Joint Stock Company **Parex banka**

PAREX BANKA

Unaudited

Public Financial Report

for the year ended 31 December 2011

MAXIMUM RECOVERY OF STATE AID

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Management report

Dear Shareholders and Collaboration Partners,

In 2011 joint stock company Parex banka worked intensively on achieving its main goal recovering funds once invested by the state as a bail. The results clearly evidence that within a short period of time Parex banka has become a high level manager of distressed assets with a strong team which is able to achieve notable results also in working with sophisticated multi-million projects in specific and even extraordinary situations. Since 1 August 2010, Parex banka has in total recovered more than 220 million lats, mainly by restructuring distressed loans and selling securities. It is important to note that due to its longsighted strategy Parex banka has continuously and consistently managed to prevent a forced sale of its assets.

Parex banka's activity is focused in three main directions during the period of account – loan restructuring, debt recovery and real estate management. In 2011 the bank has concluded several very sophisticated loan restructuring transactions which enabled Parex banka to fully recover the loans once granted to it.

However Parex banka's main achievement in 2011 was repayment of the State guaranteed international syndicated loan worth 164 million lats. The bank repaid this sum without receiving additional aid from the State. This enabled to protect the interests of the State and tax payers, and completely settle Parex banka's prior and substantial liabilities.

During the period of account Parex banka launched preparation and implementation of a large scale project with the aim to sell its subsidiary leasing companies in CIS countries. First results were achieved at the end of September 2011 when the bank made an exit from the Russian leasing market by entering into a beneficial agreement concerning the sale of its Russian subsidiaries Parex Leasing and Extroleasing. The first payment already recovered more than 14.5 million US dollars or 7.5 million lats. Until the end of 2013 Parex banka is going to continue receiving payments from gradual selling of the leasing company's problematic asset portfolio. Following the successful sale of the Parex banka leasing companies in Russia, a deal involving sale of Pareks Lizinq and Faktorinq in Azerbaijan was closed in October 2011. As a result of this deal the bank has recovered additional 3.4 million US dollars or 1.8 million lats. The prudently thought-out structure and conditions of the transaction will ensure the flow of funds necessary for repayment of the State investments thus facilitating accomplishment of the goals determined in the restructuring plan.

On 22 November 2011 the Cabinet of Ministers approved the model for Parex banka's further activity which provided for the bank's change of status. On 28 December 2011 Parex banka's extraordinary shareholder meeting adopted a decision on voluntary giving up of a bank license and determined a task for the bank's Board of Directors to start preparatory works for successful change of the company's status.

It is important to emphasize that the decision on Parex banka's change of status is a natural and logical step because it no longer provides banking services since 1 August 2010. After the bank's change status it will continue working as a joint stock company – manager of distressed assets, mainly focusing on working with distressed assets, recovery of issued loans, and selling of assets as well as asset value maintenance. The former structure of Parex banka's assets and liabilities, including clients' existing liabilities, will be preserved. The new activity model of Parex banka will be acquired after receiving a permit from the Finance and Capital Market Commission.

Parex banka's real estate portfolio has significantly increased as a result of efficient work – it exceeded the number of 800 objects at the end of reporting period. These are apartments and private buildings of various categories as well as a wide range of commercial premises in the Baltic States. Ensuring professional management of overtaken real estate, Parex banka maintains or increases the value of these assets and sells them on beneficial conditions.

In 2011 the share capital of the Parex banka was increased by 39.8 million lats. At the end of August the share capital was increased by 20 million lats by issuing 20 million ordinary registered shares with voting rights, and nominal value 1 lat per share. The second increase of the share capital took place in late November when the capital was increased by 19.8 million lats. At the end of the reporting period the amount of Parex banka's share capital was 311'027'295 lats and it consisted of 250'883'439 registered shares with voting rights and 60'143'856 registered shares without voting rights.

In December 2011 Parex banka repaid the principal of deposits made by the State in the amount of 7 million lats to the Ministry of Finance before deadline.

