MORTGAGE AND LAND BANK OF LATVIA

Condensed Consolidated and Bank Financial Statements for the year ended 31 December 2010 (unaudited)

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V a/s „Latvijas Hipotēku un zemes banka" (Bank) is a joint-stock company incorporated in the Republic of Latvia. The holder of 100% of the Bank's shares is the Ministry of Finance of the Republic of Latvia. The Bank and its subsidiaries (the Group) are engaged in banking and financial services business.

Report of the Supervisory Council and the Board of Directors

On 3 December 2009, the concept for "Transformation of the State-owned JSC "Mortgage and Land Bank of Latvia" into Development Bank" was approved by decree No 820 issued by the Cabinet of Ministers of the Republic of Latvia. The concept stipulates that Mortgage Bank be transformed into a development bank through phasing out the transactions characteristic to a commercial bank and focusing the activities of the Bank onto the branches crucial for the national economy.

Year 2010 highlights a significant step for the state-owned JSC "Mortgage and Land Bank of Latvia" on its way to development bank. The purpose of transformation is to establish a development bank for implementation of the state aid programmes by making maximum use of the infrastructure of the Mortgage Bank, its intellectual and financial potential, effecting the transformation to the best for the state and maintaining implementation continuity of the state aid programmes.

In September 2010, in accordance with the decision of the Cabinet of Ministers, a consultant – "SEB Enskilda" was attracted to the transformation. The draft transformation plan of the Mortgage Bank prepared by the financial consultant is being examined by interdepartmental working group on management of the transformation process of the Mortgage Bank headed by Mārtiņš Bičevskis – state secretary of the Ministry of Finance. The Cabinet of Ministers is to pass a decision on approval of the transformation plan.

In the complex economic situation of Latvia the Mortgage Bank proceeded with lending to the local companies operating in the branches identified by state as crucial for the national economy thus replenishing the service range of the commercial banks. In 2010 the proportion of state aid target programmes in the overall loans' portfolio of the Mortgage Bank has reached 41%. Despite the fact that in 2010 the Mortgage Bank didn't grant new commercial loans and consumer loans outside the promotional programmes, the number of retail customers remained unchanged. Whereas, the number of corporate customers increased due to implementation of the state aid programmes which testified to high customer confidence in the bank.

Also in 2011 the Mortgage Bank will continue to increase the volumes of state aid programmes by lending to entrepreneurs and promoting development of the national economy of Latvia. At the same time the Bank will proceed with improvement of quality of the services of the bank and maintaining high level of customer service.

Financial Sector and its Trends

On 31 December 2010, banking services in the Republic of Latvia were provided by 21 bank and 8 subsidiaries of foreign banks. The state-owned JSC "Mortgage and Land Bank of Latvia" operates as the only 100% state-owned commercial bank.

In 2010 the most significant event in the banking sector of Latvia was restructuring of JSC "Parex banka". A new commercial bank (JSC "Citadele banka") was established whereto the good assets were transferred leaving the rest of the assets with the so called resolution bank that continues working under the name of Parex banka.

During 11 months of 2010, the assets of the banks have decreased by 1%, reaching 21.5 bln lats at the end of November, but capital and reserves of the banks have grown by 2%. In the aforementioned period the unaudited losses of the banks amounted to 327 mln lats which was two times less than recorded in the same period last year. The major cause of losses was provisioning for risky assets. At the end of November, the profit of the banking sector before provisions and taxes amounted to 136 mln lats.

Due to prudent credit policy pursued by banks and low demand on the part of customers, the loan portfolio shrunk by 6% during 11 months of 2010. Although banks continued granting new loans, the lending volume of the banking sector in general was still less than the amounts repaid by customers and written off by banks as lost.

Meanwhile the volume of deposits grew by 10.5%, due not merely to stabilisation of the economy, but also changes to the bookkeeping of the banks – as of May, the deposits attracted as subordinated obligations are included in the deposits.

In 2010 the commercial banks concentrated on quality of the loan portfolio. Although the loan portfolio of the banking sector without late payments shrunk gradually in the first half-year, it stabilised in the second half reaching 72% at the end of November. In the 11 months of 2010, the provisions for doubtful loans rose from 8.6% to 11.4% of the total loan portfolio of the banks.

The Bank of Latvia requirements to statutory reserves have not changed since 2008: for liabilities of banks over 2 years – 3%, for all other liabilities included in the reserve base – 5%.

Report of the Supervisory Council and the Board of Directors *(continued)*

In 2010, the US Federal Reserve System didn't change the base interest rate of dollar, the European Central Bank also maintained the euro base interest rate unchanged at 1.0%. Nevertheless, the Bank of Latvia decreased the base interest rate for lat from 4% to 3.5%. The decisions of the central banks and fluctuations of the money market have affected the average interest rates of loans granted by commercial banks of Latvia. The average interest rates for loans (in lats) granted to individuals decreased from 18.9% (in January 2010) to 16.5% (in December 2010), and for legal entities – from 10.1% to 5.2% in the respective period. Also, the average interest rates for loans granted in foreign currencies have diminished: for legal entities – from 5.0% to 4.7%, and for individuals – from 5.4% to 5.1%.

Operational Results

In 2010 the gross assets of the Mortgage Bank decreased by 158.4 mln lats or 16%, stopping at 808.2 mln lats (market share – 3.7%) due to repayment of syndicated and other interbank long-term borrowings in the amount of 174.3 mln lats.

The loan portfolio (gross) has shrunk by 16% reaching 594.2 mln lats (market share – 4.2%) consisting of the development loan portfolio – 244.5 mln lats (41% of the loan portfolio) and commercial loan portfolio – 349.7 mln lats (59% of the loan portfolio). In the reporting period, the volume of deposits has grown by 36.9 mln lats reaching 363.6 mln lats (market share – 4.1%). In 2010, the Bank accumulated provisions for risky assets in the amount of 81.6 mln lats, as a result of that, the losses were 67.9 mln lats. As at 31 December 2010, the ratio of the Bank's provisions and loan portfolio was 15.6%.

As at the end of December, the capital adequacy ratio was 16.7% that significantly exceeded the statutory minimum of 8% required by the Credit Institution Law. In April 2010, the equity capital of the Bank was increased by 70.28 mln lats. The equity capital was increased as a result of the state taking over the obligations of the Mortgage Bank towards the Nordic Investment Bank and investing the said amount in the equity capital of the Bank. The European Commission (EC) has been notified of the increase of the equity capital. The EC will pass its decision on the issue after analysis of the transformation plan of the Bank.

The beginning of 2010 was marked with a positive assessment of the economic development potential of Latvia, acknowledged also by international rating agencies *Standard & Poor's Rating Services* and *Moody's Investors Service Ltd* through upgrading the credit rating outlook of Latvia to stable from negative. The Mortgage Bank is 100% state-owned bank and its rating is directly linked to the sovereign rating of Latvia. Having upgraded the rating outlook on the Latvian government's local and foreign currency rating of Baa3 to stable from negative, the *Moody's Investors Service Ltd* also changed the outlook on Mortgage Bank's Baa3 long-term foreign currency deposits rating to stable from negative. The Bank is assigned the following ratings:

- long-term foreign currency deposits – *Baa3*,
- short-term foreign currency deposits – *P3*,
- financial strength rating – *E+*,
- rating of mortgage bonds – *Baa2*,

which are investment grade ratings.

At the end of 2010 the Mortgage Bank serviced its customers in 25 branches and 9 sub-branches located in Riga and other cities of Latvia. In 2010, the Mortgage Bank optimised its customer service network, as a result of which one sub-branch was closed in Riga and two branches transformed into sub-branches. The optimisation of the service network outside Riga will continue in 2011.

Implementation of State Aid Programmes

In 2010, the Mortgage Bank proceeded with implementation of the effective state aid programmes and phasing out its commercial loan portfolio. As regards commercial activities, the Bank has ceased lending to new customers. The Bank granted commercial loans only to the existing customers in proportion to the already granted loans and for restructuring of the loans of the current commercial customers of the Bank.

Report of the Supervisory Council and the Board of Directors *(continued)*

In 2010, the Mortgage Bank, as commissioned by government, continued to implement the following state aid programmes providing support to specific groups of entrepreneurs and population:

– Programme for Improvement of Competitiveness of Businesses;
– Micro-lending Programme;
– Start-up programme "Support to Self-employment and Business Start-ups";
– SME Growth Programme "Loans for Promotion of Development of Micro, Small and Medium Enterprises and Agricultural Co-operative Unions";
– Working Capital Loans for Farmers.

Programme for Improvement of Competitiveness of Businesses

To finance the programme the Mortgage Bank borrowed from the Nordic Investment Bank (NIB) 100 mln euros (70 mln lats) in 2009. The programme is also financed by Loan Fund consisting of public financing in the amount of 61.6 mln euros (43.3 mln lats) and Mortgage Bank's financing in the amount of 21.6 mln euros (15.2 mln lats). By the end of 2010 the Programme for Improvement of Competitiveness of Businesses had granted loans for 146.7 mln lats, including 58.5 mln lats from the Loan Fund.

Micro-lending Programme

The total financing volume of the programme – 564.8 thsd lats is fully consumed. The Bank keeps granting micro loans from the resources repaid by borrowers. By the end of 2010 the Mortgage Bank had granted 296 micro loans for the sum total of 806 thsd lats.

Start –up programme „Support to Self-employment and Business Start-ups"

By the end of 2010, 1267 applicants had applied for consultations and training, 610 participants of the programme had completed their training, 498 business plans were submitted to the Bank of which 455 were examined by credit committee and 267 projects were financially supported for the total loan amount of 3.8 mln lats.

SME Growth Programme

In February 2010 the Bank launched the SME Growth Programme „Loans for Promotion of Development of Micro, Small and Medium Enterprises and Agricultural Co-operative Unions". The aim of the programme is to enhance access to funding for entrepreneurs registered in Latvia to revive and stimulate the development of the national economy of Latvia. On the 2nd of October 2009, to implement the programme, the Mortgage Bank concluded a 100 mln euro loan agreement with the European Investment Bank. In February 2010 the Mortgage Bank received the first tranche of the loan in the amount of 50 mln euro. By the end of September the SME Growth Programme had granted loans for 8.9 mln lats.

Working Capital Loans for Farmers

In May 2010 the Mortgage Bank started to grant working capital loans to farmers. The loans are granted in line with the Cabinet of Ministers Regulation No 403 of 27 April 2010 "Procedure for Granting State Aid for Acquisition of Working Capital for Production of Agricultural Produce". The total financing volume of the programme is 10 mln lats that the Mortgage Bank will receive from the State Treasury in the form of loans. As at the end of September the programme had granted 200 loans for the total amount of 7.5 mln lats.

