Baltic
International
Bank

# 2008

ANNUAL REPORT

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«BALTIC INTERNATIONAL BANK»

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# CONTENT

# Dear Ladies and Gentlemen,

It is our pleasure to present to you highlights of the Bank's performance in 2008. This edition also contains 'snapshots' of globally significant events of 2008 and information about their effects on Latvia's economy. You will learn about our positions in Latvia's banking services market, our key performance indicators and our viewpoint with respect to the perspectives of further development.

It seemed that nothing could impede healthy economic growth seen globally during the recent years. Financial markets gave investors the opportunity to earn the maximum yields which grew at an unprecedented pace. The past years were positively associated with surging markets in virtually all countries of the world, low benchmark lending rates, low inflation levels and low volatilities. The continued buoyancy resulted in that most market participants started viewing it as a 'normal' pattern of economic development. However, the world has dramatically reshaped after the 2007 - 2008 financial turmoil. Time has come to understand that it is necessary to reinvent the architecture of financial markets and, to a certain extent, to switch back to classical economic principles. Each time when the economy enters a new phase, the classical principles are adapted to modern conditions. In doing so, the society relies on a wealth of experience and expertise accumulated over the many years.

It requires substantial resources and joint efforts of many countries around the world to remedy the aftermath of the financial turbulence. It is essential that all the participants of the post-crisis recovery process choose the correct action strategy directed towards achieving efficient economic growth.

As a financial institution, we prefer the classical path to develop banking services and we still remain committed to preserving the value of customer wealth. Wealth preservation has always been our top priority.

Though we are living through tumultuous and uncertain times, we are still seeing plenty of opportunities. We can draw lessons, continue adhering to our development strategy, maximally promote the evolvement of the classical philosophy of banking services and support economically sound businesses.

We are happy that our chosen approach is appreciated by our clients and partners. We hope that our clientele will continue to grow as the years go by.

Sincerely,

Ilona Gulchak
Chairperson of the Board

# FOREWORD OF CHAIRMAN OF THE COUNCIL

## Dear Ladies and Gentlemen,

In 2008, the world witnessed adverse events that exerted a dramatic affect on the entire global economy.

In today's business environment, it is important to stay aware of what is going on in the world and to keep abreast with the latest developments. In the light of current trends in the economy and financial services industry, we offer for your attention an analytical overview of key events in 2008 and their widespread impact on the entire banking sector and the overall economy. Also, our overview will give you an insight into the Bank's current position and its vision and future direction in the turbulent times.

Last year we stepped up our efforts towards achieving our goals and objectives, such as maintenance of sound financial fundamentals, provision of a wider array of banking products, and implementation of state-of-the-art information technologies that ensure enhanced security and data protection capabilities.

Foreign exchange markets and capital markets stay highly volatile. Measures taken by the regulatory and supervisory institutions worldwide have not yet proved sufficient to restore investor confidence. We intend to continue pursuing a prudent asset allocation policy that has helped us avoid liquidity problems and ensure the safety and growth of the allocated assets.

We wish to emphasize that the economic slowdown that we are witnessing today is a natural part of the economic cycle. We are viewing it as a starting point for further development of the Bank.

We are grateful to our clients and partners for their confidence in our bank. Special thanks to our staff members for their outstanding efforts and contributions throughout the 2008!

Sincerely,

Leonid Kramnoy
Chairperson of the Council

# International Presence
# Baltic International Bank

# THE GLOBAL ECONOMY

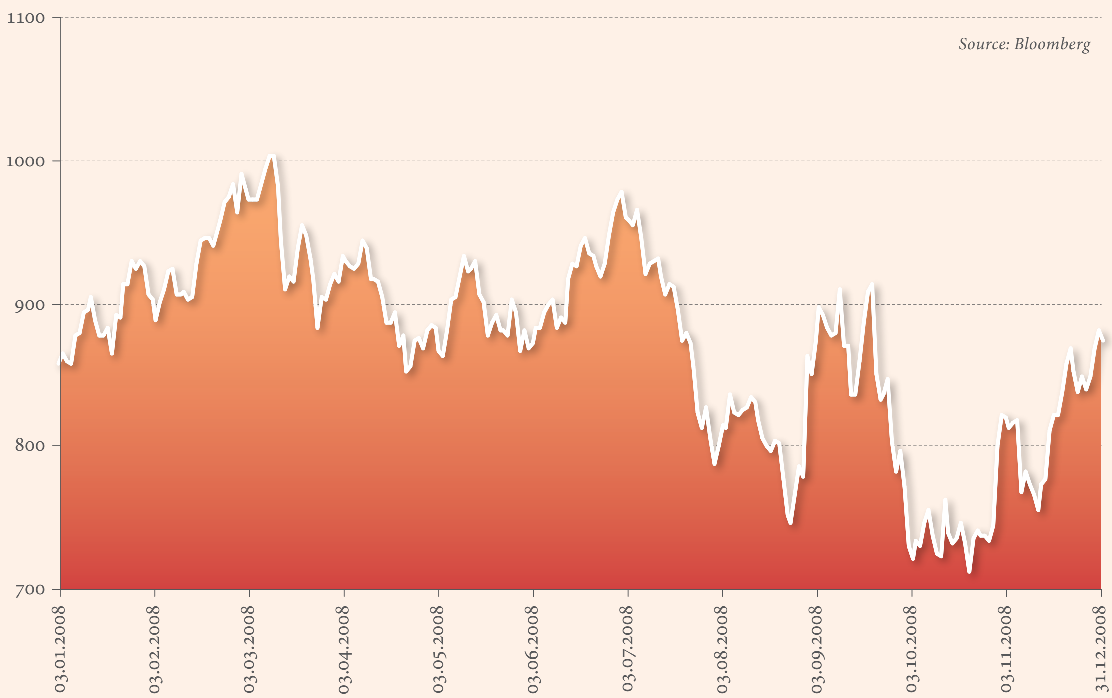
2008 was a tough year for the world economy as a whole. Companies and banks underwent rigorous testing to prove their strength, professionalism and responsiveness to market changes. Those, who were able to re-shift focus towards aligning their day-to-day efforts with key strategic priorities, such as continuing to maintain the positive reputation and respect of clients and partners and providing top-level services, had proven their ability to perform under complicated or adverse circumstances.

The global financial crisis was the main event of 2008. Other crucial events occurred against the background of the global recession.

### CHANGES IN THE GOLD SECTOR

It is widely known that for many centuries, gold has been a safe investment vehicle to preserve and grow personal wealth. Gold is a unique precious metal and a universal benchmark of value. According to expert opinion, gold tends to go up in value over the long term. Therefore, gold continues to be an especially attractive investment option. According to Bloomberg, in 2008 the gold price broke the US $1,000-per-ounce level.