In December 2011 Parex banka and Privatization Agency filed a petition against Valērijs Kargins and Viktors Krasovickis, former shareholders of the bank, demanding compensation of damages to Privatization Agency in the amount of more than 12 million lats, and collection of more than 82.7 million lats and default of 4.5 million lats in favour of Parex banka. The total sum of the claim equals nearly 100 million lats.

Most significant events after the accounting period

In February 2012 after more than 17 months of professionally hard and demanding work Parex banka recovered 27.8 million euros or 19.5 million lats by selling their right to claim toward department store «Универмаг Москва» and related companies. Thus the Bank has successfully recovered the remaining principal amount from the complex exposure in full.

On February 15, 2012 Parex banka repaid the deposits made by the State in the amount of 8 million lats to the Ministry of Finance. The repaid sum included principal sum of 5 million lats and 3 million lats of interest for using State aid.

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Christopher Gwilliam, Chairman of the Board

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Solvita Deglava, Member of the Board

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Jurijs Adamovičs, Member of the Board

Riga, 28 February 2012

The report has been approved by the Management Board of the Bank on February 28, 2012. More detailed information on the financial results of the Bank and the Group are available in the audited reports published on Bank's Internet site www.parex.lv

The original financial information is presented in thousands of Latvian lats. For the purposes of this financial information, the conversion to EUR has been done using official rate set by Bank of Latvia (1 EUR: 0.702804 LVL). Due to rounding, the figures in different disclosures may differ.

Management of the Bank

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

Statement of Responsibility of the Management

The Management of AS Parex banka is responsible for the preparation of the unaudited financial information for 2011 of the Bank and the Group.

The unaudited financial information for 2011 is prepared in accordance with the source documents and present fairly the financial position of the Bank and the Group as at 31 December 2011 and the results of their operations, changes in shareholders' equity and cash flows for the twelve month period ended 31 December 2011.

The unaudited financial information for 2011 is prepared in accordance with requirements of the Law on Financial Instruments Market and the Financial and Capital Market Commission's regulations No. 145 "Regulations on Preparation of Public Quarterly Reports of Credit Institutions".

Appropriate accounting policies have been applied on a consistent basis. Prudent and reasonable judgments and estimates have been made by the Management in the preparation of the report.

The Management of AS Parex banka are responsible for the maintenance of proper accounting records, the safeguarding of the Group's assets and the prevention and detection of fraud and other irregularities in the Group. They are also responsible for operating the Bank in compliance with the Law on Credit Institutions, regulations of the Financial and Capital Market Commission and other legislation of the Republic of Latvia applicable for credit institutions.

Balance Sheets

as at 31 December 2011 and 31 December 2010

	Reporting period *Unaudited* (EUR 000's)	Preceding reporting year *Audited** (EUR 000's)	Reporting period *Unaudited* (EUR 000's)	Preceding reporting year *Audited** (EUR 000's)
	Group	Group	Bank	Bank
Cash and deposits with central banks	7	38 338	7	38 338
Balances due from credit institutions	36 458	96 310	36 248	93 678
Financial assets held for trading	44	1 776	44	1 776
Financial assets designated at fair value through profit and loss	-	-	-	-
Available-for-sale financial assets	6 312	84 533	6 312	84 533
Loans and receivables	602 741	770 556	644 104	805 744
Held-to-maturity investments	34 601	34 445	34 601	58 857
Change in fair value of interest risk hedged portfolio	-	-	-	-
Prepayments and accrued income	1 743	5 488	1 733	5 485
Fixed assets	403	2 499	397	2 496
Investment property	57 571	28 187	26 461	19 389
Intangible assets	198	216	198	216
Investments in subsidiaries	-	-	88	85
Income tax assets	-	-	-	-
Other assets	20 514	64 689	11 800	12 449
Total assets	**760 592**	**1 127 037**	**761 993**	**1 123 046**
Due to central banks	-	-	-	-
Demand liabilities to credit institutions	23	-	23	-
Financial liabilities held for trading	2 402	2 849	2 402	2 849
Financial liabilities designated at fair value through profit and loss	-	-	-	-
Financial liabilities measured at amortised cost	741 463	1 035 153	741 463	1 035 168
Liabilities due to transfer of financial assets	-	-	-	-
Change in fair value of interest risk hedged portfolio	-	-	-	-
Accrued expenses and deferred income	1 537	2 591	1 495	2 553
Provisions	-	-	-	-
Income tax liabilities	-	-	-	-
Other liabilities	2 631	33 922	1 029	29 404
Total liabilities	**748 056**	**1 074 515**	**746 412**	**1 069 974**
Shareholders' equity	12 536	52 522	15 581	53 072
Total liabilities and shareholders' equity	**760 592**	**1 127 037**	**761 993**	**1 123 046**
Memorandum items				
Contingent liabilities	1 259	1 259	3 413	3 725
Financial commitments	228	282	22 844	28 263

