Joint Stock Company *Parex banka*

Unaudited Public Financial Report for the year ended 31 December 2010

MAXIMUM RECOVERY OF STATE AID

PAREX BANKA

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MANAGEMENT REPORT

Dear Shareholders and Cooperation Partners,

2010 was a year of substantial changes in Parex banka's activity – restructuring of one of biggest banks in Latvia which was facing financial difficulties – Parex banka – was successfully completed in 1 August with support from the State. As a result, two separate companies were formed: Citadele Bank which the largest part of assets of former Parex banka were transferred to, and Parex banka where problematic assets were left. Since 1 August 2010 Parex banka has become a unique financial institution in Latvia with an ambitious goal: to maximise the recovery of State Aid. At the same time, Parex banka has discontinued to provide such traditional banking services as taking deposits and executing money payments, issuing new loans, attracting new clients and others.

Events prior to 1 August 2010

At the beginning of the reporting period, major shareholder of Parex banka – the Republic of Latvia – provided the bank with an aid and additional capital needed. On 23 February 2010, the Cabinet of Ministers approved the increase of the bank's share capital by 31.5 million Lats (44.8 million euro) and on 26 February 2010 the capital was increased by capitalizing the respective share of State Treasury deposits placed in the bank.

On 23 March 2010, the Cabinet of Ministers of the Republic of Latvia approved the restructuring plan for Parex banka developed by Nomura International plc, international financial consultant, and on 31 March the plan was submitted for approval to the European Commission.

Evaluating the volume of attracted deposits by Parex banka, stability in Lats' money market as well as liquidity ratios of the bank, on 5 May 2010, Parex banka made an agreement with the Bank of Latvia on early repayment of the borrowed funds in the amount of 117.6 million Lats (167.3 million euro).

Events after 1 August 2010

On 1 August 2010, Parex banka commenced to work as a resolution bank with a particular goal – to maximise the recovery of State Aid. In order to achieve this goal, the bank's activities are focused on efficient restructuring of loans, recovery of debts and management of repossessed real estates for selling them in more favourable market conditions. According to Parex banka's restructuring plan, the allocated for its implementation is by 2017.

On 15 September 2010, the European Commission approved Parex banka's restructuring plan. In the international banking sector, such approval is recognised as a significant achievement within the process of Parex banka's

restructuring considering that several European banks had to wait for similar approvals for a much longer period of time.

In December 2010, Parex banka paid 9.7 million Lats (13.8 million euro) of interest payments for use of the State Aid.

In accordance with restructuring plan of joint stock company Parex banka and decision passed by the Cabinet of Ministers on 28 December 2010, the bank's share capital was increased by 9.7 million Lats (13.8 million euro). The reason for the transaction was to ensure Parex banka's compliance with the capital adequacy ratio. The issued shares were acquired by state joint stock company Privatization Agency, thus increasing the State's share in the bank's share capital. Accordingly, as of 31 December 2010, the Parex banka shareholders structure was as follows: state joint stock company Privatization Agency owned 81.83 percent of shares, European Bank for Reconstruction and Development – 14.62 percent, and minority shareholders - 3.56 percent of Parex banka's shares.

On 31 December 2010, the loan portfolio of Parex banka and Parex Banka group was 805.7 and 770.6 million euro accordingly, total assets – 1.12 and 1.13 billion euro. The equity at the end of 2010 was 69.0 and 68.4 million euro.

In accordance with the requirements of the International Financial Reporting Standards, Parex banka has made provisions for non-performing loans in amount of 164.7 million Lats during the reporting period. This adjustment affected the bank's financial results therefore Parex banka ended 2010 with losses in amount of 217.2 million euro as planned. Since all cash resources recovered by Parex banka are accumulated for the repayment of syndicated loan and State Aid, no profit from the bank's activities is envisaged according to restructuring plan. Simultaneously, the bank is taking all possible actions to limit losses and caries out deliberative and prudent operational and financial activities, scrutinises all expense items in order to achieve this goal.