**THE DYNAMICS OF GOLD PRICE CHANGES IN 2008**



**CHANGES IN CRUDE OIL PRICES**

According to Bloomberg, during the first half of 2008, crude oil prices have been continuously climbing. They touched a peak of US $148 per barrel in July. Against the background of the soaring oil prices and the growing influence of OPEC countries, the use of alternative non-fossil fuel sources of energy has become an issue of urgent concern around the world. By the end of 2008, crude oil prices crashed nearly 70 percent to US $45 per barrel.

**THE EURO/U.S. DOLLAR- PAIR**

While the gold price continued to surge and reached a new historic high, U.S. dollar hit a bottom against a basket of key world currencies, according to Bloomberg. Then it began to rally after having lost ground and returned to the “trading range” started autumn 2008. 2008 is the year of the unexpected return of the dollar. According to dire predictions from many analysts, the U.S. Dollar could collapse to absolute zero.

THE TOWER BRIDGE, LONDON.

**PRESIDENTIAL ELECTIONS**

Presidential elections in Russia (President of Russia Dmitri Medvedev) and the USA (U.S. President Barack Obama) were the most important and pivotal political events of the past year.

**2008 G-20 WASHINGTON SUMMIT**

The G-20 Leaders Summit on Financial Markets and the World Economy took place on 14-15 November 2008, in Washington, to find solutions to the economic crisis. The summit reached the Washington declaration. The leaders agreed upon the five key principles as follows:

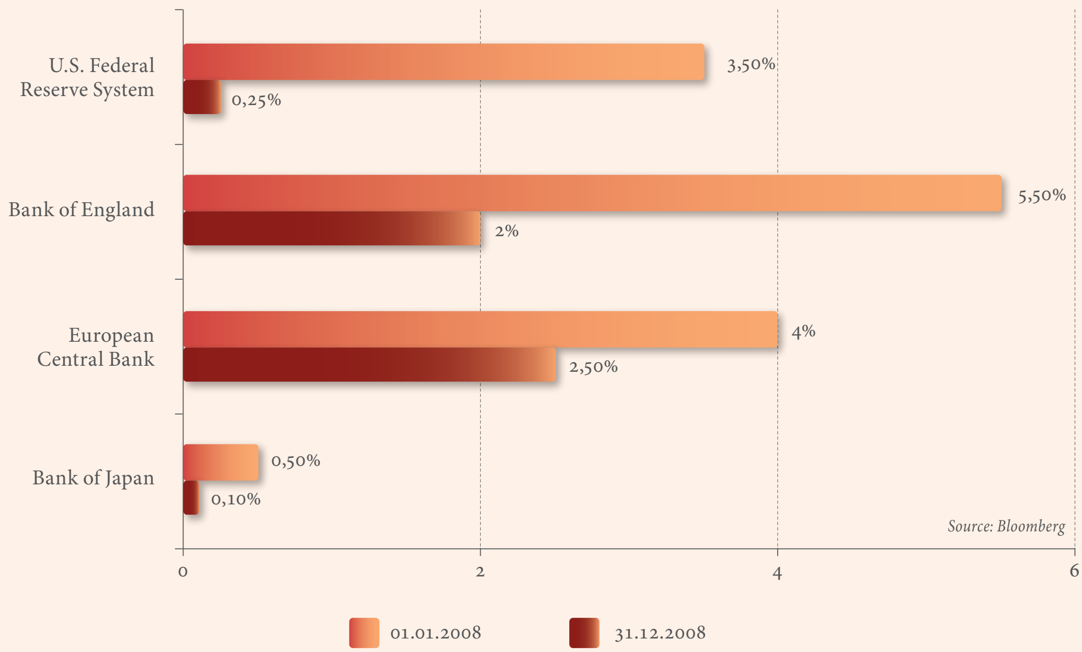
- strengthening transparency and accountability;
- enhancing sound regulation;
- promoting integrity in financial markets;
- reinforcing international cooperation;
- reforming international financial institutions.

The document underscored the critical importance of rejecting protectionism by world countries. The participating nations agreed not to impose trade barriers, investment restraints and export restraints within the next 12 months.

## The Banking Sector

The global financial turmoil drastically changed the landscape of the banking sector. The major banks were forced to make multi-billion write-downs. That in turn caused the deterioration in global liquidity conditions and the crisis of confidence: market participants lost

CHANGES IN THE BENCHMARK INTEREST RATES IN 2008




confidence in each other. Banks tightened lending standards for borrowers and elevated interest rates on newly issued loans. The global banking sector witnessed the following pivotal events: central banks around the world cut key interest rates, many banks were nationalised by government, and many countries raised the minimum deposit guaranteed.

## CENTRAL BANKS' RATE CHANGES

Financial crisis in the global banking sector led to sharp declines in interbank lending rates and exerted the intensifying downward pressure on the global economy due to higher fund raising (borrowing) costs and refinancing costs. Because the banking and consumer sectors were facing increasing difficulties, the world's largest central banks (U.S. Federal Reserve System, Bank of England, European Central Bank, Bank of Japan) decided to slash their benchmark interest rates.

## GOVERNMENT BAILOUTS

2008 went down in history as the year of collapses and bailouts of failing businesses and financial institutions such as Bear Stearns, Lehman Brothers, Fannie Mae, Freddie Mac, Bradford & Bingley and others.

## RAISING THE MINIMUM DEPOSIT GUARANTEED

Under the circumstances of the global financial crisis many countries decided to raise the insurance threshold on bank deposits. To confront the economic slowdown and to ensure financial stability, the EU economy and finance ministers agreed to raise the minimum guarantees on bank deposits across member states from 20,000 to a minimum of 50,000 euros. Individual member states decided to guarantee up to 100, 000 euros. Governments of some countries approved the statutory upper limit for reimbursement guaranteeing 100 percent of household bank deposits.

## The Impact of Global Events on Latvia's Economy

Latvia's economy has not been able to escape being affected by growing uncertainty in the global markets. Like many other nations of the world, Latvia could not be immune to the adverse effects of the global crisis such as loan interest rates hikes, credit crunch, decline in export volumes, etc. Largely due to the cumulative effects of these factors, Latvia's economy witnessed declining money inflows. Also, these factors reinforced the adverse impact on the consuming sector. According to the Central Statistical Bureau of Latvia, Latvia's GDP declined in 2008 by 4.6 percent. Also sectors such as trade, transport and communication, processing industries, and construction showed a significant slowdown. Research by the Global Property Guide found that during 2008 Riga saw house-price falls of 37 percent versus the 2007's figure, which reflects the most severe house-price plunge ever seen in Europe.