* Auditors: SIA „PricewaterhouseCoopers”

Statements of Income

for the years ended 31 December 2011 and 2010

	Reporting period *Unaudited* (EUR 000's)	*Respective period of the preceding reporting year Audited* (EUR 000's)*	Reporting period *Unaudited* (EUR 000's)	*Respective period of the preceding reporting year Audited* (EUR 000's)*
	Group	Group	Bank	Bank
Interest income	16 238	101 908	15 397	91 417
Interest expense	(47 069)	(118 803)	(46 949)	(114 252)
Dividends received	-	-	-	-
Commission and fee income	458	22 557	6	16 461
Commission and fee expense	(199)	(6 810)	(83)	(5 125)
Net gain/ (loss) on financial assets measured at amortised cost	-	-	-	-
Net gain/ (loss) on available for sale financial assets and financial liabilities	(5 186)	(200)	(5 464)	(1 592)
Net gain/ (loss) on held for trading financial assets and financial liabilities	-	1 020	-	1 143
Net gain/ (loss) on financial assets or financial liabilities designated at fair value though profit and loss	(758)	92	(830)	-
Change in fair value in hedge accounting	-	-	-	-
Gain/ (loss) from foreign exchange trading and revaluation of open positions	-	-	-	-
Profit/(loss) due to discontinued recognition of property, plant, equipment, investment properties or intangible assets	-	(17 285)	-	(15 925)
Other income	5 467	13 166	2 671	8 988
Other expense	(5 039)	(5 785)	(2 914)	(2 409)
Administrative expense	(15 879)	(58 773)	(11 078)	(43 294)
Amortisation and depreciation charge	(531)	(8 369)	(387)	(3 899)
Impairment charge and reversals, net	(50 092)	(154 846)	(50 462)	(164 670)
Impairment losses	-	-	-	-
Restructuring	-	17 459	-	-
(Loss)/ profit for the reporting period	**(102 590)**	**(214 669)**	**(100 093)**	**(233 157)**
Statements of Comprehensive Income:				
Net change in fair value revaluation reserve of securities	5 973	10 861	5 973	10 378
Other comprehensive income / (loss) for the period	**5 973**	**10 861**	**5 973**	**10 378**
Total comprehensive income / (loss) for the period	**(96 617)**	**(203 808)**	**(94 120)**	**(222 779)**
* Auditors: SIA „PricewaterhouseCoopers”				

Statements of Changes in Equity are as follows:

Group	Issued share capital *(EUR 000's)*	Share premium *(EUR 000's)*	Fair value revaluation reserve *(EUR 000's)*	Retained earnings *(EUR 000's)*	Total equity *(EUR 000's)*
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	-	-	-	(214 669)	(214 669)
Other comprehensive income for the period	-	-	10 861	-	10 861
Balance as at 31 December 2010	**385 921**	**18 062**	**(6 666)**	**(344 795)**	**52 522**
Issue of new shares	56 630	-	-	-	56 630
Net loss for the period	-	-	-	(102 590)	(102 590)
Other comprehensive income for the period	-	-	5 973	-	5 973
Balance as at 31 December 2011	**442 551**	**18 062**	**(693)**	**(447 385)**	**12 535**