Since 1 August 2010 to end of the reporting period, namely, during only five months, Parex banka through targeted and hard work has been able to recover 58 million. This amount largely consisted of monies recovered through restructuring of non-performing loans and sales of securities portfolio as considering still inactive real estate market the purchase price offered by potential buyers for real estate assets repossessed by the bank were significantly lower than its potential market price in majority of cases.

Other significant events

On 30 July 2010 Parex banka filed the claim against its former Members of the Board – Valērijs Kargins and Viktors Krasovickis – asking to compensate damages caused to the bank in the amount of more than 62 million Lats (88

million euro). On 16 August 2010, Riga district Court resolved to secure the claim, simultaneously ordering Parex banka to secure loss compensation which might occur from the enforcement of the decision. On 15 November 2010, Parex banka filed a request with Riga District Court to reduce mentioned security deposit, pointing out, inter alia, that actually the bank who wants to protect its infringed legal interests in fair trial, is put in a considerably more unfavourable position than the defendants.

On 17 September 2010 Parex banka's Council Meeting the claim from minority shareholders Firebird Republics SPV, Amber Trust and DCF Fund received on 7 September 2010 demanding to file the claim in the court against previous Board members for sales of Parex leasing in Belarus was reviewed. After thorough revaluation of the claim and enclosed documentation submitted by minority shareholders, Parex banka's Council concluded that there are no legal grounds for filing a claim and that the requests of minority shareholders are based on incomplete information.

During the reporting period, Parex banka also initiated several proceedings against particular companies of Kolonna group and I. Plaude-Relinger for permanent non-performance of liabilities toward the bank and malicious concealment of assets. Parex banka's management as a thorough and diligent proprietor has indicated several times that to protect tax payers' interests it will use all legitimate means to turn against any dishonest clients' activities or any activities punishable by law.

Main events after the end of the reporting period

In the first half of 2011 Parex banka's priority is repayment of syndicated loan without State assistance which is a significant challenge for the bank's management and employees. In accordance with the agreement made with syndicated loan lenders in March 2009, Parex banka has already repaid 70 percent of the total loan outstanding. The remaining 30 percent or 232.5 million euro are due in May 2011 therefore maximum attention is paid to the accumulation of necessary funds.

By the end of February 2011, Parex banka had accumulated 114 million euro for repayment of the syndication loan. As previously, also in 2011 the funds needed for the repayment of syndicated loan will be recovered through restructuring of non-performing loans and sales of securities portfolio without executing unprofitable forced assets sales transactions
.

Considering the total assets managed by Parex banka, thorough attention is paid to attract properly qualified professionals. Comparing with global generally accepted standards, Parex banka with its human resources of slightly over 100 employees is evaluated as an extremely efficient organization. The basis for such a successful modern company model is

continuous evaluation of administrative resources and deliberative use of outsource service providers.

After the end of accounting period, Parex banka continues to work with loan restructuring, asset recovery and real estate management thus ensuring the safeguarding and growth of assets value. Looking into Parex banka's long-term perspectives in line with the economic processes in Latvia and across the world, it is expected that along with recovery of real estate market, Parex banka will be able to carry out successfully the task set in the restructuring plan, i.e. to maximise the recovery of State Aid.

AS Parex banka
Chairman of the Board
Christopher Gwilliam

Riga, 31 March 2011

The report has been approved by the Management Board of the Bank on March 31, 2011. 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