**37%** **Research by the Global Property Guide found that during 2008 Riga saw house-price falls of 37%.**

In December 2008, Saeima (the Parliament of Republic of Latvia) supported the economic stabilisation program developed by the government. The program envisaged to revise the tax policy and to curb payroll and other expenses of public servants. In December 2008, Latvia completed its negotiations with the European Commission (EC) and the International Monetary Fund (IMF) on financial assistance as part of the economic stabilisation program.

At the end of 2008, the Ministry of Economy in conjunction with the Ministry of Finance and non-governmental organisations embarked on the entrepreneurship support program. Within the framework of the program, companies – irrespective of their asset levels, net turnover and the number of employees – are eligible to receive financial aid. It is envisaged that the financial support package will be distributed based on business plans for manufacturing products that are likely to be competitive in cross-border markets.

## Economic Recession Brings New Opportunities

The crisis brought about a new emphasis on the global economic issues. The worldwide crisis resulted in a significant economic slowdown, recession (a downturn in overall business activity) and the drop in the Business Confidence Index (BCI).

However, there is a silver lining in this crisis. It provides a strong boost to the mobilisation of strengths, abilities and intellect. Already today we are witnessing the alteration of management principles both on a governmental and private level. Market corrections affected the long-term objectives and forecasts of most companies and made them to stay more focused on client's needs, interests and patterns of behavior. During the pre-crisis period, intermediation of various types was a high-priority business activity, and this has to a certain extent fostered speculative activities. Now, there is direct evidence of the transition to the real products in demand.

For most businessmen, the process of reshaping the global economy is a period of going through financial difficulties, while the others prefer using the financial crisis as an opportunity and as an impetus to demonstrate their strengths and to enhance their presence in the market.

Under these circumstances, relations with clients and partners are of great importance. If a company is able to main-

THE CATHEDRAL OF CHRIST THE SAVIOUR, MOSCOW.

tain a dialogue and mutual understanding, to win confidence and loyalty, to have a clear-cut understanding of a client's individual needs and to stand up for a client's best interests, these factors will prove most conducive for strengthening the company's positions and, hence, enhance the company's chances for development and prosperity.

The decline in prices for various assets opens up new opportunities for investors who possess idle money that is available for investment. According to experts' forecasts, frequent mergers & acquisitions will continue in 2009.

In light of the current global economic situation, experts and analysts anticipate vigorous rates of growth in 2009 in the industries that are particularly oriented towards producing essential commodities and satisfying the primary needs of the population. These include agricultural industry, food industry, electricity and heating supply industry, and pharmaceutical industry. Downturn is expected to continue in the luxury products and services industries. It is worth mentioning that further development of the financial services sector, food industry, alternative energy industry, biotechnology industry, and nanotechnology industry will play a critical role in overcoming the aftermath of the crisis and revitalising the global economy.

It is important to remember that any recession does not necessarily imply only loss. It also implies the possibility of gain. Today, governments throughout the world make efforts to improve international relations and take joint and coordinated actions to implement the various tasks, to enforce control mechanisms designed to monitor the most prominent economic sectors, to support and develop business environment, investments in progressive and innovative projects expected to provide a basis for future economic growth in a long-term perspective.

Private sector representatives are expected and encouraged to behave in a similar manner. The coordinated decisions by governments and businesses, the search for ways to pursue mutually beneficial partnership and identification of opportunities make a significant contribution directed at overcoming the difficulties encountered. Pro-active initiatives of this kind on the part of the private sector foster the minimisation of losses, enhance the efficacy and efficiency of governmental actions and promote the general welfare of the population.

VIEW ON THE OLD CITY, RIGA.

# BANK TODAY

## The Banking Sector in Latvia

As of the end of 2008, there were 27 banks in operation throughout the Republic of Latvia, of which 6 were branches of foreign banks. As of 31 December 2008, the market share of banks with domestic ownership - as compared to the 2007 figures - increased by 0.9 percentage points to reach 22.7 percent, according to the Financial and Capital Market Commission (FCMC). Foreign shareholders owned 77.3 percent of the paid-in share capital in Latvia's banks. In 11 banks, foreign shareholders held more than 50-percent stake.

In terms of foreign ownership in the Latvian banking sector, Estonia was the biggest investor with a shareholding of 59.17 percent by the end of 2008, followed by Denmark (14.43 percent), Austria (6.08 percent), Sweden (5.83 percent) and the Russian Federation (4.13 percent), according to the Bank of Latvia.

Banks see an ever-growing demand for private banking services in Latvia. Affluent clients value and appreciate highly personalised and excellent service.

Baltic International Bank was one of the first bellwether banks in Latvia to launch private banking services. Throughout its existence, the Bank has been dedicated to continuously improve its private banking approach and to offer tailor-made solutions catering to the needs of the customers and best suited for changing market conditions. Other peer banks provide a private banking service for a relatively short period of time and undertake it as an additional line of business.

**Key performance indicators within the banking sector, according to the Association of Latvian Commercial Banks (ALCB):**

- As of end-year 2008, the aggregate assets of Latvia's banking sector totalled 23,243 billion lats, a 6.1 percent (or 1,327 billion lats) increase on a year-to-year basis.
- Together, the Latvian banks held as of 2008-end 9,763 billion lats in deposits, a 4.1 percent decline compared with the same period in 2007.
- In 2008, the total loans issued by the Latvian banks grew 11.2 percent. As a result, the aggregate loan portfolio totalled 16,588 billion lats.
- The shareholders' equity of the banking sector in 2008 decreased by 1.9 percent to attain the level of 1,702 billion lats.

## Key Characteristics

Today, the Bank is a trusted and reliable partner which possesses a vast amount of experience and expertise in providing private banking service. The Bank is targeted towards long-term relationships with its customers and business partners.

**STABLE DEVELOPMENT**

Baltic International Bank operates within the European Union. This gives our clients the opportunity to enjoy many advantages and benefits of our EU membership. The Bank adheres to the best European standards of service excellence. The Bank therefore is able to ensure high quality service and to be oriented towards the effective and long-standing partnership.

**EXPERIENCE AND STRENGTHS**

Baltic International Bank is a bank operating in Latvia – the country that traditionally has been a bridge between East and West. An unparalleled experience in working within the post-Soviet space and understanding both Eastern and Western mentalities represent our core strengths enabling us to identify services that best suit the interests of our customers.

**PERSONALISED APPROACH**

Baltic International Bank is committed to taking a personalized and customer-centric approach. The whole team's work - and especially the work of your private banker - is centred on a set of client's objectives. In private banking, the Bank combines the best international practices with in-depth understanding of the private wealth market.