Bank	Issued share capital *(EUR 000's)*	Share premium *(EUR 000's)*	Fair value revaluation reserve *(EUR 000's)*	Retained earnings *(EUR 000's)*	Total equity *(EUR 000's)*
Balance as at 31 December 2009*	**327 299**	**18 062**	**(17 044)**	**(111 088)**	**217 228**
Issue of new shares	58 622	-	-	-	58 622
Net loss for the period	-	-	-	(233 157)	(233 157)
Other comprehensive income for the period	-	-	10 378	-	10 378
Balance as at 31 December 2010	**385 921**	**18 062**	**(6 666)**	**(344 245)**	**53 072**
Issue of new shares	56 630	-	-	-	56 630
Net loss for the period	-	-	-	(100 093)	(100 093)
Other comprehensive income for the period	-	-	5 973	-	5 973
Balance as at 31 December 2011	**442 552**	**18 062**	**(693)**	**(444 339)**	**15 582**

*Before the transfer of undertaking

Statements of Cash Flows for the years ended 31 December 2011 and 2010

	Reporting period *Unaudited* (EUR 000's)	*Respective period of the preceding reporting year Audited** (EUR 000's)	Reporting period *Unaudited* (EUR 000's)	*Respective period of the preceding reporting year Audited** (EUR 000's)
	Group	Group	Bank	Bank
Cash flows from operating activities				
Profit/ (loss) before tax	(101 691)	(211 989)	(99 820)	(231 806)
Amortisation of intangible assets, depreciation of fixed assets	531	8 369	387	3 899
Change in impairment allowances and other provisions	59 156	159 636	47 470	169 083
Other non-cash items	(440)	(7 838)	(301)	426
Cash generated before changes in assets and liabilities	**(42 444)**	**(51 822)**	**(52 264)**	**(58 398)**
Change in derivative financial instruments	(277)	3 512	(277)	3 418
(Increase) in other assets	1 919	(5 098)	3 145	(13 775)
(Decrease)/ increase in other liabilities	(22 200)	33 002	(19 273)	40 011
(Increase)/ decrease in trading investments	1 168	3 011	1 168	2 538
Decrease / (increase) in balances due from credit institutions	-	2 232	-	184 899
Decrease/ (increase) in loans and receivables from customers	106 841	137 832	110 369	25 064
(Decrease) in balances due to credit institutions	10 290	(57 160)	10 269	(67 596)
(Decrease)/ increase in deposits from customers	(56 896)	170 106	(56 896)	141 505
Cash generated from/ (used in) operating activities before corporate income tax	**(1 599)**	**235 615**	**(3 759)**	**257 666**
Corporate income tax paid	(900)	(2 715)	(273)	(107)
Net cash flow generated from/ (used in) operating activities	**(2 499)**	**232 900**	**(4 032)**	**257 559**
Cash flows from investing activities				
(Purchase) of intangible and fixed assets	(129)	(777)	(127)	(539)
Proceeds from disposal of subsidiaries	12 620	4 162	12 619	3 981
Acquisitions and investments in subsidiaries	-	-	-	(13 090)
Sale of available-for-sale securities, net	86 992	100 624	90 947	132 489
Net cash flow from investing activities	**99 483**	**104 009**	**103 439**	**122 841**
Cash flows from financing activities				
Paid in share capital	56 630	13 802	56 630	13 802
Repayment of syndicated loan	(240 528)	(312 582)	(240 528)	(312 582)
Net cash flow from financing activities	**(183 898)**	**(298 780)**	**(183 898)**	**(298 780)**
Transferred to Citadele banka	-	(448 065)	-	(431 715)
Net cash flow for the year	**(86 914)**	**(409 936)**	**(84 491)**	**(350 095)**
Cash and cash equivalents at the beginning of the year	**123 322**	**533 258**	**120 689**	**470 784**
Cash and cash equivalents at the end of the year	**36 408**	**123 322**	**36 198**	**120 689**