BALANCE SHEETS AS AT 31 DECEMBER 2010 AND 2009

EUR 000's

	Reporting period *Unaudited*	**Preceding reporting year** *Audited**	**Reporting period** *Unaudited*	**Preceding reporting year** *Audited**
	Group	**Group**	**Bank**	**Bank**
Cash and deposits with central banks	38 338	224 105	38 338	202 416
Balances due from credit institutions	96 310	314 221	93 678	463 670
Financial assets held for trading	1 776	6 780	1 776	6 793
Financial assets designated at fair value through profit and loss	-	3 941	-	-
Available-for-sale financial assets	84 533	162 704	84 533	135 456
Loans and receivables to customers:				
Loans to companies and private individuals	770 556	2 362 491	805 744	2 056 627
Held-to-maturity investments	34 445	425 967	58 857	453 397
Prepayments and accrued income	5 488	6 574	5 485	5 021
Fixed assets	2 499	74 694	2 496	17 850
Intangible assets	216	4 687	216	832
Investments in subsidiaries	-	-	367	103 478
Investment property	28 187	17 938	19 389	16 689
Income tax assets	-	56 159	-	51 211
Other assets	64 689	17 185	12 167	2 683
Total assets	**1 127 037**	**3 695 051**	**1 123 046**	**3 516 129**
Due to central banks	-	238 994	-	238 994
Demand liabilities to credit institutions	5 637	875	5 637	10 165
Financial liabilities held for trading	2 849	1 333	2 849	1 369
Financial liabilities designated at fair value through profit and loss	-	1 009	-	-
Financial liabilities measured at amortised cost:				
Loans from credit institutions	248 509	546 219	248 509	565 836
Deposits from customers	705 567	2 401 593	705 567	2 192 174
Issued debt securities	-	128 842	-	129 114
Subordinated liabilities	75 455	147 906	75 455	147 916
Other financial liabilities	-	7 726	-	-
Accrued expenses and deferred income	2 591	8 435	2 553	7 150
Income tax liabilities	-	1 824	-	-
Other liabilities	17 982	12 587	13 480	6 182
Total liabilities	**1 058 590**	**3 497 343**	**1 054 050**	**3 298 900**
Shareholders' equity	68 447	197 708	68 996	217 229
Total liabilities and shareholders' equity	**1 127 037**	**3 695 051**	**1 123 046**	**3 516 129**
Memorandum items				
Contingent liabilities	1 259	9 713	3 725	16 312
Financial commitments	282	179 407	28 263	236 656

* Auditors: SIA „PricewaterhouseCoopers"

STATEMENTS OF INCOME
FOR THE YEARS ENDED 31 DECEMBER 2010 AND 2009

EUR 000's

	Reporting period *Unaudited*	Respective period of the preceding reporting year *Audited**	Reporting period *Unaudited*	Respective period of the preceding reporting year *Audited**
	Group	**Group**	**Bank**	**Bank**
Interest income	107 129	245 175	91 417	218 499
Interest expense	(124 033)	(207 573)	(114 252)	(201 073)
Commission and fee income	22 769	40 068	16 461	30 717
Commission and fee expense	(7 055)	(12 220)	(5 125)	(9 880)
Net gain/ (loss) on available for sale financial assets and financial liabilities	(201)	(16)	(1 592)	21
Net gain/ (loss) on financial assets measured at amortised cost	-	(465)	-	-
Net gain/ (loss) on financial assets or financial liabilities designated at fair value though profit and loss	92	2 215	-	2 122
Net gain/ (loss) on held for trading financial assets and financial liabilities	1 020	2 550	1 151	2 530
Gain/ (loss) from foreign exchange trading and revaluation of open positions	-	3 762	-	3 210
Net gain/ (loss) on disposal of non-current assets held for sale	(1 360)	(5 196)	-	-
Other income	16 094	21 372	8 988	14 643
Other expense	(3 105)	(6 369)	(1 066)	(5 855)
Administrative expense	(61 660)	(101 769)	(43 294)	(71 644)
Amortisation and depreciation charge	(8 369)	(16 147)	(3 899)	(11 030)
Impairment charge and reversals, net	(154 845)	(170 316)	(164 670)	(156 079)
Restructuring result	17 459	-	-	-
Corporate income tax	(2 679)	24 210	(1 352)	25 726
(Loss)/ profit for the reporting period	**(198 744)**	**(180 719)**	**(217 233)**	**(158 093)**

Statements of Comprehensive Income:

EUR 000's

	2010 year *Unaudited*	2009 year *Audited**	2010 year *Unaudited*	2009 year *Audited**
	Group	**Group**	**Bank**	**Bank**
Net change in fair value revaluation reserve of securities	10 861	31 145	10 377	30 294
Other comprehensive income / (loss) for the period	**10 861**	**31 145**	**10 377**	**30 294**
Total comprehensive income / (loss) for the period	**(187 883)**	**(149 574)**	**(206 856)**	**(127 799)**

