Information disclosed in the report is prepared in accordance with the Financial and Capital Market Commission's regulations No. 145 "Regulations on Preparation of Public Quarterly Reports of Credit Institutions".

MANAGEMENT REPORT

Dear shareholders, clients and partners,

The first half of 2010 has presented new challenges for the Parex Bank. The restructuring process that was prepared by the international financial consultant Nomura International plc was launched and implemented in a purposeful way. The Parex Bank has demonstrated responsible and professionally balanced work during very complicated economic conditions, and these efforts have ensured that the bank can develop further in the interests of all of its shareholders.

In the middle of this reporting period, on March 23, the Cabinet of Ministers approved the restructuring plan for the Parex Bank, and on May 31, it was submitted to the European Commission for its approval. The plan spoke to the splitting off of certain Parex Bank assets to create a new bank with a stable financial foundation so that it might become more successful in attracting investors and repaying the state's investment as quickly as possible. The remaining bank, the Parex Bank, will be able to sell its assets on the market in a longer period of time. Its job is to ensure maximum returns on the state's investments.

During the first half of 2010, the Parex Bank received permission from the International Monetary Fund and the Finance and Capital Markets Commission (FCMC) to increase credit limits for the bank's largest and most loyal corporate clients. It also concluded an agreement with the European Investment Bank on EUR 100 million in credit resources so that loans could be issued to small and medium enterprises. A trade financing agreement has been concluded, too, with the European Bank for Reconstruction and Development (EBRD).

On May 5, 2010, the Parex Bank concluded an agreement with the Bank of Latvia on the premature repayment of a loan of LVL 117.6 million. The decision was based on an increase in deposits at the Parex Bank, stability in the currency market for the lats, and the fact that the bank's liquidity indicators substantially exceeded stated regulations.

The bank's liquidity has improved during the reporting period, exceeding 60% as of June 30 of this year. Deposit volumes at the bank continued to increase during the half-year, and data show that total deposits at the end of June exceeded LVL 1 billion, not including deposits from the State Treasury. Since the beginning of the year, deposits at the Parex Bank and its group have increased by LVL 188.5 million and 211.5 million respectively. In terms of interest on term deposits, the Parex Bank has paid more than LVL 59 million to the State Treasury since December 2008, doing so in accordance with contractual obligations.

On February 12, 2010, Parex repaid EUR 310 million to providers of its syndicated loans. Because of the improved liquidity of the bank, it itself could cover most of that sum – EUR 165 million. The remaining EUR 145 million came from the State Treasury in the form of a term deposit.

The lending portfolio for the bank and the group on June 30, 2010, amounted to LVL 1.38 and 1.57 billion respectively, with assets of LVL 2.28 and 2.44 billion. Total equity at the end of the reporting period was LVL 124,5 and 100 million respectively. The most important shareholder, the Latvian government, provided aid to the Parex Bank and ensured additional necessary capital. On February 23, 2010, the Cabinet of Ministers approved an increase in the bank's share capital of LVL 31.5 million. The increase occurred on February 26 via capitalisation of the relevant sum from the deposits that had been made by the State Treasury.

The bank and the group concluded the first half of this year with total net losses of LVL 61.7 and 73.0 million respectively, while losses before provisions, depreciation and taxes amounted to LVL 21.3 and 22.6 million. Financial results are still being influenced seriously by the provisions that the bank and group have had to make as a result of a drop in asset value of LVL 47.8 and 54.2 million respectively.

During the reporting period, in comparison to the same period in 2009, the Parex Bank cut administrative spending by 20% (LVL 5.6 million) - communications and IT costs by LVL 0.5 million, personnel costs by LVL 4.6 million, etc. Some costs were reduced by outsourcing services. Building management at the bank's branches, for instance, now costs 80% less, while spending on office and housekeeping supplies has declined by 22%.

Significant events after the end of the reporting period

Since the end of the reporting period, the Parex Bank continued to work intensively on its restructuring plan so that when the process ended, the new bank could focus fully on its clients and on the need to enhance revenue. After the reporting period, a second test of the splitting up of the Parex Bank was

conducted to see how that would happen in practice. The test was on schedule and showed that bank operations would not be interrupted. It also showed that data migration would not cause any inconvenience to the bank's clients.