**FLEXIBILITY**

The Bank's specialisation enables the Bank to respond flexibly and effectively to market changes and to provide its customers with optimal solutions for any individual situation.

**CONFIDENTIALITY**

Baltic International Bank maintains strict confidentiality and privacy of customer information, complies with the applicable laws and regulations and the Code of Ethics, and highly values customer trust and confidence.

## Performance Highlights

Irrespective of the difficulties encountered by the banking sector due to the dramatic changes in the global financial landscape, Baltic International Bank succeeds in maintaining its positions and ensuring stability and reliability for its clients.

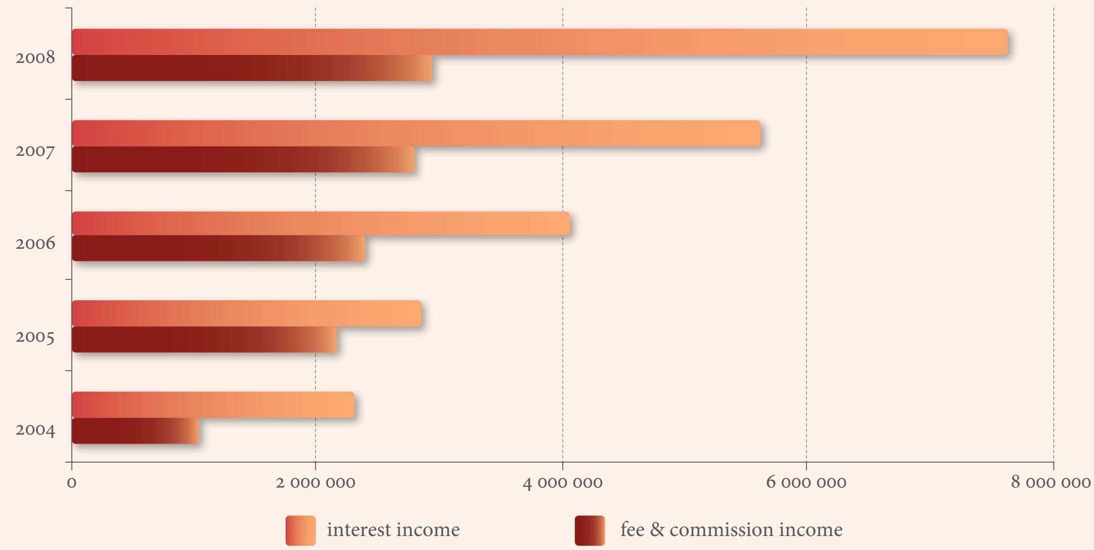
## Incomes

In 2008, the Bank preserved and strengthened its positions in Latvia's banking services market. The primary reason behind this was timely management decisions that resulted in the following figures:

**36%** **Interest income in 2008 grew by 36%.**

- Interest income in 2008 grew by 36 percent to 7 631 663 lats (2007: 38 percent). Net interest income surged by 24.8 percent and amounted to 4 900 928 lats (2007: 32 percent) by the end of the year.
- Fee and commission income rose by 5 percent. (2007: 17 percent). Net fee and commission income soared by 22.9 percent (2007: 34 percent).

THE DYNAMICS OF INTEREST INCOME AND FEE AND COMMISSION INCOME, 2004 THROUGH 2008

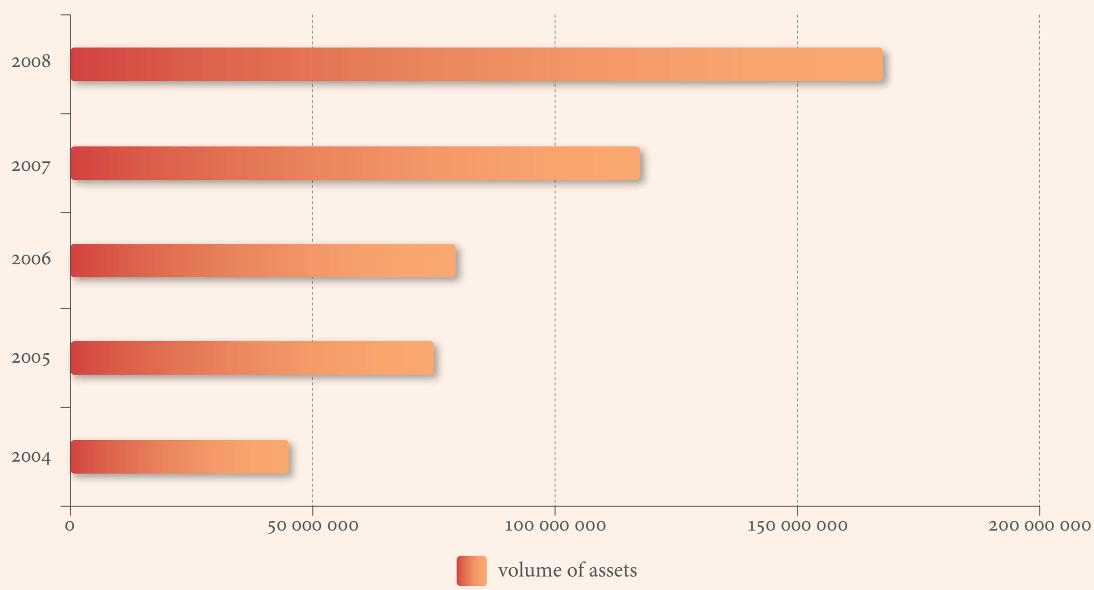



The analysis of key performance indicators (KPI) shows that the principal income figures remain stable. During the past five years, the net interest income has averaged at 29 percent of the operating income - a clear testimony of a well-diversified income structure.

## Assets

Due to Bank's chosen development strategy, decision-making tactics, ongoing improvement of the quality of customer service and provision of ever-widening array

THE DYNAMICS OF ASSET GROWTH OVER THE PERIOD 2004 THROUGH 2008



of banking products and services, the Bank experienced significant asset growth in 2008.

As a result of certain activities, the Bank's assets at the end of 2008 totalled 167 323 846 lats, a 44 percent (or 50,7 million lats) rise compared to the 2007 figure. According to the Association of Latvian Commercial Banks (ALCB), the Bank ranked at 16th position in terms of total assets as of 2008-end (2007: ranked 18th).

The Bank's asset growth was supported by an adequate increase in the total resource base, both in the owners' equity and external sources of funds.