Credit Fund

On 20 July 2010, the Cabinet of Ministers Regulation No 664 "Procedure of administration and monitoring the state and European Union support to agriculture, rural territories and development of fish farming, by establishing a Credit Fund" (hereinafter – Credit Fund) got approved, which provides for granting loans to finance projects approved by the Rural Support Service. Loans are to be granted to investments into agricultural enterprises – construction, procurement of stationary machinery and its equipment, procurement of building material and development of detail design. Loans are granted with maturity up to 15 years, with fixed or variable rate in LVL and EUR currencies. By the end of 2010, the Mortgage Bank had approved 3 projects for the total amount of 1.4 million lats.

Report of the Supervisory Council and the Board of Directors *(continued)*

During 2011 we will proceed with realisation of Banks transformation according to the decisions made by the government in order to achive goals of the conception approved on 3December 2009, which stipulates that transformation shall be finalised by 31 December 2013. Taking into consideration that after 31 December 2013 the Bank will be left with certain amount of commercial activities, during 2011. Analyses will be made to assess the most effective solution for servicing commercial activities after transformation phase.

During 2011 the Bank will also continue with internal restructuring and will strengthen its capacity to realise state support programs in the name of the government. To continue previous year traditions, the Bank plan to closely cooperate with established Regional fund in different regions of Latvia to realise socially responsible projects and promote activities and self-initiative of local residents to improve their surrounding environment.

Supervisory Council (at 31 December 2010)

Baiba Bāne	Chairman of the Council
Andžs Ūbelis	Deputy Chairman of the Council
Jānis Pone	Member of the Council

During the reporting period Ms. Baiba Brigmane and Mr. Dāvids Tauriņš resigned from the Council and Mr. Jānis Pone and Andžs Ūbelis were appointed as members of the Council.

Board of Directors (at 31 December 2010)

Rolands Paņko	Chairman of the Board
Jēkabs Krieviņš	Deputy Chairman of the Board
Jānis Bērziņš	Member of the Board
Baiba Brigmane	Member of the Board
Gints Āboltiņš	Member of the Board

During the reporting period Andris Riekstiņš resigned from the Board and Baiba Brigmane and Gints Āboltiņš as were appointed as members of the Board.

Statement of Responsibility of the Supervisory Council and the Board of Directors

The Supervisory Council and the Board of Directors (Management) are responsible for preparing the financial statements from the books of prime entry of the Group and the Bank for each financial period that present fairly the state of affairs of the Group and the Bank as at the end of the financial period and the results of their operations and cash flows for that period according to the International Financial Reporting Standards as adopted by the European Union. Prudent and reasonable judgments and estimates have been made by the Management in the preparation of the financial statements.

Management confirms that suitable accounting policies have been used and applied consistently and reasonable and prudent judgments and estimates have been made in the preparation of the condensed consolidated and bank financial statements for the period ended 31 December 2010. Management also confirms that applicable International Financial Reporting Standards as adopted in EU have been used in preparation of the financial statements and that these financial statements have been prepared on a going concern basis. Appropriate accounting policies have been applied on a consistent basis.

Management is responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the Group and the Bank and to prevent and detect fraud and other irregularities. Management is also responsible for managing the Bank in compliance with the Law on Credit Institutions, regulations of the Bank of Latvia and the Financial and Capital Market Commission as well as other legislation of the Republic of Latvia.

STATEMENT OF FINANCIAL POSITION (all amounts in thousands of Euro)

	Notes	2010		2009	
		Group	**Bank**	**Group**	**Bank**
Interest income		66,733	66,040	83,022	79,418
Interest expense		(39,774)	(39,789)	(44,052)	(43,470)
Net interest income		**26,959**	**26,251**	**38,970**	**35,948**
Fee and commission income		5,566	4,624	5,538	5,061
Fee and commission expense		(1,394)	(1,441)	(1,417)	(1,458)
Net fee and commission income		**4,172**	**3,183**	**4,121**	**3,603**
Dividend income		-	-	7	74
Net trading income		2,268	2,474	8,773	8,991
Other operating income		6,275	2,923	2,952	1,579
		39,674	**34,831**	**54,823**	**50,195**
Personnel expenses		(12,615)	(11,081)	(13,695)	(12,198)
Administrative expenses		(9,779)	(8,533)	(11,542)	(10,236)
Depreciation and amortisation		(2,721)	(2,457)	(2,897)	(2,610)
Impairment expenses	3	(108,717)	(109,400)	(105,436)	(103,490)
Loss before income tax		**(94,158)**	**(96,640)**	**(78,747)**	**(78,339)**
Income tax expense		(47)	-	1,329	1,431
Net loss for the period		**(94,205)**	**(96,640)**	**(77,418)**	**(76,908)**
Net gain from investment securities available-for-sale		4,364	4,364	751	751
Total comprehensive loss for the period		**(89,841)**	**(92,276)**	**(76,667)**	**(76,157)**
Net (loss) / profit for the period attributable to:					
Equity holders of the Bank		(94,359)	-	(77,434)	-
Non-controlling interest		154	-	16	-
Total comprehensive (loss) / profit for the period attributable to:					
Equity holders of the Bank		(89,995)	-	(76,683)	-
Non-controlling interest		154	-	16	-
Earnings per share					
Equity shareholders of the parent for the year:					
Basic and dilluted earnings per share (expressed in EUR per share)		(0.54)		(0.95)	

STATEMENT OF FINANCIAL POSITION (all amounts in thousands of Euro)

	Notes	31/12/10		31/12/09	
Assets		**Group**	**Bank**	**Group**	**Bank**
Cash and balances with Central Bank		97,007	97,007	136,591	136,591
Due from credit institutions		29,559	23,751	50,385	50,193
Derivative financial instruments		1,227	1,227	2,780	2,780
Trading securities	4	3,660	3,378	7,220	6,999
Investment securities – available for sale	4	101,741	110,650	70,990	70,990
Investment securities – held to maturity	4	35,023	35,023	61,161	61,161
Loans to customers	5	699,684	669,510	900,224	909,928
Deferred expenses and accrued income		1,682	2,915	942	757
Investment properties		15,045	1,649	1,659	1,659
Property and equipment		9,367	8,643	10,723	9,812
Intangible assets		2,577	2,059	3,136	2,449
Investments in subsidiaries and associated undertakings	7	-	1,164	398	2,174
Other assets	8	8,052	3,267	12,658	2,654
Assets held for sale	6	-	44,031	-	-
Total assets		**1,004,624**	**1,004,274**	**1,258,867**	**1,258,147**
Liabilities					
Due to credit institutions	9	238,717	238,717	539,997	539,997
Derivative financial instruments		18	18	221	221
Due to customers	10	513,889	517,387	464,851	464,939
Issued debt securities	11	46,370	47,020	53,257	54,423
Deferred income and accrued expenses		2,399	1,742	5,687	4,804
Provisions for off-balance sheet commitments		1,500	1,500	269	269
Current income tax liabilities		57	-	61	-
Deferred tax liabilities		14	-	38	-
Other liabilities		35,434	34,587	38,717	37,913
Subordinated liabilities		44,236	44,236	44,236	44,236
Total liabilities		**882,634**	**885,207**	**1,147,334**	**1,146,802**
Shareholder's equity					
Share capital	12	272,624	272,624	172,624	172,624
Reserve capital		3,591	2,935	3,591	2,935
Revaluation reserve on available for sale investments		47	47	(4,317)	(4,317)
Accumulated loss		(154,781)	(165,539)	(60,422)	(59,897)
Total shareholder's equity attributable to shareholders of the Bank		**121,481**	**119,067**	**111,476**	**111,345**
Non-controlling interest		509	-	57	-
Total shareholder's equity		**121,990**	**119,067**	**111,533**	**111,345**
Total liabilities and shareholder's equity		**1,004,624**	**1,004,274**	**1,258,867**	**1,258,147**

CONSOLIDATED STATEMENT OF CHANGES IN THE GROUP'S EQUITY
(all amounts in thousands of Euro)

	Attributable to equity holders					
	Share Capital	**Reserve capital**	**Revaluation deficit on available for sale investments**	**Retained earnings**	**Minority interest**	**Total equity**
Balance as at 31 December 2008	**69,028**	**3,591**	**(5,068)**	**18,386**	**41**	**85,978**
Loss for the period	-	-	-	(77,434)	16	**(77,418)**
Other comprehensive expenses	-	-	751	-	-	**751**
Total comprehensive (loss) / profit for the period	**-**	**-**	**751**	**(77,434)**	**16**	**(76,667)**
Shareholders cash contribution	103,596	-	-	-	**-**	**103,596**
Distribution of profit – payment for use of state capital	-	-	-	(1,374)	-	**(1,374)**
Balance as at 31 December 2009	**172,624**	**3,591**	**(4,317)**	**(60,422)**	**57**	**111,533**
Loss for the period	-	-	-	(94,359)	154	**(94,205)**
Other comprehensive income	-	-	4,364	-	-	**4,364**
Total comprehensive (loss) / profit for the period	**-**	**-**	**4,364**	**(94,359)**	**154**	**(89,841)**
Increase in minority interest (IPS „Hipo Fondi")	-	-	-	-	299	**299**
Shareholders cash contribution	100,000	-	-	-	**-**	**100,000**
Balance as at 31 December 2010	**272,624**	**3,591**	**47**	**(154,781)**	**510**	**121,991**

STATEMENT OF CHANGES IN THE BANK'S EQUITY
(all amounts in thousands of Euro)

	Share Capital	Reserve capital	Revaluation deficit on available for sale investments	Retained earnings	Total equity
Balance as at 31 December 2008	**69,028**	**2,935**	**(5,068)**	**18,385**	**85,280**
Loss for the period	-	-	-	(76,908)	**(76,908)**
Other comprehensive expenses	-	-	751	-	**751**
Total comprehensive (loss) / profit for the period	**-**	**-**	**751**	**(76,908)**	**(76,156)**
Shareholders cash contribution	103,596	-	-	-	**103,596**
Distribution of profit – payment for use of state capital	-	-	-	(1,374)	**(1,374)**
Balance as at 31 December 2009	**172,624**	**2,935**	**(4,317)**	**(59,897)**	**111,345**
Loss for the period	-	-	-	(96,640)	**(96,640)**
Other comprehensive income	-	-	4,364	-	**4,364**
Total comprehensive (loss) / profit for the period	**-**	**-**	**4,364**	**(96,640)**	**(92,276)**
Shareholders cash contribution	100,000	-	-	-	**100,000**
Balance as at 31 December 2010	**272,624**	**2,935**	**47**	**(156,537)**	**119,069**

STATEMENT OF CASH FLOWS (all amounts in thousands of Euro)