After several months of intense work, the restructuring of the Parex Bank occurred on August 1, 2010, with put of the assets being transferred to the new Citadele Bank and others left at the "resolution bank" that the Parex Bank now was. Because of long-term support from the state, the main job for Parex is to recover state investments as much as possible. The bank will particularly focus on restructuring of loans to recover as much money as possible from these assets and from the collateral of transferred loans, mostly in the area of real estate. Parex will manage the properties professionally so as to increase the value of the assets in a targeted way. Once the situation in the real estate market is stabilised, the bank will try to sell the real estate for as good a price as possible.

On July 30, the Parex Bank pursued a claim against former board members Valērijs Kargins and Viktors Krasovickis to recover losses which they caused to the bank while in office. The lawsuit seeks more than LVL 62 million in damages. On August 16, the Rīga Regional Court placed the properties of Kargins and Krasovickis under arrest to guarantee the sum needed for damages. It also ordered the Parex Bank to ensure financing for losses that could be caused by the implementation of a court ruling by paying LVL 7 million into the account of the court bailiff. Parex did so on August 19.

On July 30, Parex shareholders held an extraordinary meeting to elect council members Michael J. Bourke (Chairman of the Council), Sarmīte Jumīte (Deputy Chairman), Vladimirs Loginovs and Mary Ellen Collins. All of these Council Members have extensive international experience in the financial sector. Mr Bourke has nearly 40 years of professional experience in banking. He has served as an advisor to the Bank of Latvia in setting up a modern bank oversight system. From 1997 until 2006, Mr Bourke was president and board chairman of the Rietumu Banka, and in 2009 he was elected to the Parex Bank council. The Irish government has appointed him its honorary consul in Latvia.

Also on July 30, the council elected Christopher Gwilliam, Solvita Deglava and Jurijs Adamovičs to the Parex Bank Board. They are highly qualified specialists with substantial international experience in the financial world. Gwilliam was elected Chairman of the Board. He has more than 30 years of experience in the financial sector, including time spent in Eastern and Central Europe. He has worked with lending issues, as well as consultations, particularly in relation to bank privatisation and the corporate market. Gwilliam has much experience in the recovery, recapitalisation and change management at banks.

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The report has been approved by the Management Board of the Bank on 26 August 2010. More detailed information on the financial results of the Bank and the Group for 2009 are available in the audited reports published on Bank's Internet site www.parex.lv

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BALANCE SHEETS AS AT 30 JUNE 2010 AND 31 DECEMBER 2009

LVL 000's

	Reporting period *Unaudited* Group	Preceding reporting year *Audited** Group	Reporting period *Unaudited* Bank	Preceding reporting year *Audited** Bank
Cash and demand deposits with central banks	197 771	157 502	183 825	142 259
Demand deposits with credit institutions	110 066	208 495	98 819	183 831
Financial assets held for trading	2 581	4 765	2 565	4 774
Financial assets designated at fair value through profit and loss	2 590	2 770	-	-
Available-for-sale financial assets	102 015	114 349	65 619	95 199
Loans and receivables to customers:				
Loans to credit institutions	20 363	12 341	96 313	142 038
Loans to companies and private individuals	1 572 142	1 660 368	1 378 974	1 445 406
Held-to-maturity investments	288 193	299 371	302 291	318 649
Prepayments and accrued income	3 827	4 620	2 849	3 529
Fixed assets	47 435	52 495	10 030	12 545
Intangible assets	2 982	3 294	480	585
Investments in subsidiaries	-	-	81 692	72 725
Investment property	4 003	878	-	-
Income tax assets	41 630	39 469	38 801	35 991
Other assets	40 826	36 180	17 803	13 619
Total assets	**2 436 424**	**2 596 897**	**2 280 061**	**2 471 150**
Due to central banks	24 684	167 966	24 684	167 966
Demand liabilities to credit institutions	610	615	1 144	7 144
Financial liabilities held for trading	1 331	937	1 320	962
Financial liabilities designated at fair value through profit and loss	889	709	-	-
Financial liabilities measured at amortised cost:				
Loans from credit institutions	168 049	383 885	172 275	397 672
Deposits from customers	1 899 368	1 687 849	1 729 209	1 540 669
Issued debt securities	110 138	90 551	110 171	90 742
Subordinated liabilities	104 192	103 949	104 198	103 956
Other financial liabilities	6 799	5 430	-	-
Accrued expenses and deferred income	6 352	5 928	5 295	5 025
Income tax liabilities	827	1 282	-	-
Other liabilities	13 116	8 846	6 353	4 345
Total liabilities	**2 336 355**	**2 457 947**	**2 154 649**	**2 318 481**
Shareholders' equity	100 069	138 950	125 412	152 669
Total liabilities and shareholders' equity	**2 436 424**	**2 596 897**	**2 280 061**	**2 471 150**
Memorandum items				
Contingent liabilities	15 025	6 826	12 041	11 464
Financial commitments	102 633	126 088	145 951	166 323