Changes in the Group's equity are as follows:

EUR 000's

	Issued share capital	Share premium	Fair value revaluation reserve	Retained earnings	Total equity
Balance as at 31 December 2008	**92 525**	**18 062**	**(48 672)**	**50 593**	**112 508**
Issue of new shares	234 774	-	-	-	234 774
Net loss for the period	-	-	-	(180 719)	(180 719)
Other comprehensive income for the period	-	-	31 145	-	31 145
Balance as at 31 December 2009	**327 299**	**18 062**	**(17 527)**	**(130 126)**	**197 708**
Issue of new shares	58 622	-	-	-	58 622
Net loss for the period	-	-	-	(198 744)	(198 744)
Other comprehensive income for the period	-	-	10 861	-	10 861
Balance as at 31 December 2010	**385 921**	**18 062**	**(6 666)**	**(328 870)**	**68 447**

Changes in the Bank's equity are as follows:

EUR 000's

	Issued share capital	Share premium	Fair value revaluation reserve	Retained earnings	Total equity
Balance as at 31 December 2008	**92 525**	**18 062**	**(47 339)**	**47 007**	**110 255**
Issue of new shares	234 774	-	-	-	234 774
Net loss for the period	-	-	-	(158 095)	(158 095)
Other comprehensive income for the period	-	-	30 294	-	30 294
Balance as at 31 December 2009	**327 299**	**18 062**	**(17 045)**	**(111 088)**	**217 228**
Issue of new shares	58 622	-	-	-	58 622
Net loss for the period	-	-	-	(217 233)	(217 233)
Other comprehensive income for the period	-	-	10 379	-	10 379
Balance as at 31 December 2010	**385 921**	**18 062**	**(6 666)**	**(328 321)**	**68 996**

STATEMENTS OF CASHFLOWS
FOR THE YEARS ENDED 31 DECEMBER 2010 AND 2009

EUR 000's

	Reporting period *Unaudited*	Respective period of the preceding reporting year *Audited*	Reporting period *Unaudited*	Respective period of the preceding reporting year *Audited*
	Group	**Group**	**Bank**	**Bank**
Cash flows from operating activities				
Profit/ (loss) before tax	(196 064)	(204 929)	(215 881)	(183 821)
Amortisation of intangible assets, depreciation of fixed assets	8 369	16 147	3 899	11 030
Change in impairment allowances and other provisions	160 851	170 316	169 082	156 079
Other non-cash items	(7 786)	341	427	1 113
Cash generated before changes in assets and liabilities	**(34 630)**	**(18 125)**	**(42 473)**	**(15 599)**
Change in derivative financial instruments	3 512	12 405	3 418	12 126
(Increase) in other assets	(8 722)	(6 530)	(13 775)	4 479
(Decrease)/ increase in other liabilities	19 434	(26 373)	21 503	(22 316)
(Increase)/ decrease in trading investments	3 011	4 435	2 538	5 050
Decrease / (increase) in balances due from credit institutions	2 232	31 097	184 899	(238 782)
Decrease/ (increase) in loans and receivables from customers	137 832	351 577	25 064	251 366
(Decrease) in balances due to credit institutions	(57 160)	(47 575)	(67 597)	(29 335)
(Decrease)/ increase in deposits from customers	170 106	(188 967)	141 506	(226 064)
Cash generated from/ (used in) operating activities before corporate income tax	**235 615**	**111 944**	**255 083**	**(259 075)**
Corporate income tax paid	(2 715)	(3 500)	(106)	(1 150)
Net cash flow generated from/ (used in) operating activities	**232 900**	**108 444**	**254 977**	**(260 225)**
Cash flows from investing activities				
(Purchase) of intangible and fixed assets, net	(777)	(14 939)	(539)	(1 487)
Proceeds from disposal of intangible and fixed assets	4 162	1 827	3 980	922
Acquisitions and investments in subsidiaries	-	-	(13 090)	(30 841)
Cash inflows from maturing held-to-maturity securities		53 160		84 307
(Purchase)/sale of available-for-sale securities, net	100 624	84 520	132 490	101 190
Net cash flow generated from/ (used in) investing activities	**104 009**	**124 568**	**122 841**	**154 091**
Cash flows from financing activities				
Repayment/ repurchase of debt securities	13 802	-	13 802	-
Repayment of syndicated loans	(312 582)	(232 500)	(310 000)	(232 499)
Raised subordinated capital	-	18 395	-	18 400
Net cash flow used in financing activities	**(298 780)**	**(214 105)**	**(296 198)**	**(214 099)**
Transferred to Citadele	**(448 065)**	**-**	**(431 714)**	**-**
Net decrease in cash and cash equivalents for the period	**(409 936)**	**18 907**	**(350 094)**	**(320 233)**