	2010		2009	
	Group	**Bank**	**Group**	**Bank**
Cash flows from operating activities				
(Loss) before taxation	(94,159)	(96,641)	(78,747)	(78,339)
Depreciation and amortisation	2,721	2,457	2,897	2,610
Increase in provision for impairment losses	108,717	109,400	105,436	103,490
(Profit) / loss from sale of property and equipment	(272)	13	(598)	115
Increase/ (decrease) in deferred income and accrued expenses	(3,315)	(3,062)	1,974	2,126
(Increase)/ decrease in deferred expenses and accrued income	(740)	(2,158)	80	46
(Increase) / decrease in other assets	(6,756)	1,754	(8,142)	(3,217)
Increase in other liabilities	(2,255)	(2,298)	19,815	20,013
(Decrease)/ increase in cash and cash equivalents from operating activities before changes in assets and liabilities	**3,941**	**9,465**	**42,715**	**46,844**
Decrease in balances due from credit institutions	4,520	4,520	46,746	46,746
Decrease in loans to customers	91,595	86,915	53,793	22,308
Decrease/ (increase) in trading securities	3,560	3,621	(1,753)	(1,719)
(Decrease) / increase in balances due to credit institutions	29,345	29,345	(156,512)	(129,049)
Increase in balances due to customers	49,038	52,448	31,766	31,696
Decrease in debt securities issued	(6,887)	(7,403)	(4,597)	(3,431)
Cash and cash equivalents used in operating activities	**175,112**	**178,911**	**12,158**	**13,395**
Corporate income tax paid	**(47)**	**-**	**(3)**	**-**
Cash flows from investing activities				
Purchase of investment securities	(246,732)	(255,640)	(321,922)	(321,922)
Sale of investment securities	246,806	246,806	320,631	320,631
Purchases of property and equipment	(1,148)	(931)	(1,574)	(1,386)
Proceeds from property and equipment disposal	492	20	1,268	31
Proceeds from disposal of investments in associated entities	-	-	23	-
Acquisition of investments in associated entities	-	-	-	-
Cash and cash equivalents used in investing activities	**(582)**	**(9,745)**	**(1,574)**	**(2,646)**
Cash flows from financing activities				
Increase in minority interest	299	-	-	
Repayment of syndicated loan	(206,999)	(206,999)		
Shareholders cash contribution	-	-	61,596	61,596
Dividend paid	-	-	(1,374)	(1,374)
Cash and cash equivalents generated from financing activities	**(206,700)**	**(206,999)**	**60,222**	**60,222**
Increase / (decrease) in cash and cash equivalents	**(32,217)**	**(37,833)**	**70,803**	**70,971**
Cash and cash equivalents at the beginning of the year	158,027	157,835	87,225	86,865
Cash and cash equivalents at the end of the year	**125,810**	**120,002**	**158,028**	**157,836**
Cash flow from interest received	63,104	62,800	78,119	75,360
Cash flow from interest paid	39,318	39,334	48,489	47,443

NOTES TO THE FINANCIAL STATEMENTS

1 GENERAL INFORMATION

The Mortgage and Land Bank of Latvia was established as a state-owned commercial bank on 19 March 1993 by the Government of Latvia based on the Decree No 140 adopted by the Cabinet of Ministers. The Bank was registered with the Register of Enterprises of the Republic of Latvia on 3 June 1993. According to the Commercial Law the Bank was registered in the Commercial Register on 14 July 2004.

The operations of the Bank are regulated by the law On Credit Institutions and other effective laws of the Republic of Latvia, the Statutes of the Bank, the instructions of the Bank of Latvia and Financial and Capital Market Commission, as well as the decrees and regulations of the Cabinet of Ministers of the Republic of Latvia. The Bank is under the jurisdiction of the Ministry of Finance of the Republic of Latvia that represents the interests of the shareholder on behalf of the Cabinet of Ministers and holds 100% of the Bank's shares.

The principal activities of the Bank have been dividend by commercial activities, where Bank provides universal bank's services, and state support programs, where Bank issues loans under state and European Union programs.

On 3 December 2009, the concept for Transformation of the State-owned JSC Mortgage and Land Bank of Latvia into a Development Bank was approved by Order No 820 issued by the Cabinet of the Republic of Latvia. The concept stipulates that the Mortgage Bank be gradually transformed into a development bank, phasing out commercial functions to completely refuse from them by 31 December 2013 at the latest. The Mortgage Bank will be gradually reducing its commercial loan portfolio and the portfolio balance outstanding at the end of the transition period will be realised or transferred to another financial institution.

In April 2010 the shareholder of the Bank increased share capital of the Bank by LVL 70 million. The Shareholder sent a notification to European Commission requesting to approve the share capital increase. The management of the Bank expects that decision will be made after review of Bank‘s transformation plan as described below. Thus, the approval from European Commision towards the bank's shareholder is still pending at the date of the issue of these Finacial Statements. If this approval was not been obtained, the bank's shareholder would need to perform actions to obtain repayment of made capital increase. The increase has been recognized as equity and included in capital adequacy calculation.

In September 2010, in accordance with the Cabinet's decision, a consultant – SEB Enskilda - was attracted to ensure the transformation process. The consultant was engaged to draw the transformation plan of the Bank. The tranformation plan shall include actions to be taken by the Bank, which currently have not been agreed and therefore are uncertain.

Therefore, the Bank's management has not been able to assess the potential effect, if any, which the approval of the transformation plan, including related approval on Bank's equity, could produce on the Bank's future operations, presentation of Bank‘s asset and liability term structure and their valuation s, as well as capital adequacy. A decision on the transformation plan will be adopted by the Cabinet of the Republic of Latvia after the approval of the annual report.

Given the existing circumstances, the Bank's management has adopted the going concern assumption based on the budget and action plan for 2011 approved by the Bank's Council and shareholder, stating that the Bank will be in compliance with all regulatory requirements and assuming positive decision over capital increase made in April 2010. The Bank's management also expects that the transformation plan that will be approved to implement the transformation process will encompass measures and resources which may be necessary to achieve compliance with the regulatory requirements and will not cast any doubt upon the appropriateness of the going concern assumption.

These financial statements on pages 9 to 77 have been accepted by the Board of Directors on 3 February 2011 and accepted by the Supervisory Council on 9 February 2011. In accordance with the Commercial Law of the Republic of Latvia, the shareholders' meeting has the right to make decision on approval of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT

The Group and the Bank manages all the major risks affecting the operation of the Group and the Bank in accordance with the Risk Management Policy approved by the Council of the Bank. The Risk Management Policy stipulates and describes the aggregate of measures used to ensure that a possibility of suffering losses is minimized in the event the invested or receivable resources would not be repaid or recovered in due time or full amount or the Group or the Bank would suffer other losses or would not derive the planned profit. Risk management is an integral component of the internal control system of the Group and the Bank and the risk management system has been established taking into account the size and structure of the Group and the Bank, as well as the best advisable practice, incl. the guidelines of Basel bank supervisory committee.

The Group and the Bank abides by the following principles in its risk management:

- risk assessment and management shall be an integral component of the every-day functions of the Group and the Bank;
- while assuming the risks the Group and the Bank shall be capable of implementing the aims and assignments defined in its development strategy in a longer run;
- the Group and the Bank shall operate by maintaining an optimum balance between profitability and safeguarding against the risks, i.e. the profitability must be as high as possible, however, the Group and the Bank shall not be exposed to material risks;
- in accordance with their authority and competence the employees of the Group and the Bank shall know the customer and understand fully the nature of each transaction (operation) to be able to identify and assess the risks associated with the transaction (operation) and find the best solution both for the customer and the Group or the Bank;
- the Group and the Bank shall assess the probable losses that it might incur by assuming the risks and avoid extraordinary losses in its operation;
- the Group and the Bank shall identify and assess the probable risks before launching new products or services or entering new markets;
- where necessary, the Group and the Bank shall reduce the risk limits, sell the assets subject to the risk or even cease operations on the respective markets should these be assessed as excessively risky.

In light of the changes in the world's financial markets and economy, the Group and the Bank continued improving the risk management system, developing and improving risk management methods, which enhance more accurate and timelier identification of the major risks characteristic to operations of the Group and the Bank and evaluate their impact on further operation of the Group and the Bank.

In managing the risks the Group and the Bank apply various methods and instruments for measuring risks, set the limits and maintain the appropriate controls. The Council of the Bank has approved the policies for managing the risks characteristic for operations of the Group and the Bank.
Each of the structural units involved in risk management maintains an appropriate internal control, efficiency assessment of which is the responsibility of the Internal audit department.

Credit Risk
The Group and the Bank are subject to the credit risk. The credit risk is the risk of the customer or co-operation partner being unable to or refusing to meet its liabilities towards the Group or the Bank in full amount and due time.
The Group and the Bank manages the credit risk according to the Credit Risk Management Strategy and Policies as well as internal regulations, procedures and instructions of credit operations.
The Credit Risk Management Strategy and Policies of the Bank describe and define the principles for the management of the credit risk and it relates to all activities of the Group and the Bank involving credit risk – lending, financial market transactions (operations), intermediary activities on behalf of the clients and issue of guarantees to third parties.
Management process of credit risk within the Group and the Bank encompasses establishment of guidelines and limitations, granting of loans or setting limits to particular clients or groups of interrelated clients; administration, monitoring and evaluation of files of clients or interrelated client groups, as well as appropriate control of the process, operation of management information system and evaluation of the total efficiency of the process.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT (continued)

In establishment of guidelines and limitations, the Group and the Bank primarily follows the common strategy of the Group and the Bank, credit risk management strategy, as well as their historic experience in credit risk management, which allows defining adequate limitations of concentration, as well as adequate assessment of creditworthiness and collateral, passing decisions in decision-making institutions of the appropriate level. As the common strategy of the Group and the Bank encompasses gradual transformation of the Bank into development bank, the risk stemming from implementation of framework funding programmes becomes an increasingly significant risk source for the Group and the Bank.

The Bank's Lending department and Promotional Programmes Office bear the responsibility for daily credit risk management in lending operations, incl. when setting criteria of creditworthiness and collateral adequacy, while decisions about assuming credit risk within the set limits are made by branch, regional and the Central lending committees, or the Board of the Bank. The daily supervision and administration of loans is conducted on the basis of each individual borrower's risk grade and affiliation, determined by organizational structure of the Group and the Bank.