* Auditors: SIA „PricewaterhouseCoopers"

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STATEMENTS OF INCOME
FOR 6 MONTHS PERIOD ENDED 30 JUNE 2010 AND 30 JUNE 2009

LVL 000's

	Reporting period *Unaudited*	**Respective period of the preceding reporting year** *Unaudited*	**Reporting period** *Unaudited*	**Respective period of the preceding reporting year** *Unaudited*
	Group	**Group**	**Bank**	**Bank**
Interest income	51 303	101 611	45 711	89 681
Interest expense	(58 444)	(77 165)	(55 864)	(75 095)
Dividends received	4	38	1 360	38
Commission and fee income	13 284	14 503	9 779	11 254
Commission and fee expense	(3 892)	(4 307)	(3 005)	(3 514)
Net gain/ (loss) on available for sale financial assets and financial liabilities	(506)	(325)	(1 213)	(300)
Net gain/ (loss) on financial assets or financial liabilities designated at fair value though profit and loss	42	24	-	-
Net gain/ (loss) on financial assets measured at amortised cost	126	-	-	-
Net gain/ (loss) on held for trading financial assets and financial liabilities	(930)	4 932	(763)	4 938
Gain/ (loss) from foreign exchange trading and revaluation of open positions	2 459	1 237	1 596	996
Net gain/ (loss) on disposal of non-current assets held for sale	(1 301)	(1 119)	-	-
Other income	5 965	5 086	3 085	3 257
Other expense	(614)	(4 814)	(128)	(4 449)
Administrative expense	(30 140)	(38 696)	(21 895)	(27 526)
Amortisation and depreciation charge	(4 824)	(5 108)	(2 087)	(4 039)
Impairment charge and reversals, net	(54 198)	(56 281)	(47 831)	(46 577)
Corporate income tax	8 670	6 409	9 510	6 807
(Loss)/ profit for the reporting period	**(72 996)**	**(53 975)**	**(61 745)**	**(44 529)**

Statements of Comprehensive Income:

LVL 000's

	01.01.2010.-30.06.2010. *Unaudited*	**01.01.2009.-30.06.2009.** *Unaudited*	**01.01.2010.-30.06.2010.** *Unaudited*	**01.01.2009.-30.06.2009.** *Unaudited*
	Group	**Group**	**Bank**	**Bank**
Net change in fair value revaluation reserve of securities	2 615	9 965	2 988	9 893
Other comprehensive income / (loss) for the period	**2 615**	**9 965**	**2 988**	**9 893**
Total comprehensive income / (loss) for the period	**(70 381)**	**(44 010)**	**(58 757)**	**(34 636)**

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PERFORMANCE RATIOS OF THE GROUP AND THE BANK

	Reporting period ***Unaudited***	**Respective period of the preceding reporting year** ***Unaudited***	**Reporting period** ***Unaudited***	**Respective period of the preceding reporting year** ***Unaudited***
	Group	Group	Bank	Bank
Return on equity (ROE) (%)*	(122.16)	(84.71)	(88.82)	(68.22)
Return on assets (ROA) (%)*	(5.80)	(3.43)	(5.20)	(2.91)

* Average value is calculated as the arithmetic mean of the balance sheet assets or residual capital and reserves at the beginning of the reporting period and at the end of the reporting period.

RATINGS ASSIGNED BY RATING AGENCIES

	Long-term rating	**Short-term rating**	**Financial strength rating**	**Support rating**	**Rating's outlook**
Moody's Investors Service	B2	Not Prime	E	-	Developing
Fitch	RD	RD	F	5	*

* Outlook for this rating is not assigned.