## Resource Base

From the analysis of the dynamics of deposit growth it becomes apparent that over the past five years, deposits and other important indicators have demonstrated solid growth. Buoyant growth of deposits seen in 2007 (a 53.9 percent increase) continued into 2008. Total deposits in 2008 grew by 56 percent (or 54.2 million lats) to reach 151 173 224 lats, of which:

- deposits repayable at call totalled 92 356 589 lats (or 61 percent) (2007: 59 958 316 lats);
- term deposits totalled 58 816 635 lats (or 39 percent) (2007: 36 697 062 lats).

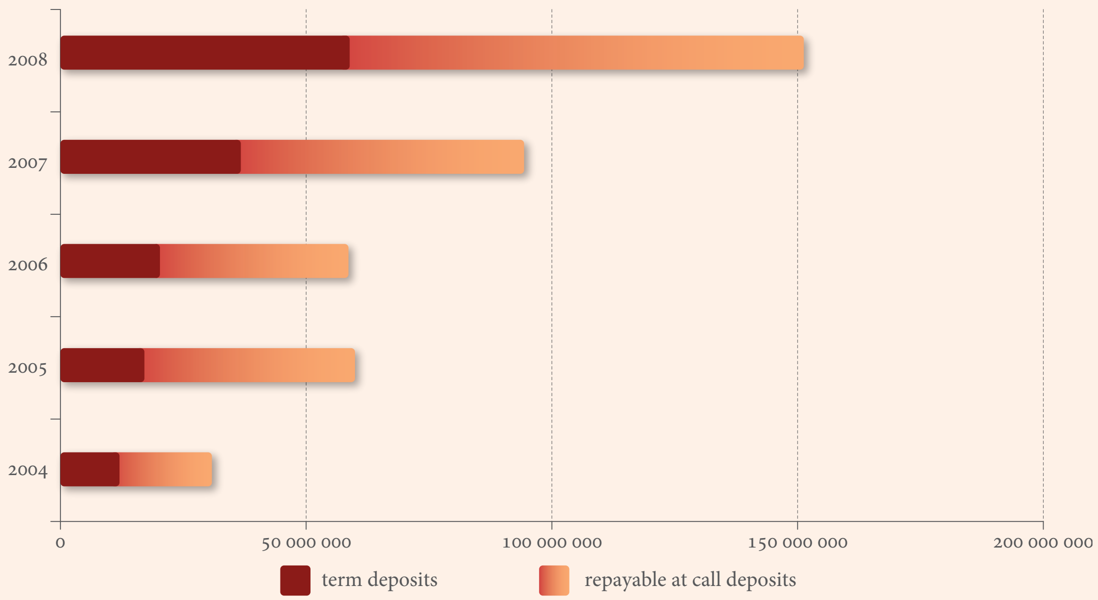
In 2008, term deposits increased by 21,8 million lats, showing a 59.1 percent rise, while deposits repayable at call increased by 32,4 million lats, or 54.0 percent.

The Bank saw no need to resort to the external borrowing (i.e. raising funds from external capital markets).

**56%** **Total deposits in 2008 grew by 56%.**

According to the Association of Latvian Commercial Banks (ALCB), Baltic International Bank ranked at 13th position in terms of deposits as of 2008-end (2007: 15th position).

THE DYNAMICS OF DEPOSIT GROWTH OVER THE PERIOD 2004 THROUGH 2008



## Loan Portfolio

Amid the overall economic slump in Latvia, the domestic banking sector witnessed a significant slowdown in lending activities and deterioration in the quality of loan portfolios. This in turn resulted in a decline of profits from lending operations.

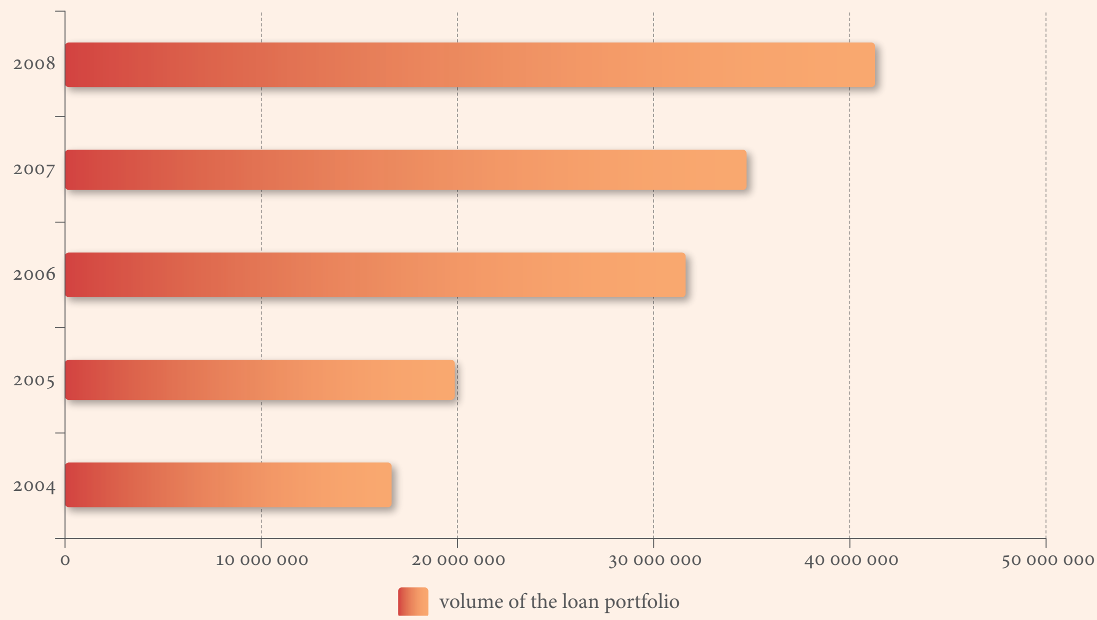
According to the Financial and Capital Market Commission (FCMC), the total loans extended by the Latvian banking sector in 2008 were up 11 percent (versus 37 percent in 2007). The average figure of loans as a percentage share of the total assets of Latvia's banking sector was 71 percent (the average figure). 59 percent of the total loans from the Latvian banking sector were loans with maturity of more than 5 years; 27 percent of the loans were mid-term loans (with maturity of 1 to 5 years).

During 2008, the Bank's loan portfolio continued growing at a moderate pace. As of 2008-end, the net loan portfolio totalled nearly 41 million lats, an 18.6 percent rise over the previous year. By the end of 2008, the Bank's loans as a percentage share of its total assets made up 24.5 percent.