The Risk management committee conducts the integrated monitoring of credit risk, incl. credit risk concentration and loan portfolio quality, while independent control of credit risk is performed by the Risk management department, its functions are detached from the business functions. Risk management department bears the responsibility for analysis of credit risk concentration, setting of limits and their control, quality assessment of the loan portfolio and building of provisions, as well as independent evaluation of lending operations and daily management of credit risk in operations with financial instruments.
Stress testing of the loan portfolio and scenario analysis is conducted within the Group and the Bank within the framework of the credit risk management on a regular basis, and not less than once a year, which includes changes of various macro-environment affecting factors (for instance, drop of real estate property prices, households' income decrease, contingent changes in development of various industries of national economy, and similar) and demonstrates the eventual impact on the Group's and the Bank's profitability, loan portfolio quality, volume of provisions and level of capital adequacy.
The Group and the Bank manages credit risk concentrations according to the Risk Exposures Controlling Policy that stipulates the methods of analysis of the credit risk concentrations and its controlling instruments including limits on credit risk concentrations. Credit risk concentration is managed by measuring and setting limits on the following concentrations:

- ratio of large exposure concentration and own funds (internal limit - 400%,), as of 31.12.2010 was 33.6% (as of 31.12.2009 – 47.1%);
- ratio of single client's (related clients' group) large exposure and own funds, which may not exceed 25%, as of 31.12.2010 was 22.2% (as Bank of 31.12.2009 – 20.7%);
- ratio of risk exposures with persons related to the Bank and own funds, which may not exceed 15%, as of 31.12.2010 was 1.0% (as of 31.12.2009 – 2.6%).
- proportion of risk concentration in a single economic sector in the Bank's credit portfolio and own funds as of 31.12.2010 was 131.9% (as of 31.12.2009 – 120.9%) in operations related to real estate;

Since the Bank's strategy is not focused on servicing the non-residents business, the proportion of the Bank's total claims to non-residents was small and as of 31.12.2010 was 7.3% (as 31.12.2009 – 7.1%) of the Bank's total assets. The Group and the Bank manages the country risk that results from the lending operations to non-residents according to the Country Risk Management Policy.

The management of the Group and the Bank has performed calculation of losses on the basis of all the facts at its disposal, unbiased proofs of depreciation, and believes the calculations disclosed in the financial reports are reasonable, considering the available information. Nonetheless, having the present awareness, it might occur, as a result of the next year's actual events, differing from the assumptions, that the respective book values of assets and liabilities be corrected.

Liquidity Risk
The liquidity risk relates to the ability of the Group and the Bank to redeem the legally valid claims of its customers and other creditors in due time and secure that the increase of the anticipated claims presents reasonable costs.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT (continued)

The principles for management of liquidity risk are determined by the Liquidity Maintenance Strategy, Liquidity Risk Management Policy and Business Continuity Plan for Liquidity Crisis Situation. The Bank maintains that the liquid assets do not fall below 30% (set by the FCMC) of its short-term liabilities at all times. The Assets and Liabilities Committee of the Bank stipulates the guidelines for liquidity risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the liquidity risk.
The Bank uses the GAP method to evaluate the liquidity risk. The Bank has set liquidity net position limit in each significant currency and total liquidity net position limit as well as maximum deposit amount from a single depositor to control the liquidity risk. At least once a month, scenario analysis or stress testing is conducted, to reveal the impact of contingencies on liquidity of the Group and the Bank.
Compliance with the liquidity ratio (min – 30%) was 84.76% as of 31.12.2010 (as of 31.12.2009 – 82.2%).

Foreign Currency Risk
The foreign currency risk occurs due to the differences between the asset and liability positions of foreign currencies that, as a result of the fluctuations of the exchange rates, affect the cash flow and financial results of the Group and the Bank. The principles for the management of the foreign currency risk are outlined in the Foreign Currency Risk Management Policy of the Bank. Monitoring of the foreign currency risk is conducted by the Assets and Liabilities Management Committee of the Bank, whereas the Treasury Department provides for daily management of the foreign currency risk.

The Group and the Bank maintains a cautious foreign currency risk management policy and controls the foreign currency risk by imposing limits on the open currency positions for each currency and all currencies together consolidating in lats and by complying with the open currency position limits established in the law On Credit Institutions. The biggest exposures for the Group and the Bank were in EUR and USD currencies as of December 31, 2010. Upon evaluation of the foreign currency risk level for the Bank, measuring its sensitivity to foreign currency rate changes, a decision was made that Latvia would continue its participation in Exchange rate mechanism (ERM II)), which means that the rate of Lats and Euro would remain fixed. Thus, the impact of changes in foreign currency exchange rates has been measured only for the USD open position. By using a simplified scenario, assuming that the LVL/USD rate would change +/-5% on the final date of the reporting period and assuming that all the other variables remain unchanged, it provides following figures (LVL thousands):

	31.12.2010			**31.12.2009**		
	USD open position	Impact on profit/loss statement +5%	Impact on profit/loss statement -5%	USD open position	Impact on profit/loss statement +5%	Impact on profit/loss statement - 5%
Group	97	(5)	5	(381)	19	(19)
Bank	(131)	7	(7)	(432)	22	(22)

Interest Rate Risk
The interest rate risk is related to the influence of the fluctuations of the market rates onto the interest income and expenses of the Group and the Bank. The management principles of the interest rate risk are defined in the Interest Rate Risk Management Policy. To assess the interest rate risk, the Group and the Bank analyses the maturity structure of the assets and liabilities sensitive to the changes in interest rates and susceptibility of the maturity structure to the potential fluctuations of the interest rates on a regular basis. The Assets and Liabilities Management Committee monitors the interest rate risk, whereas the Treasury Department is responsible for the daily management of the interest rate risk.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT (continued)

With the purpose to minimize the adverse effect of interest rate changes onto interest income and the economic value of the Group and the Bank, the Bank, within the framework of the Interest rate risk management programme, has set established limits, capping the overall interest rate risk exposure to all balance and off-balance-sheet items susceptible to interest rate risks.

Interest rate risk sensitivity analysis is calculated as the impact on net interest income and the economic value of the Bank, with interest rates changing by 100 basis points (thsd. LVL):

		31/12/2010		**31/12/2009**	
	Change in interest rate	Impact on net interest income	Impact on equity	Impact on net interest income	Impact on equity
LVL	+100/-100 bp	480/ (480)	(940)/940	918/(918)	(244)/244
USD	+100/-100 bp	(6)/6	-	4/(4)	-
EUR	+100/-100 bp	(25)/25	(44)/44	(543)/543	(2)/2

Impact on economic value shows impact on equity and have been calculated fixed rate available for sale financial assets for the effects of assumed changes in interest rates based on assumption of parallel shift in yield curve. shows analyses have been calculating using .Sensitivity on interest income is the effect of changes in interest rates on the profit or loss for a year based on the floating rate financial assets and liabilities held at 31 December 2010.

Operational risk

The operational risk results from intentional or unintentional deviations from the standards adopted in daily operation of the Group and the Bank, for example human mistake or fraud, disturbances in the operation of the information systems, insufficient control procedures or their ignorance. The Group and the Bank manages operational risk according to the Operational Risk Management Policy. The operational risk is measured by using the method of self assessment and statistical analysis, whereas the operational risk information system, established within the Group and the Bank, is used to identify, analyze and control the Operational risk, it registers and analyses occurrences of operational risk and calculates the scale of actual or potential losses. Structural units of the Group and the Bank are responsible for the management of the operational risk in the daily operations, but the Risk Management Committee supervises the operational risk. The Risk Management Department is responsible for implementation of the operational risk management as well as the operational risk assessment in the Group and the Bank.

The Bank has implemented Business Continuity Plan under the operational risk management measures, which includes guidelines on actions to be taken by the Bank, its structural units and employees at occurrence of risks that can have substantial negative effect on the Bank's operations.

Capital Adequacy

Capital adequacy shows the capital resources of the Group and the Bank that are required to protect them against risks, potential and characteristic to the current and future operations of the Group and the Bank.

Capital adequacy maintenance strategy and Capital adequacy evaluation process policy describes the processes of evaluation, planning and maintenance of the capital adequacy.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT (continued)

The goals of the Bank in capital management are:

- comply with the requirements of the Financial and Capital Market Commission, as well as the strategic goals to capital volume requirement and capital adequacy, established by the management of the Bank;
- maintain operation capability of the Group and the Bank, bringing profit to the shareholder and benefiting other interested parties;
- use the capital effectively and support the development of operations of the Group and the Bank by means of a healthy capital base.

Capital adequacy is evaluated on a regular basis and a report is monthly submitted to the supervisory institution, in accordance with the requirements of the Financial and Capital Market Commission.

The Group and the Bank completely follows the requirements of Basel II in their capital adequacy evaluation process. Own funds of the Group are constituted by aggregate of Tier I and Tier II capital, less the reduction of own funds.

In order to calculate the minimum capital charge for credit and market risks according the requirements of the Financial and Capital Market Commission, the Group and the Bank use the standardised approach, and basic indicator approach – for operational risk. As of 31.12.2010, the capital adequacy ratio of the Bank was 16.7% (as of 31.12.2009 - 12.8%) which exceeded the statutory minimum of 8% for the ratio of the own capital and total of risk-weighted assets and off-balance sheet items. In order to maintain that the capital at disposal of the Group and the Bank is sufficient to cover all risks of the current and scheduled operations, the Group and the Bank conducts the internal capital adequacy evaluation process (ICAAP) once a year, calculating capital requirements for those significant risks which do not have minimum regulatory capital requirements determined. The results of the internal capital adequacy evaluation as of 31.12.2010 were as follows:

	31/12/10	
	Group	**Bank**
Capital base for internal capital adequacy evaluation	104,233	102,542
Total internal capital requirement	68,602	70,047
Internal capital adequacy ratio	12.2%	11.7%
Surplus of capital base	35,631	32,495

Capital adequacy evaluation process includes:

- analysis of changes in operation of the Group and the Bank, according the goals for the next period established in development and risk strategies of the Group;
- identification of essential risks;
- analysis of the amount of own funds at disposal of the Group and the Bank, capital requirements and capital reserves volume;
- planning of capital adequacy and identifying quantitative goals;
- analysis of the results of the capital adequacy evaluation process.

The Group and the Bank have identified the following essential operation-affecting risks for determining the internal capital requirements:

Credit risk

The volume of funds required to cover the credit risk is identified by means of the standardized approach, complemented by a scenario analysis and assessing, whether the volume of funds estimated by the standardized method is sufficient for covering the credit risk of the Group.

NOTES TO THE FINANCIAL STATEMENTS

2 RISK MANAGEMENT (continued)

Market risks

The volume of funds required to cover the market risk is identified by means of the standardized approach. Complementary to that, the Group performs capital adequacy evaluation by using the internal valuation model, which looks at the actual risk level of the currency risk position. The volume of the internal capital requirement for the risk is determined according the largest value.