Detailed information about ratings can be found on the web sites of the rating agencies: www.moodys.com; www.fitchratings.com

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CONSOLIDATION GROUP

No.	Name of company	Registration number	Registration address	Country of domicile	Company type*	% of total paid-in share capital	% of total voting rights	Basis for inclusion in the group**
1	AS "Parex banka"	LV-40003074590	Latvia, Riga LV-1010, Republikas laukums 2A	LV	BNK	100	100	MAS
2	IPAS "Parex Asset Management"	LV-40003577500	Latvia, Riga LV-1010, Republikas laukums 2A	LV	IPS	100	100	MS
3	Regalite Holdings Limited	CY-HE93438	Cyprus, Nicosia 1075, 58 Arch. Makarios 3 Avenue, Iris Tower, 6th floor, office 602	CY	PLS	100	100	MS
4	AB "Parex bankas"	LT-112021619	Lithuania, Vilnius LT-03107, K. Kalinausko 13	LT	BNK	100	100	MS
5	SIA "Parex Express Kredīts"	LV-40003238125	Latvia, Riga LV-1010, Republikas laukums 2A	LV	CFI	100	100	MS
6	AS "Parex atklātais pensiju fonds"	LV-40003397312	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PFO	100	100	MS
7	AAS "Parex Dzīvība"	LV-40003786859	Latvia, Riga LV-1010, Republikas laukums 2A	LV	APS	100	100	MMS
8	OU "Parex Leasing & Factoring"	EE-10925733	Estonia, Tallinn 10119, Roosikrantsi 2	EE	LIZ	100	100	MS
9	ZAO "Parex Asset Management"	RU-1037706024872	Russia, Moscow 119049, Donskaja 4 - 2	RU	IBS	100	100	MMS
10	OOO "Parex Asset Management Ukraina"	UA-32984601	Ukraine, Kiev 01034, Glibocicka 17	UA	IBS	100	100	MMS
11	SIA "E & P Baltic Properties"	LV-40003754637	Latvia, Riga LV-1010, Republikas laukums 2A	LV	IPS	50	50	MMS
12	UAB "Parex faktoringas ir lizingas"	LT-126233315	Lithuania, Vilnius LT03107, K.Kalinausko 13	LT	LIZ	100	100	MMS
13	UAB "Parex investiciju valdymas"	LT-111829843	Lithuania, Vilnius LT01109, Gyneju 16	LT	IBS	100	100	MMS
14	AP Anlage & Privatbank AG	CH-130.0.007.738-0	Switzerland, Freienbach 8807, Kantonsstrase 1	CH	BNK	100	100	MS
15	OOO "Parex Leasing and Factoring"	AZ-1105-T10-3749	Azerbaijan, Baku AZ1065, Dz.Dzabbarli 44, "Caspian Plaza"	AZ	LIZ	100	100	MS
16	OOO "Ekspress Lizing"	RU-1037867006726	Russia, St. Petersburg 192019, Sedova 11, liter A	RU	LIZ	100	100	MS
17	LLC "Laska Lizing"	UA-33104543	Ukraine, Kiev 03150, Dimitrova 5	UA	LIZ	100	100	MS
18	LLC "Parex Leasing"	RU-1047796715603	Russia, Moscow 111116, Energeticheskaja 3	RU	LIZ	100	100	MS
19	OOO "Extroleasing"	RU-1027739537220	Russia, Moscow 111116, Energeticheskaja 3	RU	LIZ	100	100	MS
20	Calenia Investments Limited	CY-HE156501	Cyprus, Nicosia 1075, 58 Arch. Makarios 3 Avenue, Iris Tower, 6th floor, office 602	CY	PLS	100	100	MS
21	SIA "Parex Līzings un faktorings"	LV-50003760921	Latvia, Riga LV-1010, Republikas laukums 2A	LV	LIZ	100	100	MS
22	SIA "Rīgas Pirmā Garāža"	LV-40003397543	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS

