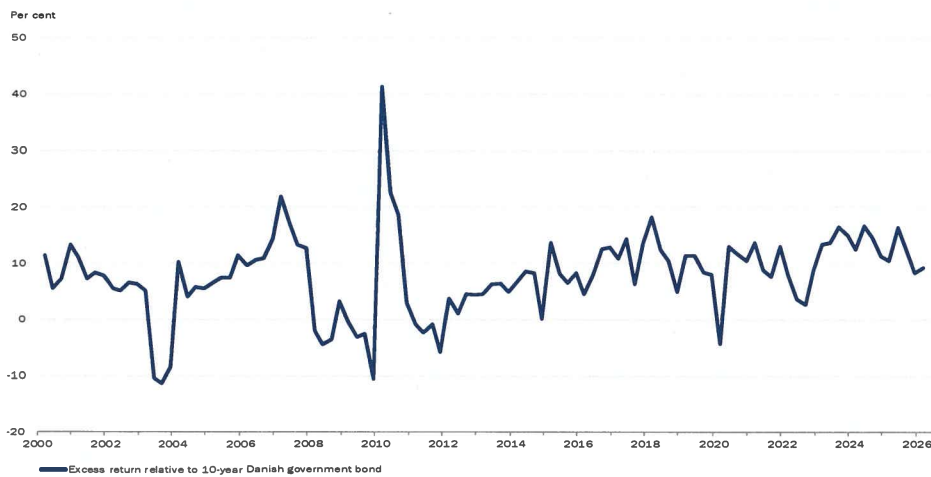


Note: Leverage is defined as total assets, guarantees and credit commitments divided by core capital (including Additional Tier 1 capital). Up to 2006, capital headroom is calculated as capital base less the individual solvency need (set at 8 per cent before 2005). From 2007 onwards, capital headroom is calculated as actual Common Equity Tier 1 capital less the total Common Equity Tier 1 requirement (including capital buffers). Weighted average (for the full period). Latest observation: Q1 2026.

Source: The Danish Financial Supervisory Authority.

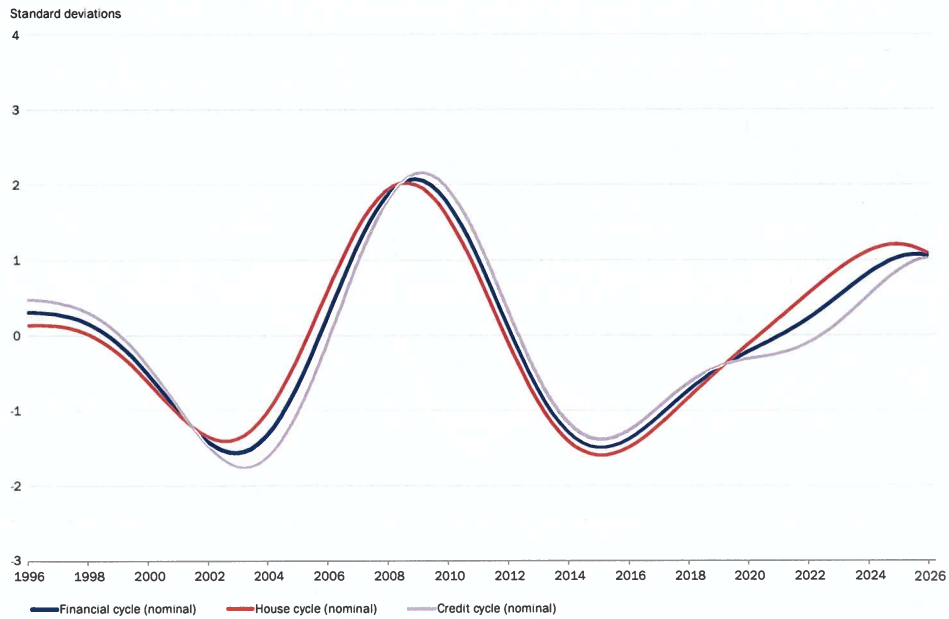
Banks' return on equity

Chart 6



Note: Banks' return on equity (weighted average) less the current yield on 10-year Danish government bonds. Banks' return on equity is annualised. Latest observation: Q1 2026.

Source: The Danish Financial Supervisory Authority and Nordea Analytics.



Note: The financial cycle is illustrated on the basis of series for nominal credit and house prices. The credit series is 'Lending by Faroese banks, accounting data'; see note under the tab 'Lending relative to GDP', and house prices are measured as the average annual house price in Tórshavn. The underlying series are standardised before the composite financial cycle is calculated. The value of the cycle should therefore not be assigned any interpretation as such, but rather reflects the phase of the cycle. The trend and the cyclical component in the series are estimated using a band-pass filter; see Drehmann et al. (2012), *Characterising the financial cycle: don't lose sight of the medium term!*, BIS Working Papers, No. 380, June. Latest observation: Q4 2025.

Source: The Danish Financial Supervisory Authority, Danmarks Nationalbank, Hagstova Føroya and own calculations.

Appendix C – Effects on other countries

Foreign institutions must also comply with a Faroese buffer

Foreign credit institutions with credit exposures in the Faroe Islands must also comply with a countercyclical capital buffer on their Faroese exposures. There is so-called mandatory reciprocity for the countercyclical capital buffer up to 2.5 per cent for EU countries.¹⁰ Reciprocity means that the relevant authorities across countries recognise each other's measures, so that institutions are subject to equivalent requirements.

Effects in other countries of a higher buffer in the Faroe Islands

According to the European Systemic Risk Board, macroprudential authorities must assess the possible cross-border effects of macroprudential measures. The Council's approach to assessing such effects is described in the note *Reciprocity of macroprudential measures* on the Council's website [\[link\]](#).

The Council assesses that Faroese institutions will not materially change their lending abroad as a result of an increase of 1 percentage point in the countercyclical capital buffer in the Faroe Islands. Faroese institutions are predominantly exposed to the Faroese economy. One institution has exposures to the Greenlandic economy. The Council's assessment is based, inter alia, on experience from the build-up of the countercyclical capital buffer and the systemic buffer rate for exposures in the Faroe Islands.

Danish banks generally have limited exposure to the Faroese economy. A small number of Danish mortgage credit institutions have larger exposures when seen relative to the size of the Faroese economy. All of these institutions will be required to comply with an increase of 1 percentage point in the countercyclical capital buffer rate on their Faroese exposures. The effect on capital requirements for the Danish institutions will, however, be limited, as Faroese exposures account for a relatively small share of their total exposures.

¹⁰ The same applies to countries with which the EU has concluded agreements in the financial area.