Operational risk

The volume of funds required to cover the operational risk is defined as 15% of the median of net interest and noninterest income of the Group for the last three years in aggregate, which is then compared to the accumulated statistical data by the Group accounting for losses incurred by operational risk occurrences within previous periods and the maximum permissible annual losses to operational processes of the Group determined in the annual operational risk evaluation. The volume of the internal capital requirement for the risk is determined according the largest value.

Interest rate risk

The volume of funds required to cover the interest rate risk is defined as the volume of anticipated losses, which may arise due to the economic value of the Group shrinking as a result of interest rate changes, in the case of parallel shift of the interest rate curve by 200 basis points. The volume of estimated losses is defined as the absolute value of the change of the economic value.

Risk of laundering of funds derived from criminal activities and terrorism financing (LFDCATF)

To determine the volume of funds required to cover the LFDCATF risk, the Group analyzes: the ratio of non-resident deposits of the total deposit volume; customers that require further investigation, volume of deposits; changes in the non-resident deposit volume; amount of trust operations. In addition to that, the Group analyzes the efficiency of the internal control system in the area of LFDCATF.

Concentration risks

When determining the volume of funds required to cover the concentration risk, the Group analyzes the concentration risk of a single customer / group of interrelated customers, industry concentration risk, currency mismatch concentration risk and collateral concentration risk in loan portfolio; and include the aggregate volume of funds required to cover these risks in the capital adequacy estimate.

Other risks (reputation, strategy, business etc.)

To cover the other risks, the Group reserves funds according to the simplified method, maintaining respective risk management and risk mitigating activity.

In order to maintain that the funds of the Group and the Bank are sufficient for covering losses in case of contingencies, and are sufficient throughout the entire economic cycle, the Group and the Bank, in addition to funds reserved for risk covering, determine reserve funds by using the simplified method.

The Group and the Bank maintain the cover for the aggregate of the internal capital requirement and capital reserves by own funds, regular evaluation of the internal capital adequacy and maintenance of an adequate level of funds.

Within the framework of capital adequacy evaluation process, stress testing is conducted to provide the confidence that the Group and the Bank are well capitalized with various economic development scenarios.

NOTES TO THE FINANCIAL STATEMENTS

3 IMPAIRMENT EXPENSES

	2010		2009	
	Group	**Bank**	**Group**	**Bank**
Impairment expenses on:				
- loans	89,544	90,269	76,537	76,324
- other assets	1,233	361	2,121	323
- securities	33	33	2,178	2,178
- investments in subsidiaries	-	710	-	235
- goodwill	86	-	-	-
- due from credit institutions	33	33	-	-
- provisions for off balance sheet liabilities	1,202	1,202	174	174
	92,131	**92,608**	**81,010**	**79,234**
Release of impairment expenses on:				
- loans	(9,542)	(9,542)	(4,557)	(4,551)
- other assets	(268)	(268)	(491)	(105)
- securities	(857)	(857)	(344)	(344)
- provisions for off balance sheet liabilities	(337)	(337)	(15)	(15)
	(11,004)	**(11,004)**	**(5,407)**	**(5,015)**
Recovery of loans written off in the previous periods	**(4,720)**	**(4,717)**	**(1,502)**	**(1,486)**
Total impairment expenses, net	**76,407**	**76,887**	**74,101**	**72,733**

NOTES TO THE FINANCIAL STATEMENTS

4 TRADING AND INVESTMENT SECURITIES

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Trading securities				
Latvian Treasury bills and government bonds	509	509	3,004	3,004
Non-OECD government bonds	-	-	160	160
Latvian corporate bonds	106	106	1,452	1,452
OECD corporate bonds	-	-	217	217
Non-OECD corporate bonds	-	-	26	26
Equity shares in Latvian corporate entities	-	-	41	41
Equity shares in non-OECD corporate entities	-	-	19	19
Investment funds registered in Latvia	1,957	1,759	155	-
Total trading securities	**2,572**	**2,374**	**5,074**	**4,919**
Securities held to maturity				
OECD government bonds	1,293	1,293	1,251	1,251
Non-OECD government bonds	6,057	6,057	7,432	7,432
OECD corporate bonds	10,111	10,111	19,926	19,926
Non-OECD corporate bonds	6,591	6,591	5,889	5,889
Latvian corporate bonds	3,517	3,517	12,111	12,111
Total securities held to maturity	**27,569**	**27,569**	**46,609**	**46,609**
Impairment allowance	(2,955)	(2,955)	(3,625)	(3,625)
Total net securities held to maturity	**24,614**	**24,614**	**42,984**	**42,984**
Securities available-for-sale				
Latvian Treasury bills and government bonds	67,601	66,939	49,892	49,892
OECD government bonds	371	371	-	-
Investment funds registered in Latvia*	3,532	10,455	-	-
Total securities available-for-sale	**71,504**	**77,765**	**49,892**	**49,892**
Total net trading and investment securities	**98,690**	**104,753**	**97,950**	**97,795**

*Bank has consolidated certain closed investment funds in the consolidated reports.

NOTES TO THE FINANCIAL STATEMENTS

4 TRADING AND INVESTMENT SECURITIES (continued)

The following table shows the division of the Bank's debt securities by rating agency designation (*Moody`s investors Service*) as at 31 December 2010:

	Trading securities	Investment securities available-for-sale	Securities held to maturity	Total net
Aa1 - Aa3	-	371	3,320	3,691
A1 - A3	-	-	4,611	4,611
Baa1 - Baa3	509	66,939	12,034	79,482
Lower than Baa3	106	-	2,050	2,156
Unrated	-	-	2,599	2,599
Total	**615**	**67,310**	**24,614**	**92,539**

The following table shows the division of the Bank's debt securities by rating agency designation (*Moody`s Investors Service*) as at 31 December 2009:

	Trading securities	Investment securities available-for-sale	Securities held to maturity	Total net
Aa1 - Aa3	1,317	-	7,326	8,643
A1 - A3	15	-	5,162	5,177
Baa1 - Baa3	3,164	49,892	13,459	66,515
Lower than Baa3	164	-	8,944	9,108
Unrated	199	-	8,093	8,292
Total	**4,859**	**49,892**	**42,984**	**97,735**

All securities are quoted on stock exchange. The average yield on investment securities as at 31 December 2010 was 3.5% (2009: 6.6%).

5 LOANS TO CUSTOMERS

Loans by type of borrower:

	31/12/10		31/12/09	
	Group	Bank	Group	Bank
Private companies	402,026	328,597	483,804	429,800
Individuals	175,101	142,177	205,104	196,841
Financial institutions	297	47,582	621	70,304
State owned companies	6,543	6,543	2,420	2,420
Management / personnel	6,851	5,634	7,468	6,167
Local government	1,279	1,109	1,614	1,319
Public and religious institutions	596	528	673	673
Accrued interest on loans	4,977	3,324	5,412	5,418
Total gross loans	**597,670**	**535,494**	**707,116**	**712,942**
Allowance for impairment loss	(105,929)	(64,960)	(74,435)	(73,441)
Total net loans	**491,741**	**470,534**	**632,681**	**639,501**

97.9% from loans issued by the Bank and the Group are loans to residents of Latvia.

NOTES TO THE FINANCIAL STATEMENTS

5 LOANS TO CUSTOMERS (continued)

Economic sector risk concentrations within the customer loan portfolio are as follows:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Individuals	181,952	147,811	212,572	203,008
Manufacturing	88,797	78,285	97,082	88,123
Real estate	70,661	76,183	80,198	82,336
Agriculture and forestry	77,418	62,835	90,692	75,857
Financial intermediaries	149	47,435	669	70,353
Other industries	35,411	26,723	50,956	45,789
Retail trade and wholesale distribution	44,056	30,315	55,514	49,168
Construction	30,845	22,800	40,341	38,327
Hotels and restaurants	21,526	13,011	24,985	24,608
Transport, warehousing and communications	26,757	12,336	33,412	15,254
Electricity, gas and water utilities	11,155	10,753	9,863	9,652
Fishing	2,687	2,574	3,806	3,730
Municipal authorities	1,279	1,109	1,614	1,319
Accrued interest on loans	4,977	3,324	5,412	5,418
Total gross loans	**597,670**	**535,494**	**707,116**	**712,942**

The extent of loan and advance concentration with respect to individual non-bank customers with total credit exposures equal to or exceeding Ls 1,000 thousand is presented below:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Number of customers	63	52	73	75
Total credit exposure of customers	172,847	212,339	197,327	269,010
Percentage of total gross portfolio of loans	28.9%	39.6%	28.1%	38.0%

At 31 December 2010 the top ten borrowers represented 11.3% (10.3% at 31 December 2009) of the total loan portfolio.

The Latvian banking legislation requires that any credit exposure to a non-related entity or group of non-related entities may not exceed 25% of a credit institution's equity and the total credit exposure to all related parties may not exceed 15% of equity. The Latvian Financial and Capital Market Commission has agreed that these limits are not applicable to the Bank's credit exposure to its fully owned leasing subsidiary SIA "Hipolīzings".

As at 31 December 2010, the Bank was in compliance with the legal requirement set for the total amount of non-zero risk credit exposure.