No.	Name of company	Registration number	Registration address	Country of domicile	Company type*	% of total paid-in share capital	% of total voting rights	Basis for inclusion in the group**
23	SIA "Parex Private Banking"	LV-40003103438	Latvia, Riga LV-1050, Smilšu 7	LV	PLS	100	100	MS
24	OOO "Extrocredit"	RU-1067746758518	Russia, Moscow 111116, Energeticheskaja 3	RU	CFI	99	99	MMS
25	LLC "Parex Leasing and Factoring"	GE-205224461	Georgia, Tbilisi, Kazbegi avenue 44	GE	LIZ	100	100	MS
26	SIA "RPG interjers"	LV-40103157899	Latvia, Riga LV-1010, Republikas laukums 1	LV	PLS	100	100	MMS
27	SIA "PR Speciālie projekti"	LV-40103195231	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
28	OOO "Parex Investments Ukraine"	UA-35726203	Ukraine, Kiev 03150, Gorkovo 172	UA	IBS	100	100	MMS
29	OAO Parex Ukrainian Equity Fund	UA-10681020000023247	Ukraine, Kiev 03150, Gorkovo 172	UA	IBS	100	100	MMS
30	SIA "NIF"	LV-40103250571	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
31	SIA "NIF Dzīvojamie īpašumi"	LV-40103253915	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
32	SIA "NIF Komercīpašumi"	LV-40103254003	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
33	SIA "NIF Zemes īpašumi"	LV-40103255348	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
34	UAB "Nekilnojamojo turto valdymo fondas"	LT-302462108	Lithuania, Vilnius LT03107, K.Kalinausko 13	LT	PLS	100	100	MMS
35	OÜ "Restruktureeritud Kinnisvarafond"	EE-11788043	Estonia, Tallinn 10119, Roosikrantsi 2	EE	PLS	100	100	MMS
36	SIA "NIF Projekts 1"	LV-50103300111	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS

*BNK – bank, IBS – investment brokerage company, IPS – investment management company, PFO – pension fund, CFI – other financial institution, LIZ – leasing company, PLS – company providing various support services, APS – insurance company.
** MS – subsidiary company, MMS – subsidiary of the subsidiary company, KC – joint venture, MAS – parent company.

INFORMATION ABOUT PAREX BANKA'S BRANCHES

As at 30 June 2010 the Bank was operating a total of 23 branches, including 4 foreign branches, 32 mid-size client service centres and 5 representative offices.

ISSUED SHARE CAPITAL AS AT 30 JUNE 2010

Shareholders	Nominal value (LVL)	Number of shares	Paid-in share capital (LVL)	Voting rights	Paid-in share capital (%)
SJSC "Privatizācijas Aģentūra"	1	200 420 791	200 420 791	144 470 791	76.64%
EBRD	1	51 444 325	51 444 325	51 444 325	19.67%
Other	1	9 662 179	9 662 179	5 468 323	3.69%
Total		**261 527 295**	**261 527 295**	**201 383 439**	**100%**

MANAGEMENT OF THE BANK AS AT 30 JUNE 2010

Council of the Bank

Name	Position
Juris Jākobsons	Chairman of the Council
Michael Joseph Bourke	Deputy chairman of the Council
Laurence Phillip Adams	Member of the Council
Juris Vaskāns	Member of the Council
Klāvs Vasks	Member of the Council

Management of the Bank

Name	Position
Nils Melngailis	President; Chairman of the Management Board, p.p.
Guntis Beļavskis	Member of the Management Board, p.p.
Vladimirs Ivanovs	Member of the Management Board
Valters Ābele	Member of the Management Board

Roberts Stuģis was dismissed from duties as a member of the Management Board according to 15 March 2010 Council's decision.

New Council of Parex banka was elected during extraordinary meeting of shareholders on 6 April 2010. Following Council members were elected – Juris Jākobsons, Michael J. Bourke, Laurence Phillip Adams, Juris Vaskāns and Klāvs Vasks. Two new representatives were elected to the Council – Juris Jākobsons and Klāvs Vasks. Representatives of Ministry of Finance Andžs Ūbelis and Kaspars Āboliņš have resigned from Parex banka's Council effective 31 March 2010.

INFORMATION ON CERTAIN PARTIES THAT WERE RELATED TO THE BANK AT THE MOMENT IT RECEIVED STATE AID

Pursuant to FCMC regulations on preparation of quarterly public reports of banks (Article 14[1]) the following table represents summary of material transactions with certain parties that were related to the Bank at the moment it received the State Aid:

LVL 000's

	1st half of 2010			1st half of 2009		
	Period-end balance	**Average interest rate ***	**Interest income/ (expense)**	**Period-end balance**	**Average interest rate ***	**Interest income/ (expense)**
Loans issued by the Bank	31 496	2.14%	321	29 512	2.78%	636
Deposits placed with the Bank	28 001	1.53%	(975)	28 009	12.12%	(1 398)
Subordinated financing provided to the bank	36 006	6.73%	(1 898)	36 010	14.20%	(2 282)

* according to period-end rates

Loan contracts were entered into force in the period from 2002 – 2008 and are maturing in 2018. Loans are USD and EUR denominated.