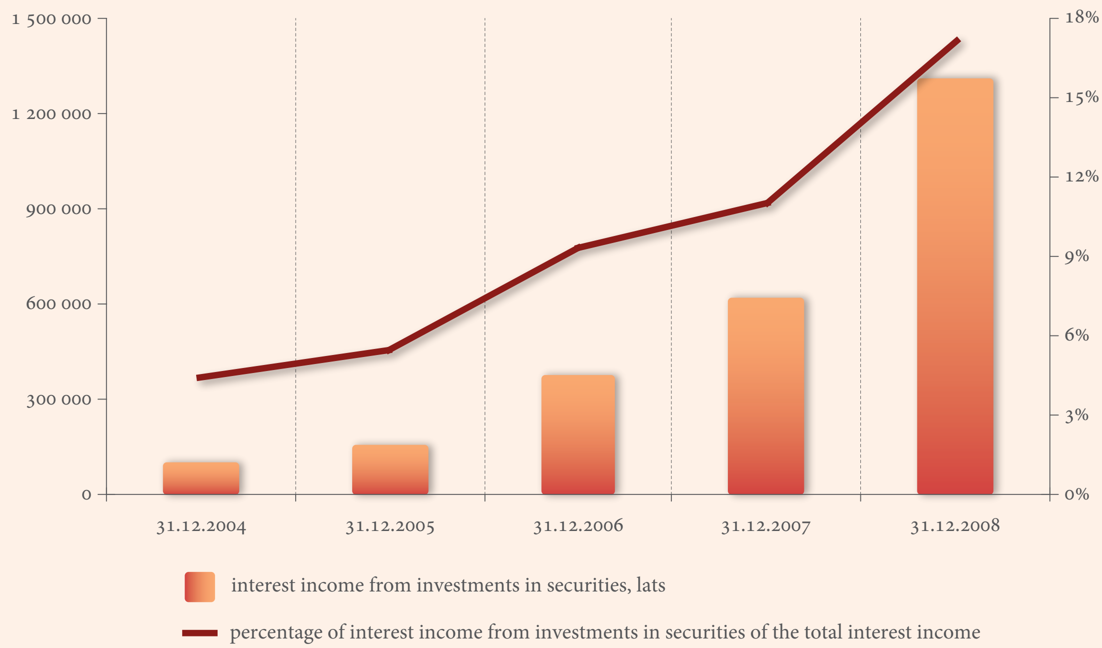
Residential mortgage loans accounted for nearly a half of the total loan portfolio. Consumer loans accounted for less than 3% of the total lending. Out of the total loans, 73 percent were loans with maturity of 1 to 5 years. Loans with maturity of more than 5 years accounted for 16 percent of the total loan portfolio of the Bank.

Prior to granting loans, the Bank conducts a thorough due diligence investigation and evaluates financial condition and creditworthiness of the potential borrowers. Factors such as an individual approach, search for a solution that best suits a particular client's needs complemented by the efficient and effective performance of the Bank's personnel in the area of loan administration contributed to the im-

THE DYNAMICS OF THE LOAN PORTFOLIO GROWTH OVER THE PERIOD 2004 THROUGH 2008



THE DYNAMICS OF CHANGES IN INTEREST INCOME EARNED FROM INVESTMENTS IN SECURITIES OVER THE PERIOD 2004 THROUGH 2008




provement of the quality of the loan portfolio. Also in the years to come, the Bank intends to follow the golden mean rule with respect to risk-return trade-off, to gradually build up its loan portfolio and to manage credit quality.

## Securities Portfolio

In light of the developments within the global financial markets and in line with the Bank's strategy of the optimal risk/return combination, last year the Bank displayed vigilance and prudence, while conducting transactions in securities.

The Bank's investment policy provides a blended stock/bond portfolio. The strategy is directed towards deriving yields and offsetting the stock market risks at the expense of a substantial portion of fixed-income securities. As of 31 December 2008, the stock-to-bond proportion within the securities portfolio was as follows: 2.8 percent (stocks) and 97.2 percent (bonds).

To enhance its financial stability, the Bank sold a certain portion of volatile debt securities and equity securities. It is worth mentioning that last year interest income from securities transactions surged substantially (by 112 percent versus 2007). Also, its percentage of the total interest income grew to 17 percent - 6 percentage points higher versus 2007.

Consistency with the chosen investment policy, monitoring of the financial condition of the issuers, tracking the developments in the global financial markets and immediate response to market changes – either already observable or anticipated - these are the core tasks in managing the securities portfolio of the Bank for the foreseeable future.

THE DYNAMICS OF GROWTH IN ASSETS
UNDER MANAGEMENT OVER THE PERIOD 2004 THROUGH 2008


## Assets under Management

By using a combination of conservative and innovative approach to asset management, the Bank creates additional opportunities for preserving and enhancing customers' wealth. Bank maintains an ongoing professional contact with its clients. After having identified the client's goals and objectives and having evaluated all existing risks, the Bank provides recommendations that are always customised for client's unique circumstances and wishes.

Due to a regular and in-depth analysis of market opportunities, the Bank is able to ensure that its clients can avail of the best investment products.

As of 31 December 2008, the Bank's assets under management totalled 55 807 525 lats – a rise by 78.1 percent (or 24.5 million lats) over the previous year.
According to the Association of Latvian Commercial Banks, the Bank ranked at 2nd position in terms of assets under management in the Latvian banking sector in 2008. As of 31 December 2007, 5th position.

## Capital Management and Capital Adequacy

During the past five years the Bank has been demonstrating a vigorous growth. The dynamics of changes in shareholders' equity is consistent with the dynamics of asset growth and ensures maintenance of an 8 percent capital adequacy ratio (CAR) set forth by the Financial and Capital Market Commission. According to the Internal Capital Adequacy Assessment Process (ICAAP), the Bank's capital adequacy ratio complies with the approved internal limits. Starting in 2008, the Bank calculates its capital requirements under Basel II (the New Basel Capital Accord). Basel II builds upon modern techniques and promotes modern and effective risk management. As of 31 December 2008, the Bank's capital adequacy ratio was 10.42 percent.

## Liquidity

As of 31 December 2008, the Bank's liquidity ratio stood at 76.8 percent - 7.3 percentage points higher than at the end of 2007. The ratio is 2.5 times above the regulatory threshold of 30 percent set forth by the Financial and Capital Market Commission (FCMC). The liquidity ratio is also brought into compliance with the internal limits set forth by the Bank.

As part of its liquidity management strategies, Bank adopts a conservative approach. To minimise the adverse aftermath of the global liquidity crunch, the Bank maintains its liquidity at the highest level. As of 2008-end, highly liquid assets represented by cash balances (vault cash), funds available in nostro accounts held with correspondent banks and short-term interbank loans together accounted for almost 99 percent of the total liquid assets.