Cash and cash equivalents at the beginning of the year	**533 258**	**514 351**	**470 783**	**791 016**
Cash and cash equivalents at the end of the period	**123 322**	**533 258**	**120 689**	**470 783**

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	Regalite Holdings Limited	CY-HE93438	Cyprus, Nicosia 1075, 58 Arch. Makarios 3 Avenue, Iris Tower, 6th floor, office 602	CY	PLS	100	100	MS
3	OOO "Parex Leasing and Factoring"	AZ-1105-T10-3749	Azerbaijan, Baku AZ1065, Dz.Dzabbarli 44, "Caspian Plaza"	AZ	LIZ	100	100	MS
4	OOO "Ekspress Lizing"	RU-1037867006726	Russia, St. Petersburg 192019, Sedova 11, liter A	RU	LIZ	100	100	MS
5	LLC "Laska Lizing"	UA-33104543	Ukraine, Kiev 03150, Dimitrova 5	UA	LIZ	100	100	MS
6	LLC "Parex Leasing"	RU-1047796715603	Russia, Moscow 111116, Energeticheskaja 3	RU	LIZ	100	100	MS
7	OOO "Extroleasing"	RU-1027739537220	Russia, Moscow 111116, Energeticheskaja 3	RU	LIZ	100	100	MS
8	SIA "Parex Private Banking"	LV-40003103438	Latvia, Riga LV-1050, Smilšu 7	LV	PLS	100	100	MS
9	OOO "Extrocredit"	RU-1067746758518	Russia, Moscow 111116, Energeticheskaja 3	RU	CFI	99	99	MMS
10	LLC "Parex Leasing and Factoring"	GE-205224461	Georgia, Tbilisi, Kazbegi avenue 44	GE	LIZ	100	100	MS
11	SIA "NIF"	LV-40103250571	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
12	SIA "NIF Dzīvojamie īpašumi"	LV-40103253915	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
13	SIA "NIF Komercīpašumi"	LV-40103254003	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
14	SIA "NIF Zemes īpašumi"	LV-40103255348	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
15	UAB "Nekilnojamojo turto valdymo fondas"	LT-302462108	Lithuania, Vilnius LT03107, K.Kalinausko 13	LT	PLS	100	100	MMS
16	OÜ "Restruktureeritud Kinnisvarafond"	EE-11788043	Estonia, Tallinn 10119, Roosikrantsi 2	EE	PLS	100	100	MMS
17	SIA "NIF Projekts 1"	LV-50103300111	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
18	SIA "NIF Projekts 2"	LV-40103353475	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
19	SIA "NIF Projekts 3"	LV-40103353511	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS

*BNK – bank, CFI – other financial institution, LIZ – leasing company, PLS – company providing various support services.
** MS – subsidiary company, MMS – subsidiary of the subsidiary company, MAS – parent company.

INFORMATION ABOUT PAREX BANKA'S BRANCHES

As at 31 December 2010 the Bank was operating a total of 2 branches, including 2 foreign branches, and 4 representative offices.