NOTES TO THE FINANCIAL STATEMENTS

5 LOANS TO CUSTOMERS (continued)

Analysis of loans issued by the Bank by type of valuation:

	31/12/10 Bank			31/12/09 Bank		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Individually assessed loans	47,700	310,281	357,981	77,726	425,222	502,948
Collectively assessed loans	100,786	76,727	177,513	126,907	83,087	209,994
Total gross loans	**148,486**	**387,008**	**535,494**	**204,633**	**508,309**	**712,942**
Allowance for impairment loss – individually assessed	(8,663)	(50,843)	(59,506)	(21,676)	(50,670)	(72,346)
Allowance for impairment loss – collectively assessed	(1,502)	(3,952)	(5,454)	(444)	(651)	(1,095)
Total net loans	**138,321**	**332,213**	**470,534**	**182,513**	**456,988**	**639,501**

Analysis of loans issued by the Group by type of valuation:

	31/12/10 Group			31/12/09 Group		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Individually assessed loans	82,019	337,254	419,273	87,298	409,824	497,122
Collectively assessed loans	101,052	77,345	178,397	126,907	83,087	209,994
Total gross loans	**183,071**	**414,599**	**597,670**	**214,205**	**492,911**	**707,116**
Allowance for impairment loss – individually assessed	(19,525)	(80,523)	(100,048)	(21,855)	(51,485)	(73,340)
Allowance for impairment loss – collectively assessed	(1,599)	(4,282)	(5,881)	(444)	(651)	(1,095)
Total net loans	**161,947**	**329,794**	**491,741**	**191,906**	**440,775**	**632,681**

The following table provides the division of loans and advances to customers by quality (Bank):

	31/12/10 Bank			31/12/09 Bank		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Neither past due nor impaired	106,856	268,597	375,453	125,815	327,405	453,220
Past due but not impaired	21,129	29,917	51,046	27,707	43,148	70,855
Impaired	20,501	88,494	108,995	51,111	137,756	188,867
Total loans	**148,486**	**387,008**	**535,494**	**204,633**	**508,309**	**712,942**
Allowance for impairment loss	(10,165)	(54,795)	(64,960)	(22,120)	(51,321)	(73,441)
Total net loans	**138,321**	**332,213**	**470,534**	**182,513**	**456,988**	**639,501**

NOTES TO THE FINANCIAL STATEMENTS

5 LOANS TO CUSTOMERS (continued)

The following table provides the division of loans and advances to customers by quality (Group):

	31/12/10 Group			31/12/09 Group		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Neither past due nor impaired	112,411	230,374	342,785	132,982	293,910	426,892
Past due but not impaired	22,424	36,042	58,466	29,311	54,630	83,941
Impaired	48,236	148,183	196,419	51,912	144,371	196,283
Total loans	**183,071**	**414,599**	**597,670**	**214,205**	**492,911**	**707,116**
Allowance for impairment loss	(21,124)	(84,805)	(105,929)	(22,299)	(52,136)	(74,435)
Total net loans	**161,947**	**329,794**	**491,741**	**191,906**	**440,775**	**632,681**

The following table provides an analysis of loans and advances to customers past due but not impaired:

	31/12/10 Bank			31/12/09 Bank		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Past due up to 30 days	13,800	20,385	34,185	19,696	24,249	43,945
Past due 30-60 days	2,535	2,609	5,144	3,659	8,857	12,516
Past due 60-90 days	961	1,031	1,992	2,192	3,935	6,127
Past due over 90 days	3,833	5,892	9,725	2,160	6,107	8,267
Total loans	**21,129**	**29,917**	**51,046**	**27,707**	**43,148**	**70,855**

The following table provides the division of loans and advances to customers past due but not impaired:

	31/12/10 Group			31/12/09 Group		
	Individuals	Companies	Total loans	Individuals	Companies	Total loans
Past due up to 30 days	14,824	25,939	40,763	21,300	35,731	57,031
Past due 30-60 days	2,535	2,626	5,161	3,659	8,857	12,516
Past due 60-90 days	961	1,031	1,992	2,192	3,935	6,127
Past due over 90 days	4,104	6,446	10,550	2,160	6,107	8,267
Total loans	**22,424**	**36,042**	**58,466**	**29,311**	**54,630**	**83,941**

The following table provides fair values of collaterals of impaired loans:

NOTES TO THE FINANCIAL STATEMENTS

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Impaired loans	196,419	108,995	196,283	188,867
Fair value of collateral	109,714	58,706	129,762	124,430

5 LOANS TO CUSTOMERS (continued)

The following table provides the division of restructured loans and advances to customers by type of borrower:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Individuals	23,712	18,681	10,596	10,596
Companies	64,002	57,990	62,454	62,454
Total net restructured loans	**87,714**	**76,671**	**73,050**	**73,050**

Analysis of movement in impairment allowance for loans:

	31/12/10 Bank			31/12/09 Bank		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**
As at beginning of the year	**22,120**	**51,321**	**73,441**	**3,423**	**6,050**	**9,473**
Impairment charge, net	12,556	68,171	80,727	21,563	50,210	71,773
Adjustment (foreign exchange fluctuation)	16	28	44	27	40	67
Accrued interest	(1,019)	(3,363)	(4,382)	-	-	-
Write-off of loans	(14,543)	(42,549)	(57,092)	(2,893)	(4,979)	(7,872)
As at end of the year	**19,130**	**73,608**	**92,738**	**22,120**	**73,411**	**73,441**
impairment for loan	*10,165*	*54,795*	*64,960*	-	-	-
*impairment for asstes held for sale**	*8,965*	*18,813*	*27,778*	-	-	-

* Bank has decided to sell certain loans to its subsidiary during 2011. As a result these loans are classified as held for sale in financial position and are valued net of impairment charge. Due to expected sales of these loans the Bank have incurred additional impairment expenses in amount of LVL 9,662 thousand.
** Written down loan include loans sold to Banks subsidiary during 2010, with impairment allowance at time of write-down of 13 million LVL.
*** Management uses judgment to conclude when loans are written off. Generally loan is considered for write-off, when both collateral have been realized or its remaining value is not significant from outstanding loan amount and loan is delayed more than 360 days. The Bank continue to work with recoveries from loan if possible, after write-down of loans.

Analysis of movement in impairment allowance for loans:

	31/12/10 Group			31/12/09 Group		
	Individuals	**Companies**	**Total loans**	**Individuals**	**Companies**	**Total loans**

NOTES TO THE FINANCIAL STATEMENTS

As at beginning of the year	**22,299**	**52,136**	**74,435**	**3,530**	**6,730**	**10,260**
Impairment charge, net	12,791	67,211	80,002	21,635	50,345	71,980
Adjustment (foreign exchange fluctuation)	16	28	44	27	40	67
Accrued interest	(1,119)	(3,620)	(4,739)	-	-	-
Write-off of loans	(12,863)	(30,950)	(43,813)	(2,893)	(4,979)	(7,872)
As at end of the year	**21,124**	**84,805**	**105,929**	**22,299**	**52,136**	**74,435**

5 LOANS TO CUSTOMERS (continued)

The loans to customers include finance lease receivables. As at 31 December 2010 finance lease receivables may be analysed as follows:

	31/12/10 Group	31/12/09 Group
Falling due within:		
1 month	1,179	1,493
1 – 3 months	2,644	3,028
3 – 6 months	3,232	4,340
6 –12 months	6,424	8,758
1 – 5 years	22,221	36,097
more than 5 years	225	546
Total	**35,925**	**54,262**

Finance leases by type of leased assets:

	31/12/10 Group	31/12/09 Group
Manufacturing and agricultural equipment	10,420	15,448
Transport vehicles	25,505	38,814
Total	**35,925**	**54,262**

The average interest rate for the loan portfolio as at 31 December 2010 was 5.9% per annum (5.5% at 31 December 2009).

6 ASSETS HELD FOR SALE

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Private companies	-	33,574	-	-
Individuals	-	23,886	-	-
Public and religious institutions	-	68	-	-
Accrued interest on loans	-	1,195	-	-
Total gross assets/loans for sale	**-**	**58,723**		
Provisions for impairment losses	-	(27,778)	-	-
Total net assets/loans for sale	**-**	**30,945**	**-**	**-**

Assets held for sale include non-performing lokans which Bank has intended to sell to its subsiudiary SIA „Hipotēku bankas nekustamā īpašuma aģentūra". Before the decision to transfer the assets to Bank's

NOTES TO THE FINANCIAL STATEMENTS

subsidiary, the impairment allowance was in amount of LVL 18,116 thousand. Management have estiamted expected cash flows from sales of these assets by assessing fair value of collaterals, related maintainace costs and expected time of holding collateral. Due to these estimates additional loss of LVL 9,662 thousand was recognised.

7 INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED UNDERTAKINGS

The Bank's direct investments in subsidiaries and associated entities are specified as follows:

	Share capital	Total equity	Bank's share (%)	Investment value 31/12/10	Investment value 31/12/09
SIA "Hipolīzings"	645	1,246	100%	300	300
SIA "Hipotēku bankas nekustamā īpašuma aģentūra"	915	(1,262)	100%	915	915
SIA „Risku investīciju sabiedrība"	500	361	100%	500	500
KS „Mazo un vidējo komersantu atbalsta fonds"	101	4	47.62%	48	48
Total				**1,763**	**1,763**
Impairment provision				(945)	(235)
Total net investments in subsidiaries and associated entities				**818**	**1,528**

The consolidation group also includes the following entities: IPS „Hipo Fondi" (51% owned by SIA „Risku investīciju sabiedrība"(as at 31 December 2009 – 83%)) and SIA „Rīgas centra namu pārvalde" (100% owned by SIA „Risku investīciju sabiedrība").

For the purposes of value reduction test, the Bank has treated its subsidiary companies as cash generating units. The recoverable amounts of the cash generating units were determined by estimating their operating value. The estimates used discounted cash flow forecasts for the coming years, where the major value-affecting factors are:

- Subsidiary company's financial plan for the coming years. Financial plan and business growth in the next years was estimated for each company individually, on the basis of operational peculiarities of each company, taking into account the general economic situation within the industry and the future development trends.

- Discount rate, determined individually to each subsidiary company according to CAPM model and evaluating the business risk of each individual company in comparison with market risk.

As at 31 December 2010 the carrying amount of cash generating unit exceeded its estimated value in use. Therefore impairment loss in the amount of LVL 710 thousand was recognised as expense in the reporting period (2009: LVL 235 thousand)

NOTES TO THE FINANCIAL STATEMENTS

8 OTHER ASSETS

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Financial assets	2,809	1,993	2,548	2,040
Non-financial assets	4,098	503	7,001	129
Total other assets (gross)	**6,907**	**2,496**	**9,549**	**2,169**
Impairment provision	(1,248)	(198)	(653)	(304)
Total other assets (net)	**5,659**	**2,298**	**8,896**	**1,865**

9 DUE TO CREDIT INSTITUTIONS

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Due to credit institutions registered in OECD area	153,161	153,161	361,226	361,226
Due to credit institutions registered in Latvia	14,610	14,610	18,286	18,286
	167,771	**167,771**	**379,512**	**379,512**

Due to credit institutions include the following syndicated loans which totaled to 55 mln EUR (at 31 December 2009: 262 mln EUR):

Lender/arranger	Initial amount	Currency	Maturity
Sumitomo Mitsui Banking Corporation (3 participants)	18,488	EUR	15.06.2012
Raiffeisen Zentralbank Osterreich (15 participants)	85,000	EUR	16.06.2012

The average interest rate for due to credit institutions as at 31 December 2010 was 2.9% (at 31 December 2009: 2.4%).

NOTES TO THE FINANCIAL STATEMENTS

10 DUE TO CUSTOMERS

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Individuals	227,954	227,954	206,742	206,742
Financial institutions	49,400	51,852	55,298	55,336
Private companies	49,794	49,801	41,769	41,793
State owned companies	9,023	9,023	8,034	8,034
Public and religious organisations	7,329	7,329	4,996	4,996
Local government	7,146	7,146	3,411	3,411
Central government	6,478	6,478	2,912	2,912
Accrued interest	4,039	4,039	3,537	3,537
Total due to customers	**361,163**	**363,622**	**326,699**	**326,761**

Due to customers analysis by term:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
On demand	83,518	84,928	63,179	63,214
Term balances	277,645	278,694	263,520	263,547
Total due to customers	**361,163**	**363,622**	**326,699**	**326,761**

97.8% of the deposits with the Bank are the Bank's liabilities to residents of Latvia, the remaining 2.2% of the deposits are liabilities to other countries residents.