**76,8%** **As of 31 December 2008, the Bank's liquidity ratio stood at 76.8%.**

## Payment Cards

The steady growth of the Bank and the increase in its assets contributed to the rise in the indicators in the Bank's payment card business.

Over the past year, the cumulative number of payment cards increased by 26 percent; the total number of top brand cards increased by 35.5 percent. The volume of transactions through card accounts grew by 16 percent.

In developing card products, the Bank's strategy centres on the following priorities: convenience for our clients, orientation towards exclusive products and top class

THE INDEPENDENCE SQUARE, KYIV.

professional services. In 2008, the Bank embarked on a number of projects aimed at elevating the level of security and functionality of payment cards, in particular, developing cards with the heightened security features to enable our clients to make cards payments over the Internet in a safe and secure environment, integrating SMS service functionality, and enhancing card acceptance capabilities.

To improve service quality, the Bank included into the range of its card products the world's most exclusive cards World Signia and Platinum Card. Along with a wide array of financial services (cash withdrawals, all types of payments and settlements in different currencies, lending services), holders of these cards can avail of a unique package of non-financial services, including 24-hour concierge service, insurance, access to airport VIP lounges, emergency medical and legal referrals and information abroad, and others.

**26%** **Over the past year, the cumulative number of payment cards increased by 26%.**

BLACKHEADS HOUSE (MELNGALVJU NAMS), RIGA.

## Human Resources Policy

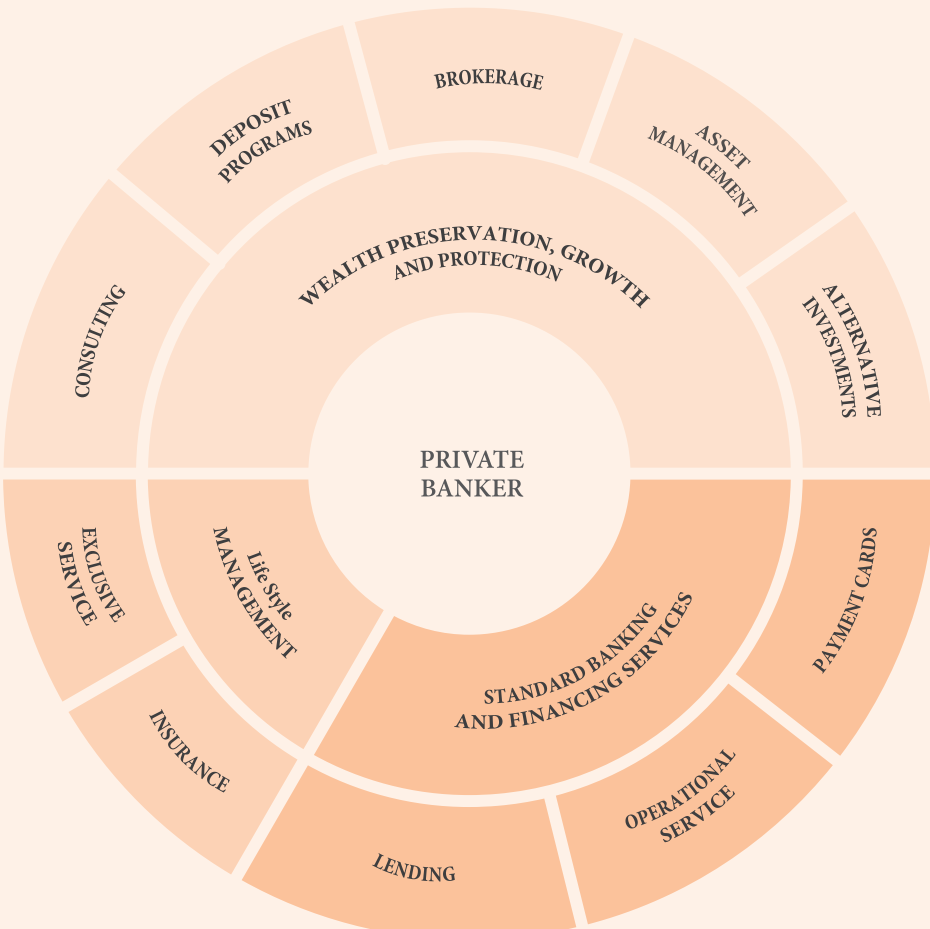
In 2008, the Bank proactively carried out personnel recruitment and selection activities and specifically focused on the calibre, qualifications and aptitudes of people recruited into the Bank. The Bank has always attached priority to the selection of highly qualified personnel because employees are those who ensure the service quality and reliability. Instilling and maintaining corporate values is vitally important to the personnel management.

The Bank is committed to long-term employment relationships and creates work environment that fosters professional growth. The staff members are offered the opportunity to upgrade their professional skills and to attend training programs made available in Latvia, other EU member states and Russia. The Bank provides support for talented employees, job prospects and career advancement opportunities.

The Bank considers personality traits as a part of employee selection. Adherence to the timeliness and accuracy standards is very important. However, qualifications such as problem solving skills, ability to find creative solutions to non-standard problems, own initiative, inspiration and improvisation are highly desirable. In customer service, key requirements include professional skills, openness and interpersonal communication skills in the workplace and ability to deliver the highest standards of performance.

# PERSPECTIVES OF FURTHER DEVELOPMENT

Amid highly volatile financial markets and the global economic recession, virtually all businesses are caused to fight fiercely for their consumers. The overall trend analysis may lead one straight to the conclusion that those companies dedicated to the principles of effectiveness of business management, flexibility in decision making, high quality customised services and protection of clients' interests are particularly well poised to earn customer confidence. They succeed in gaining confidence from ever-growing number of clients, hence strengthening their positions in the market.




PRODUCTS & SERVICES OVERVIEW.

# PERSPECTIVES OF FURTHER DEVELOPMENT

Under the current circumstances, Baltic International Bank's development strategy ensures incontestable competitive advantages. A thorough analysis and ongoing monitoring of both the internal and external business environment enables the Bank to provide services geared towards individual customer needs and wishes. By rendering exclusive and personalised banking services, the Bank proudly positions itself as a reliable and professional partner for its clients.

The Bank has always stayed oriented towards preserving, safeguarding and enhancing customer wealth and intends to continue in this way. The Bank's conservative investment philosophy combined with modern investment standards and practices fosters stability of the Bank and greater customer loyalty. The Bank intends to continue pursuing a prudent and well-thought-out investment policy designed to preserve the value of customer wealth. The Bank has always been clearly focused on growth and progress.

Personalised approach and individually tailored solutions, improvement of the quality of banking products and services and development of the spectrum of innovative products remain at the centre of our priorities for 2009.