Deposit contracts were entered into force in 2008 and are maturing in 2011. Deposits are LVL denominated.

Subordinated financing contracts were entered into force in 2008 and have maturities ranging 2015 through 2018. Subordinated financing is LVL and EUR denominated. Prior repayment can be unilaterally requested only upon liquidation of the Bank.

RISK MANAGEMENT

Risk management principles are set out in Group's Risk and Capital Management Policy. The Group adheres to the following key risk management principles:

- The Group aims to ensure an acceptable risk level in all operations. Risks are always assessed in relation to the expected return. Risk exposures that are not acceptable for the Group are avoided, limited or hedged;
- The Group does not assume high or uncontrollable risks irrespective of the return they provide. Risks should be diversified and those risks that are quantifiable should be limited or hedged;
- The Group pursues prudent risk management policy, that is aligned with the Group' business and ensures effective total risk mitigation;
- Risk management is based on awareness of each and every Group's employee about the nature of transactions he/she carries out and related risks;
- Risk limit system and strict controls are essential risk management elements. Control of risk level and compliance with limits is ensured by structured risk limit systems for all material risks;
- The Group aims to ensure low risk exposure, diversified asset portfolio, limited risks in financial markets and low level of operational risk.

Risk management is an essential element of the Group's management process. Risk management within the Group is controlled by independent units - Risk and Compliance Sector.

The Group is exposed to the following main risks: credit risk, market risk, interest rate risk, liquidity risk, currency risk and operational risk. The Group has approved risk management policies for each of these risks, which are briefly summarised below.

Credit risk

Credit risk is the risk that the Group will incur a loss from debtor's non-performance or default. The group is exposed to credit risk in to its lending, investing and trading activities, as well as in respect to the guarantees issued to third parties and other off-balance sheet commitments to third parties.

Credit risk management is based on adequate risk assessment and decision-making. For material risks, risk analysis is conducted by independent units of Risk and Compliance Sector. The analysis of credit risk comprises evaluation of customer's creditworthiness and collateral and its liquidity. The analysis of creditworthiness of a legal entity includes analysis of the industry, the company, and its current and forecasted financial position. The analysis of creditworthiness of an individual includes the analysis of the customer's credit history, income and debt-to-income ratio analysis, as well as the analysis of social and demographic factors. In the event of material risks, lending decision is made by the Credit Committee, and further reviewed by the Bank's Management Board.

After the loan is issued, customer's financial position is monitored on a regular basis in order to timely identify potential credit losses.

To limit its credit risk, the Group has set the following concentration limits: individual counterparty limit, limit for group of mutually related customers, limit for large risk exposures, limit for the Group's related parties, an industry limit, limit by customer type and loan product.

The Group reviews its loan portfolio on a regular basis to assess its quality and concentrations, as well as to evaluate the portfolio trends.

Credit risk identification, monitoring and reporting is the responsibility of Risk and Compliance Sector.

Market risk

Market risk is the risk that the Group will incur a loss as a result of the mark-to-market revaluation of balance sheet and off-balance sheet items caused by changes in market values of financial instruments due to changes in foreign exchange rates, interest rates and other factors.

Position risk of financial instruments is assessed and limits are set by the Financial Market and Counterparty Committee (FMCC). The decisions of FMCC are approved by the Bank's Management Board. Market risk is managed by the Group's business units and subsidiaries which can accept market risk in line with the set limits and investment restrictions of the respective portfolio. Market risk is measured, monitored and risk levels are reported by Risk and Compliance Sector.

To manage market risk, the Group sets individual limits to issuers and financial instruments, as well as products exposed to market risk. To assess position risk the Group also uses scenario analysis.

Interest rate risk

Interest rate risk is related to the negative impact of interest rate changes on the Group's income and economic value.

Interest rate risk management in the Group is carried out in accordance with the Group's Interest rate Risk Management Policy. Interest rate risk is assessed and decisions are made by Assets and Liabilities Management Committee (ALCO). The decisions of ALCO are approved by the Bank's Management Board. ALCO sets the acceptable interest rate risk level and the Group's internal limit system, monitors the compliance with the approved limits and use of the instruments for the management of interest rate risk. Interest rate risk measurement, management and reporting are responsibilities of Treasury Sector. Interest rate risk management in the Group is coordinated by the Risk and Compliance Sector.