ISSUED SHARE CAPITAL AS AT 31 DECEMBER 2010

Shareholders	Nominal value (LVL)	Number of shares	Paid-in share capital (EUR)	Voting rights	Paid-in share capital (%)
SJSC "Privatizācijas Aģentūra"	1	221 933 292	315 782 625	156 283 292	81.83%
EBRD	1	39 631 824	56 391 005	39 631 824	14.61%
Other	1	9 662 179	13 748 042	5 468 323	3.56%
Total		**271 227 295**	**385 921 672**	**201 383 439**	**100%**

MANAGEMENT OF THE BANK AS AT 31 DECEMBER 2010

Council of the Bank

Name	Position
Michael Joseph Bourke	Chairman of the Council
Sarmīte Jumīte	Deputy chairman of the Council
Vladimirs Loginovs	Member of the Council
Mary Ellen Collins	Member of the Council

Management of the Bank

Name	Position
Christopher John Gwilliam	Chairman of the Management Board, p.p.
Solvita Deglava	Member of the Management Board, p.p.
Jurijs Adamovičs	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 April 6, 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.

On July 30, 2010 the new members were elected to the Management Board: Solvita Deglava and Christopher John Gwilliam, who took up their duties on August 1, 2010, and Jurijs Adamovičs, who took up his duties on August 16, 2010.

On August 1, 2010 the following board members have finished their work at the Bank's Management Board: Vladimirs Ivanovs, Valters Abele and Guntis Beļavskis. 16th August 2010 was the last working day for Nils Melngailis at the Bank's Management Board (till July 31 – as the Chairman of the Board, from August 1 till August 16 – as the member of the Board).

The Extraordinary Board meeting took place on July 30, 2010, where the new Council of the Bank was elected - Michael J. Bourke, Sarmīte Jumīte, Mary E. Collins and Vladimirs Loginovs. 31st July 2010 was the last working day at the Council of the Bank for Juris Jākobsons , Juris Vaskāns, Klāvs Vasks, Laurence Philip Adams.

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:

EUR 000's

	2010 year			2009 year		
	Period-end balance	**Average interest rate ***	**Interest income/ (expense)**	**Period-end balance**	**Average interest rate ***	**Interest income/ (expense)**
Loans issued by the Bank	2 693	0.00%	760	41 317	2.10%	1 446
Deposits placed with the Bank	-	-	(1 578)	39 848	7.90%	(4 303)
Subordinated financing provided to the bank	51 230	6.00%	(4 388)	51 234	11.20%	(6 784)

* 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.

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

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

- Undertaking an acceptable risk level is one of the Group's main functions in all areas of operation. 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 elements of risk management. 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 an independent unit unrelated to customer servicing - Risk Management Division.

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 losses 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 Risk Management Division. 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.

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 Management Division.

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.

Due to the specific nature and limited scale of the Bank's operations since the split of the bank on August 1, the Group does not take up new market risks. Market risk assessment, evaluation of undertaken positions, as well as risk monitoring and reporting is carried out by Finance Planning and Control Division and Risk Management Division.

Interest rate risk

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

Interest rate risk measurement, management and reporting in the Group is coordinated by Finance Planning and Control Division and Risk Management Division. Bank's interest rate risk assessment and relevant decision making is 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.

Under ordinary circumstances the Group manages its liquidity risk in accordance with the Group's Liquidity Risk Management Policy. Liquidity risk is assessed and related decisions are made by the Bank's Management Board. Daily liquidity management, as well as liquidity risk measurement, monitoring and reporting, is ensured by the Risk Management Division and Finance Planning and Control Division. Liquidity risk management in the Group is coordinated by the Risk Management Division and Finance Planning and Control Division. 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 related to mismatch in foreign currency asset and liability positions that impact the Group's cash flow and financial results via fluctuations in currency exchange rates.

Currency risk management in the Group is carried out in accordance with the Group's Currency Risk Management Policy. Day-to-day currency risk monitoring, management and reporting is the responsibility Risk Management Division and Finance Planning and Control Division. 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 in compliance with the requirements of Latvian legislation. To assess currency risk, the Group also uses scenario analysis.

Operational risk

Operational risk is the risk of suffering 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 undertake / accept operational risks with potential impact exceeding 10% of the Group's net annual revenues, or risks with unquantifiable impact that are concurrently unmanageable (it is impossible to prevent such risks or provide for their consequences – e.g. non-compliance with legal regulations etc.) , 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:

- 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;
- 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;
- Insurance;
- Investments in appropriate data processing and information protection technologies.