The average interest rate for demand deposits at 31 December 2010 was 0.1% (0.4% at 31 December 2009), for term deposits – 4.2% (5.9% at 31 December 2009).

11 ISSUED DEBT SECURITIES

The purpose of mortgage bonds issuing was to attract financial resources for refinancing of the long-term mortgage loans.

The average annual interest rate of the issued securities was 3.8% (as at 31 December 2009: 4.9%).

Statement on Mortgage bond coverage as at 31 December 2010

NOTES TO THE FINANCIAL STATEMENTS

(a) Issued mortgage bonds

ISIN	Security class	Number of mortgage bonds	Face value	Registered volume	Coupon rate, %	Maturity date	Outstanding volume, LVL	Book value LVL
LV0000800100	AH	20,000	100 LVL	2,000,000	7.5%	15.08.2011.	1,150,000	1,182,112
LV0000800217	BA	100,000	100 USD	10,000,000	1.375%*	15.08.2011.	2,630,595	2,644,259
LV0000800688	C01CC	250,000	100 EUR	25,000,000	5.70%	15.02.2011.	8,721,165	8,904,381
LV0000800340	CA	200,000	100 EUR	20,000,000	1.4375**	15.02.2012.	10,978,783	11,042,582
LV0000800142	AL	50,000	100 LVL	5,000,000	6.0%	15.08.2012.	5,000,000	5,110,524
LV0000800159	AM	70,000	100 LVL	7,000,000	5.25%	15.08.2013.	3,862,400	3,930,903
						Total	**32,342,943**	**32,814,761**

* floating coupon rate (6 month LIBOR plus 0.8%) that is revised twice every year on 15 February and 15 August
**floating coupon rate (6 month EURIBOR plus 0.29%) that is revised twice every year on 15 February and 15 August

11 ISSUED DEBT SECURITIES (continued)

(b) Structure of Mortgage bond coverage

Mortgage bonds in circulation are secured by assets included in the Mortgage Bond Cover Register which as of 31 December 2010 amounted to LVL 41,142 thousand (as at 31 December 2009: LVL 94,666 thousand). Assets included in the Mortgage Bond Cover Register consisted of mortgage loans (ordinary cover) in the amount of LVL 39,634 thousand and substitute cover amounting LVL 1,508 thousand (as at 31 December 2009: mortgage loans - LVL 85,186 thousand and substitute cover amounting - LVL 9,480 thousand).

As at 31 December 2010 the amount of assets included in the Mortgage Bond Cover Register exceeds the amount of mortgage bonds in circulation by 17.1% (as at 31 December 2009: 65.4%) of the amount of weighted assets included in the Mortgage Bond Cover Register (minimum statutory requirement: 10%). All mortgage bonds issued by the Bank are assigned Baa2 rating by Moody's Investors Service. All issued debt securities are quoted on the Official List of the Riga Stock Exchange.

12 SHARE CAPITAL

Share capital as at 31 December 2010 and 31 December 2009 was as follows:

		31/12/10		31/12/09
Fully paid share capital	**Number**	**LVL**	**Number**	**LVL**
Ordinary shares	191,601,311	191,601,311	121,320,911	121,320,911
Total fully paid share capital	**191,601,311**	**191,601,311**	**121,320,911**	**121,320,911**

According to the Articles of Association, the fully paid share capital of the Bank consists of 191,601,311 ordinary shares in the total amount of LVL 191,601,311, owned by the Republic of Latvia. The nominal value of each share is LVL 1.

In accordance with the decision of the bank`s shareholder, the Bank has increased its fixed capital by LVL 70,280 thousand. Thus the total volume of the fixed capital has reached LVL 191,601 thousand. The increase of fixed capital was performed according the state budget law for year 2010 and as disclosed under Note 1 the European Commission (EC) has been notified of the increase of the equity capital. The EC will pass its decision on the issue after analysis of the transformation plan of the Bank.

13 CASH AND CASH EQUIVALENTS

NOTES TO THE FINANCIAL STATEMENTS

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Cash	9,795	9,795	7,715	7,715
Placements with the Bank of Latvia	58,382	58,382	88,282	88,282
Placements with other credit institutions	12,209	12,137	26,780	26,645
Placements with other credit institutions with the original maturity less than 3 months	8,144	4,134	5,000	5,000
Placements from other credit institutions with the original maturity less than 3 months	(110)	(110)	(16,715)	(16,715)
	88,420	**84,338**	**111,062**	**110,927**

14 RELATED PARTY TRANSACTIONS

Related parties are defined as shareholder who has significant influence over the Bank, members of the Council, the Board of Directors and the Bank's higher level management, their close relatives and companies in which they have a controlling interest as well as Bank's subsidiaries and companies, in which the Bank is having a significant influence.

The following loans and deposits were held with related parties at 31 December 2010:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Loans:				
- Members of the Council and the Board and high level management	1,052	1,052	1,260	1,260
- subsidiaries	-	69,449	-	73,765
- other related parties	2,775	2,775	3,261	3,261
Total loans held by related parties	**3,827**	**73,276**	**4,521**	**78,286**
Deposits:				
- Members of the Council and the Board and high level management	433	433	479	479
- subsidiaries	-	435	-	63
- other related parties	374	374	1,067	1,067
Total deposits held by related parties	**807**	**1,242**	**1,546**	**1,609**

The Banka has entered into a guarantee agreement with SIA Hipolīzings for covering lease losses totalling LVL 6,000 thousand. According to the agreement, the Bank has established impairment allowance for doubtful lease receivables. The balance of the above provisions as at 31 December 2010 amounted to LVL 3,615 thousand (31 December 2009: LVL 3,886 thousand). Impairment allowance for other receivables from subsidiaries as at 31 December 2010 amounted to LVL 2,586 thousand (31 December 2009: LVL 196 thousand).

In order to maintain specialization, concentration of competence and higher efficiency within the framework of non-performing loans management process, the Bank has made a decision to concentrate the management function of these loans within the subsidiary company of the Bank SIA "Hipotēku bankas nekustamā īpašuma aģentūra" (LLC Real Estate Agency of the Mortgage bank). During the reporting period, the Bank has sold its non-performing loans of LVL 10,142 thousand, book value, to the subsidiary company SIA "Hipotēku bankas

NOTES TO THE FINANCIAL STATEMENTS

nekustamā īpašuma aģentūra" for LVL 9,866 thousands, as a result of which the Bank recognized additional losses of LVL 276 thousands.

The process of handing over the non-performing loans to SIA "Hipotēku bankas nekustamā īpašumu aģentūra" is going to be carried on in 2011 as well.

Bank's income / (expenses) from transactions with related parties:

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Interest income from loans to related parties	89	3,135	226	2,775
Interest expenses for deposits held from related parties	(50)	(52)	(111)	(129)
Total income, net	**39**	**3,083**	**115**	**2,646**

14 RELATED PARTY TRANSACTIONS (continued)

The average interest rate as at 31 December 2010 on loans issued to related parties was 3.9% per annum (2.5% as at 31 December 2009). The average interest rate as at 31 December 2010 on deposits held for related parties was 1.4% per annum (4.6% as at 31 December 2009).

The Bank has entered in number of transactions with other government entities. The most significant being obtaining financing from Investment and Development Agency of Latvia, Ministry of Finance, Rural Support Service, Rural Development Fund which is used to co-finance development programs of the Bank. Total obtained financing for 2010 is LVL 5,466 thousand. (2009: LVL 14,767 thousand).

The Group and the Bank have entered into transactions with related parties in ordinary course of business at commercial terms.

15 SEGMENT ANALYSIS

Group's operations are managed based on two operating segments:

Promotional programs: operating segment comprises loans to particular SME's or individuals according to priorities defined by the Government or within the scope of European Union promotional programs.

Commercial services (Bank): operating segment comprises Bank's services to individuals and legal entities, loans to customers, accounts, savings and investments, serving payment cards.

Commercial services (Associated companies): operating segment comprises associated companies' services with real estate, leasing and asset management.

NOTES TO THE FINANCIAL STATEMENTS

15 SEGMENT ANALYSIS (continued)

2010 Group	Promotional programs	Commercial services Bank	Commercial services Associated comp.	Reconciliation	Group
Revenue form external customers	19,335	31,180	6,301		56,816
Intersegment revenue	1,524	8,788	439	(10,751)	-
Total revenues	**20,859**	**39,968**	**6,740**	**(10,751)**	**56,816**
External expense	(37,091)	(81,001)	(4,899)		(122,991)
Intersegment expense	(5,491)	(1,963)	(3,297)	10,751	-
Total expenses	**(42,582)**	**(82,964)**	**(8,196)**	**10,751**	**(122,991)**
Loss before income tax	**(21,723)**	**(42,996)**	**(1,456)**	**-**	**(66,175)**
					-
Income tax expense	-	-	-	-	(33)
					-
Net loss for the period	**(21,723)**	**(42,996)**	**(1,456)**	**-**	**(66,208)**
Total revenue comprise:					
Interest income	17,339	26,194	3,367	-	46,900
Interest income from other segments	556	4,291	12	(4,859)	-
Fee and commission income	202	3,004	706	-	3,912
Fee and commission income from other segments	-	1,521	131	(1,652)	-
Other income	1,794	1,982	2,228	-	6,004
Other income from segments	968	2,976	296	(4,240)	-
Total revenue	**20,859**	**39,968**	**6,740**	**(10,751)**	**56,816**
Total expense comprise:					
Interest expense	(1,567)	(26,385)	(1)	-	(27,953)
Interest expense to other segments	(1,054)	(568)	(3,237)	4,859	-
Fee and commission expense	-	(883)	(97)	-	(980)
Fee and commission expense to other segments	(1,477)	(131)	(44)	1,652	-
Administrative expenses*	(809)	(12,679)	(2,251)	-	(15,739)
Administrative expenses to other segments	(2,960)	(1,264)	(16)	4,240	-
Depreciation and amortization	(32)	(1,695)	(185)	-	(1,912)
Provision for impairment losses	(34,683)	(39,359)	(2,365)	-	(76,407)
Total expense	**(42,582)**	**(82,964)**	**(8,196)**	**10,751**	**(122,991)**

* Administrative expenses are allocated between promotional programs and commercial bank based on Management's estimate of split of administrative expenses and number of worked hours between the two segments.