* Auditors: SIA „PricewaterhouseCoopers”

Consolidation Group as at 31 December 2011

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 "Ekspress Lizing"	RU-1037867006726	Russia, St. Petersburg 192019, Sedova 11, liter A	RU	LIZ	100	100	MS
4	OOO "Laska Lizing"	UA-33104543	Ukraine, Kiev 03150, Dimitrova 5	UA	LIZ	100	100	MS
5	SIA "Parex Private Banking"	LV-40003103438	Latvia, Riga LV-1050, Smilšu 7	LV	PLS	100	100	MS
6	OOO "Parex Leasing and Factoring"	GE-205224461	Georgia, Tbilisi, Kazbegi avenue 44	GE	LIZ	100	100	MS
7	SIA "NIF"	LV-40103250571	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
8	SIA “NIF Dzīvojamie īpašumi”	LV-40103253915	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
9	SIA “NIF Komercīpašumi”	LV-40103254003	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
10	SIA “NIF Zemes īpašumi”	LV-40103255348	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
11	UAB “NIF Lietuva”	LT-302462108	Lithuania, Vilnius LT03107, K.Kalinausko 13	LT	PLS	100	100	MMS
12	OÜ “ NIF Eesti”	EE-11788043	Estonia, Tallinn 10119, Roosikrantsi 2	EE	PLS	100	100	MMS
13	SIA “NIF Projekts 1”	LV-50103300111	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
14	SIA “NIF Projekts 2”	LV-40103353475	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
15	SIA “NIF Projekts 3”	LV-40103353511	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
16	SIA “NIF Projekts 4”	LV-40103398418	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
17	SIA “NIF Projekts 5”	LV-40103398850	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
18	SIA “NIF Projekts 6”	LV-40103398865	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS

*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.

Notes

Information about Parex banka's structure

As at 31 December 2011 the Bank had 2 foreign branches and 4 representative offices.

Issued share capital as at 31 December 2011

Shareholders	Nominal value (LVL)	Number of shares	Paid-in share capital (EUR)	Voting rights	Paid-in share capital (%)
SJSC "Privatizācijas Aģentūra"	1	261 733 152	372 412 724	205 783 152	84.15%
EBRD	1	39 631 824	56 391 005	39 631 824	12.74%
Other	1	9 662 319	13 748 241	5 468 463	3.11%
Total		**311 027 295**	**442 551 970**	**250 883 439**	**100%**

Information on certain parties that were related to the Banka 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					
	2011 year			**2010 year**		
	Period-end balance	**Average interest rate ***	**Interest income/ (expense)**	**Period-end balance**	**Average interest rate ***	**Interest income/ (expense)**
Loans issued by the Bank	2 705	0.00%	-	2 693	0.00%	760
Deposits placed with the Bank	-	-	-	-	-	(1 578)
Subordinated financing provided to the bank	51 230	4.52%	(3 122)	51 230	6.00%	(4 388)

* According to period-end rates

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.