The Group manages interest rate risk by using the gap analysis of the risk sensitive assets and liabilities, duration analysis and sensitivity analysis of assets and liabilities as well as stress testing of interest rate risk. Based on the market analysis and the Group's financing structure, ALCO sets customer deposit interest rates. During the period when restrictions are imposed on the Bank's activities, these functions are carried out by the Bank's Management Board.

Liquidity risk

Liquidity risk is the risk that the Group will be unable to meet its legal payment obligations. The purpose of liquidity risk management is to ensure the availability of liquid assets sufficient to meet potential obligations.

The Group manages its liquidity risk in accordance with the Group's Liquidity Risk Management Policy. Liquidity risk is assessed and decisions are made by ALCO. The decisions of ALCO are approved by the Bank's Management Board. ALCO sets the acceptable liquidity risk level, the Group's internal limit system and defines instruments for the management of liquidity risk, as well as monitors the compliance with the set limits. Liquidity risk management is the responsibility of the Treasury Sector, while risk measuring, monitoring and reporting is within the responsibility of the Risk and Compliance Sector.

Liquidity risk is assessed and related decisions are made by the Bank's Management Board. Daily liquidity management, as well as liquidity risk measurement, management and reporting is ensured by the Treasury Sector in collaboration with Finance department. Liquidity risk management in the Group is coordinated by the Risk and Compliance Sector. However the main source of liquidity is the funding provided by the State Treasury. In 2010 the Bank is in compliance with liquidity ratio requirements and meets mandatory reserve requirements in the Bank of Latvia.

Currency risk

Currency risk is a risk of loss arising from fluctuations in currency exchange rates.

Currency risk management in the Group is carried out in accordance with the Group's Currency Risk Management Policy. Currency risk is assessed and decisions on limits set are made by the Financial Market and Counterparty Committee (FMCC). The decisions of FMCC are approved by the Bank's Management Board. FMCC defines the acceptable currency risk level and the Group's internal limit system, as well as monitors compliance with these limits.

Day-to-day currency risk management is the responsibility of Treasury Sector, while risk monitoring and reporting is the responsibility of Risk and Compliance Sector. The Group has set a limit for open currency positions in each currency at 10% of its equity, and the limit for the total open currency position at 20% of its equity. The limits are equal to the requirements by Latvian legislation. To assess currency risk, the Group also uses scenario analysis.

As at the date of approval of this report, due to limited access to currency risk mitigation instruments, the Bank and Group was not able to comply with the limits in relation to certain open currency positions. The full compliance will be restored, once the Bank is able to operate as before in the financial markets and re-opens the limits with currency dealers.

Operational risk

The Group defines operational risk as the risk of losses resulting from processes that are deficient or non-compliant with requirements of external and internal regulations, losses resulting from actions of employees and system malfunctioning, as well as losses resulting from actions of third parties or from other external conditions, including legal risk (risk of penalty fees, sanctions applied by external institutions, losses resulting from litigation and other similar events), but excluding strategic risk and reputation risk. The Group further divides operational risk into the following categories: personnel risk, process risk, IT and systems risk, external risk.

The Group does not accept operational risks with potential impact exceeding 10% of the Group's net annual revenues, as well as unmanageable risks or risks with unquantifiable impact, irrespective of the financial gains this could bring (i.e., the Group does not perform business activities incurring such operational risks).

The Group applies following approaches for operational risk management:

- Self-assessment of operational risk – the business-owners of the products and processes perform identification and evaluation of potential operational risk events, assessment of the existing control systems and the analysis of the required risk mitigation measures using self-assessment questionnaires and brainstorming sessions with the experts of the respective process;
- Defining operational risk indicators – use of statistical, financial and other indicators that reflect the level of various operational risk types and its changes within the Group;
- Defining the limits of the acceptable losses;
- Operational risk measurement by recording and analysing operational risk events, the extent of the respective damage incurred, causes and other related information (data base of operational risk losses and incidents);
- "Four-eye-principle" and segregation of duties;
- Business continuity planning;
- Risk assessment within product development;
- Insurance;
- Investments in appropriate data processing and information protection technologies.