NOTES TO THE FINANCIAL STATEMENTS

15 SEGMENT ANALYSIS (continued)

31/12/10 Group	Promotional programs	Commercial services Bank	Commercial services Associated comp.	Reconciliation	Group
Reportable segment assets	**221,272**	**539,392**	**75,754**		
Segment assets comprise:					
Cash and balances with Central Bank	-	68,177	-	-	68,177
Securities	18,220	80,271	199	-	98,690
Securities to other segments	-	-	226	(226)	-
Due from credit institutions	-	20,702	72	-	20,774
Due from other segments	-	57,107	435	(57,542)	-
Loans to customers	202,094	229,790	59,857	-	491,741
Loans to other segments	-	69,595	-	(69,595)	-
Other assets	958	10,748	14,965	-	26,671
Other assets to other segments	-	3,002	-	(3,002)	-
Total assets	**221,272**	**539,392**	**75,754**	**(130,365)**	**706,053**
Reportable segment liabilities and shareholder's equity	**221,272**	**539,392**	**75,754**		
Segment liabilities comprise:					
Due to customers	26,206	334,957	-	-	361,163
Due to other segments (deposits)	-	435	-	(435)	-
Issued debt securities	-	32,589	-	-	32,589
Issued debt securities to other segments	-	226	-	(226)	-
Other liabilities	75,514	118,857	1,106	-	195,477
Other liabilities to segments	57,107	-	70,686	(127,793)	-
Subordinated liabilities	-	31,089	-	-	31,089
Shareholders equity *	62,445	21,239	2,051	-	85,735
Shareholders equity to other segments	-	-	1,911	(1,911)	-
Total liabilities and shareholder's equity	**221,272**	**539,392**	**75,754**	**(130,365)**	**706,053**

* Shareholder equity for promotional programs is calculated as share capital increase performed both in 2009 and 2010, less any accumulated losses and equity allocated to commercial activities . In April 2010 the management has decided to allocate certain amount of equity from promotional program to commercial bank activities, based on internally calculated regulatory capital requirement for commercial bank. Promotional programs are charging 5% interest for this capital, which is presented in interest income in this segment reporting. As at 31 December 2010 promotional program had allocated shareholder equity of LVL 40,000 to commercial activities. The charge for year 2010 was LVL 968 thousand and is disclosed as other income.

NOTES TO THE FINANCIAL STATEMENTS

15 SEGMENT ANALYSIS (continued)

2009 Group	**Promotional programs**	**Commercial services Bank**	**Commercial services Associated comp.**	**Reconciliation**	**Group**
Revenue form external customers	12,406	53,205	6,377		71,988
Intersegment revenue	219	9,173	405	(9,797)	-
Total revenues	**12,625**	**62,378**	**6,782**	**(9,797)**	**71,988**
External expense	(31,645)	(91,346)	(4,341)		(127,332)
Intersegment expense	(6,492)	(624)	(2,681)	9,797	-
Total expenses	**(38,137)**	**(91,970)**	**(7,022)**	**9,797**	**(127,332)**
Loss before income tax	**(25,512)**	**(29,592)**	**(240)**	**-**	**(55,344)**
					-
Income tax expense	-	-	-	-	934
					-
Net loss for the period	**(25,512)**	**(29,592)**	**(240)**	**-**	**(54,410)**
Dividend from other segments	-	47	-	(47)	**-**
Total revenue comprise:					
Interest income	11,858	38,968	4,147	-	54,973
Interest income from other segments	219	5,688	52	(5,959)	-
Fee and commission income	234	3,203	813	-	4,250
Fee and commission income from other segments	-	2,826	-	(2,826)	-
Other income	314	11,034	1,417	-	12,765
Other income from segments	-	659	353	(1,012)	-
Total revenue	**12,625**	**62,378**	**6,782**	**(9,797)**	**71,988**
Total expense comprise:					
Interest expense	(2,554)	(27,435)	(461)	-	(30,450)
Interest expense to other segments	(3,518)	(271)	(2,170)	5,959	-
Fee and commission expense	-	(996)	-	-	(996)
Fee and commission expense to other segments	(2,348)	-	(478)	2,826	-
Administrative expenses	(542)	(15,411)	(2,294)	-	(18,247)
Administrative expenses to other segments	(626)	(353)	(33)	1,012	-
Depreciation and amortization	(24)	(1,810)	(202)	-	(2,036)
Provision for impairment losses	(28,525)	(45,694)	(1,384)	-	(75,603)
Total expense	**(38,137)**	**(91,970)**	**(7,022)**	**9,797**	**(127,332)**
Dividend from other segments	-	47	-	(47)	**-**

NOTES TO THE FINANCIAL STATEMENTS

15 SEGMENT ANALYSIS (continued)

31/12/09 Group	Promotional programs	Commercial services Bank	Commercial services Associated comp.	Reconciliation	Group
Reportable segment assets	**282,915**	**721,318**	**78,530**		
Segment assets comprise:					
Cash and balances with Central Bank	-	95,997		-	95,997
Securities	-	97,795	155	-	97,950
Securities to other segments	-	-	820	(820)	-
Due from credit institutions	-	35,276	135	-	35,411
Due from other segments	35,843	84,159	62	(120,064)	-
Loans to customers	246,813	317,902	67,966	-	632,681
Loans to other segments	-	74,786	-	(74,786)	-
Other assets	259	13,047	9,392	-	22,698
Other assets to other segments	-	2,356	-	(2,356)	-
Total assets	**282,915**	**721,318**	**78,530**	**(198,026)**	**884,737**
Reportable segment liabilities and shareholder's equity	**282,915**	**721,318**	**78,530**	-	-
Segment liabilities comprise:					
Due to customers	-	324,749	-	-	324,749
Due to other segments (deposits)	-	62	-	(62)	-
Issued debt securities	-	37,429	-	-	37,429
Issued debt securities to other segments	-	820	-	(820)	-
Other liabilities	144,966	266,862	1,256	-	413,084
Other liabilities to other segments	84,159	35,843	75,662	(195,664)	-
Subordinated liabilities	-	31,089	-	-	31,089
Shareholders' equity	53,790	24,464	132	-	78,386
Shareholders equity to other segments	-	-	1,480	(1,480)	-
Total liabilities and shareholder's equity	**282,915**	**721,318**	**78,530**	**(198,026)**	**884,737**

NOTES TO THE FINANCIAL STATEMENTS

16 OFF BALANCE SHEET ITEMS AND CONTINGENT LIABILITIES

	31/12/10		31/12/09	
	Group	**Bank**	**Group**	**Bank**
Contingent liabilities				
outstanding guarantees	16,081	18,466	12,080	14,194
Financial commitments				
unutilised loan facilities	23,033	84,631	32,685	55,077
Other liabilities	91	91	252	252
Total	**39,205**	**103,188**	**45,017**	**69,523**

Competition council has made a claim against the Bank and other banks operating in Latvian market in relation to payment card fee determination. The Bank does not agree with objections raised by Competition council. The case has not been finalized, but the management of the Bank does not expect that material loss due to this will be incurred.

17 CAPITAL ADEQUACY CALCULATION

Based on the requirements set by the Financial and Capital Market Commission (FCMC), the Group's and the Bank's equity to be utilised in the capital adequacy ratio as at 31 December 2010 has been calculated as follows:

	31/12/2010	
	Group	**Bank**
Tier 1		
- paid-in share capital	191,601	191,601
- legal and other reserves	2,774	2,063
- audited retained earnings	(42,823)	(42,096)
- loss for the period	(66,208)	(67,920)
- negative revaluation reserve on investment securities available-for-sale	-	-
- intangible assets	(1,811)	(1,447)
Total Tier 1	**83,533**	**82,201**
Tier 2		
- subordinated capital (restricted to 50% of Tier 1)	31,084	31,084
- decrease of subordinated capital	(10,217)	(10,217)
- other elements reducing capital	(167)	(526)
Total Tier 2	**20,700**	**20,341**
Capital base	**104,233**	**102,542**

The total of Tier 2 may not exceed the total of Tier 1.

NOTES TO THE FINANCIAL STATEMENTS

17 CAPITAL ADEQUACY CALCULATION (continued)

The following table shows the Group's asset weightings used in calculation of capital adequacy ratio according to the FCMC requirements and calculation of the Group's capital adequacy ratio according to the FCMC requirements:

	Credit equivalent	Balance	Risk weighted assets
Assets and off-balance sheet items			
Claims or contingent claims on central governments or central banks		134,096	2,216
Claims or contingent claims on regional governments or local authorities		468	468
Claims or contingent claims on institutions		24,630	10,601
Claims in the form of covered bonds		6,525	3,263
Claims or contingent claims on corporates		311,714	297,668
Claims secured by real property		42,676	14,929
Retail exposures		114,185	83,850
Past due items		75,772	88,441
Shares of investment funds		12,214	12,214
Other claims		29,251	20,372
Derivative financial instruments	1,915	862	385
Deductions from capital:			
Intangible assets		1,811	
Total assets and off-balance sheet items		**754,204**	**534,407**
Calculation of capital requirements			
Capital requirement for the Group's portfolio credit risk	8%		42,752
Capital requirements for market risk			-
Operational risk capital requirement			5,179
Capital requirement for the Group's portfolio credit risk and market risk			**47,931**
Capital base			**104,233**
Capital adequacy ratio (Capital base / Capital requirement x 8%)			**17.4%**

NOTES TO THE FINANCIAL STATEMENTS

17 CAPITAL ADEQUACY CALCULATION (continued)

The following table shows the Bank's asset weightings used in calculation of capital adequacy ratio according to the FCMC requirements and calculation of the Bank's capital adequacy ratio according to the FCMC requirements:

	Credit equivalent	Balance	Risk weighted assets
Assets and off-balance sheet items			
Claims or contingent claims on central governments or central banks		134,096	2,216
Claims or contingent claims on regional governments or local authorities		468	468
Claims or contingent claims on institutions		26,610	10,997
Claims in the form of covered bonds		6,525	3,263
Claims or contingent claims on corporates		381,121	340,083
Claims secured by real property		42,676	14,929
Retail exposures		114,185	83,850
Past due items		66,575	74,645
Shares of investment funds		12,214	12,214
Other claims		21,164	12,284
Derivative financial instruments	1,915	862	385
Deductions from capital:			
Intangible assets		1,446	
Total assets and off-balance sheet items		**807,942**	**555,334**
Calculation of capital requirements			
Capital requirement for the Group's portfolio credit risk	8%		44,427
Capital requirements for market risk			-
Operational risk capital requirement			4,761
Capital requirement for the Group's portfolio credit risk and market risk			**49,188**
Capital base			**102,542**
Capital adequacy ratio (Capital base / Capital requirement x 8%)			**16.7%**