The following table represents the details of Group's subordinated capital:

Counterparty	Residence country	Currency	Issue size, 000's	Interest rate	Original agreement date	Original maturity date	Amortised cost (EUR 000's) 31/12/2011	Amortised cost (EUR 000's) 31/12/2010
Notes-private placement	UK	EUR	20,000	5.954%	28/12/2007	28/12/2022	18 849	18 789
Private person	Latvia	LVL	7,500	6M Rigibid + 3%	28/09/2007	26/09/2017	10 674	10 674
Private person	Latvia	LVL	7,500	6M Rigibid + 3%	28/09/2007	26/09/2017	10 674	10 674
Notes – public issue	n/a	EUR	5,050	11%	08/05/2008	08/05/2018	5 449	5 435
Private person	Latvia	EUR	15,000	12%	20/06/2008	14/05/2015	15 085	15 085
Private person	Latvia	LVL	1,500	6M Rigibid + 3%	30/10/2008	30/10/2018	2 134	2 134
Private person	Latvia	LVL	1,500	6M Rigibid + 3%	30/10/2008	30/10/2018	2 134	2 134
Private person	Latvia	LVL	2,284	6M Rigibid + 3%	04/12/2008	18/09/2015	3 250	3 250
Private person	Latvia	LVL	2,284	6M Rigibid + 3%	04/12/2008	18/09/2015	3 250	3 250
Private person	Latvia	LVL	1,416	6M Rigibid + 3%	04/12/2008	29/09/2015	2 015	2 015
Private person	Latvia	LVL	1,416	6M Rigibid + 3%	04/12/2008	29/09/2015	2 015	2 015
Total							**75 529**	**75 455**

Financial instruments as at 31 December 2011 and 31 December 2010

	EUR 000's			
	Reporting period *Unaudited* Group	Preceding reporting year *Audited** Group	Reporting period *Unaudited* Bank	Preceding reporting year *Audited** Bank
Financial assets held for trading (net):	**44**	**1 776**	**44**	**1 776**
Available-for-sale financial assets (net):	**6 312**	**84 533**	**6 312**	**84 533**
Russia (gross)	*7 686*	-	*7 686*	-
Impairment allowance	*(4 992)*	-	*(4 992)*	-
Russia (net)	2 694	21 026	2 694	21 026
Germany	-	23 544	-	23 544
Great Britain	-	13 398	-	13 398
Republic of Kazakhstan	-	14 287	-	14 287
Other	-	8 766	-	8 766
Latvia	3 618	3 512	3 618	3 512
Held-to-maturity investments (net):**	**34 601**	**34 445**	**34 601**	**58 857**
Russia (gross)	-	-	-	*33 196*
Impairment allowance	-	-	-	*(8 783)*
Russia (net)	-	-	-	24 412
Latvia	34 601	34 445	34 601	34 445
Total	**40 957**	**120 754**	**40 957**	**145 166**

* Auditors: SIA „PricewaterhouseCoopers”
**The fair value of held-to-maturity investments as at 31 December 2011 was 28 928 (31.12.2010 - 51 828) *EUR 000's* for the bank and 28 928 (31.12.2010 - 27 414) *EUR 000's* for the group.

Financial liabilities measured at amortised cost as at 31 December 2011 and 31 December 2010

	EUR 000's			
	Reporting period Unaudited Group	Preceding reporting year Audited* Group	*Reporting period Unaudited* Bank	Preceding reporting year Audited* Bank
Loans from credit institutions	18 894	254 146	18 894	254 146
Deposits from customers	38 011	705 552	38 011	705 567
Debt securities	609 029	-	609 029	-
Subordinated liabilities	75 529	75 455	75 529	75 455
Total	**741 463**	**1 035 153**	**741 463**	**1 035 168**

* Auditors: SIA „PricewaterhouseCoopers”

Risk management

The Group's risk is managed according to principles set out in Group's Risk 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, where possible, avoided, limited or hedged;
- The Group does not assume new 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;
- 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;
- The Group aims to ensure as low as possible risk exposure 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 its lending and loan restructuring activities.

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. All decisions about loan restructuring or changes in loan agreements are 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.

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 Finance, Risk Management & Operational Department. Liquidity risk management in the Group is coordinated by the Finance, Risk Management & Operational Department. The main source of liquidity is the funding provided by the Ministry of Finance. In 2011 the Bank was in compliance with liquidity ratio requirements.

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 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.

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 Finance, Risk Management & Operational Department. 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.