Baltic International Bank is dedicated and committed to supporting the initiatives of the world's leading countries with respect to innovative projects encompassing the various spheres and aspects of the life of the society. In today's changing economic, political and ecological environment every individual can contribute to the process of stabilisation and improvement of the quality of human life at all levels.

The Bank is prepared to encourage the spread of different ideas that can provide further impetus to the recovery of manufacturing industries. Also, the Bank will support other initiatives aimed at boosting economic buoyancy and bolstering financial stability.

THE SUSPENSION (VANSU) BRIDGE, RIGA.

# JSC «BALTIC INTERNATIONAL BANK»

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2008

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# Dear Ladies and Gentlemen,

We are pleased to present to you our 2008 financial statements. Despite the upheavals in the global economy, the year 2008 was an important landmark for the implementation of the Bank's strategy aimed at developing private banking services.

2008 was a difficult year for the entire global banking system. The global financial crisis has also affected the Latvian market of banking services. This in turn has led to a slowdown in overall economic activities during the second half of the year.

Nevertheless, irrespective of rapid changes in the economic environment, the Bank has been able to retain its position, thus proving the appropriateness of the chosen business model based on a conservative approach to managing the Bank's own funds and customer funds. Meanwhile, preserving the value of the funds, hence, maintaining the trust and confidence of our customers remain our priorities.

As a result of implementing our business model, tracking the key market trends and satisfying customer requirements, the total amount of deposits and the concluded trust agreements increased by 61 percent to 207 million lats as at 31 December 2008. The amount of term deposits reached 59 million lats, showing a 59 percent increase over the 2007 figure.

Starting from the second half of 2008, the priority of our trading policy was to considerably reduce market risks by selling a portion of the Bank's securities portfolio. The remaining portion of the portfolio comprised held-to-maturity securities, of which more than 95 percent were fixed-income securities. In an effort to maintain stability, the Bank minimized the risks inherent in its trading book.

In our opinion, the overriding feature of the Bank's activity is the stability of the Bank's principal income whose structure is well-diversified. Over the past two years, the Bank's fee and commission income stood at around 25 percent of the operating income. Net interest income and net fee and commission income remained solid, growing 24.9 percent and 22.9 percent, respectively, year-on-year.

During fiscal year 2008, the Bank's assets grew 44 percent to LVL 167 323 846. It is worth emphasizing that the Bank's loan portfolio has increased during the year 2008 (19%). Loan portfolio as a percentage share of total assets is comparatively small compared to the average figure in Latvia's banking sector. At the end of 2008, loans as a percentage of total assets made up 24.5 percent (the average figure in Latvia's banking sector was 71 percent). Residential mortgage loans accounted for nearly a half of the total real estate exposure, whilst the Bank's exposure to consumer lending accounted for a bit less than 3% of the total lending. In 2009, the Bank continues growing its loan portfolio at a slow pace. The Bank has a stronger focus on managing credit quality and maintaining the chosen model of moderate risk-return trade off.

# REPORT OF THE CHAIRMAN OF THE SUPERVISORY COUNCIL AND THE CHAIRPERSON OF THE MANAGEMENT BOARD

One of the main priorities of the Bank's resource allocation policy was, and still remains, the maintenance of liquidity at the highest level. At the end of 2008, the Bank's liquidity ratio stood at 76.9 percent. The ratio is considerably higher that the average ratio in Latvia's banking sector and is well above the minimum regulatory threshold of 30 percent.

During the year 2008, we concentrated on the following tasks: to effectively manage and optimize business processes; to continue developing the range of services tailored to our customers' needs taking into account the current situation in the global financial markets. Major investments were made in technology, infrastructure as well in training our personnel.

Our principal goal was - and still remains - preserving the funds entrusted to us by our customers. Therefore, last year we developed innovative services and products, such as additional deposit programmes, capital guaranteed products and alternative investments.

In response to the current changes, corporations and individuals need to take a fundamentally different look at development and growth possibilities. The Bank believes it is necessary to support a system that encourages economic growth through the best mix of state-imposed stability and private initiative.

Our plans for 2009 include continuing to enlarge our customer base, raising the professionalism of the personnel and enhancing the quality of services, taking a sensible approach to risk management and supporting stability and reliability of our organisation.

We appreciate that our clients associate our bank with the values of stability they need. We wish to thank all of our partners for a successful cooperation and express our gratitude to all of our employees for their outstanding performance at the time we need it the most.

We are sure that our prudent strategy and our professional team will enable us to continue being the custodians of our clients' trust.

27 March 2009

Leonid Kramnoy
Chairman of the Council

Ilona Gulchak
Chairperson of the Board

# SUPERVISORY COUNCIL AND MANAGEMENT BOARD

**SUPERVISORY COUNCIL (as of 31 December 2008)**

| Name | Position held | Appointed | Re-appointed |
|---|---|---|---|
| Leonid Kramnoy | Chairman of the Council | 10/10/2003 | 25/03/2008 |
| Valeri Belokon | Member of the Council | 25/03/2008 | - |
| Viacheslav Kramnoy, sr. | Member of the Council | 18/07/1997 | 25/03/2008 |

**MANAGEMENT BOARD (as of 31 December 2008)**

| Name | Position held | Appointed | Re-appointed |
|---|---|---|---|
| Ilona Gulchak | Chairperson of the Board | 25/01/2008 | - |
| Natalya Tkachenko | Member of the Board, | 01/08/2007 | - |
| | Deputy Chairperson of the Board | 26/02/2008 | - |
| Alon Nodelman | Member of the Board | 15/08/2003 | 21/05/2007 |
| Janis Apelis | Member of the Board | 15/08/2003 | 21/05/2007 |
| Bogdan Andrushchenko | Member of the Board | 13/09/2005 | 21/05/2007 |
| Dinars Kolpakovs | Member of the Board | 13/09/2005 | 21/05/2007 |
| Albert Reznik | Member of the Board | 26/02/2008 | - |
| Ilze Lase | Nominee Member of the Board | 13/09/2005 | - |

In the year 2008, the following changes were made in the composition of JSC "Baltic International Bank" Council and Board:

**Supervisory Council:**

According to resolution of the General Meeting of Shareholders held on 25 March 2008, Vilori Belokon resigned from his post as the Deputy Chairman of the Council and Valeri Belokon was elected as a member of the Council.

**Management Board:**

According to the Council's resolution of 25 January 2008, Valeri Belokon resigned from his post of the Chairman of the Board. Ilona Gulchak was appointed as the next Chairperson of the Board. According to the Council's resolution of 26 February 2008, Natalja Tkachenko was appointed the Deputy Chairperson of the Board and Albert Reznik was elected as a member of the Board.

There were no changes in the Supervisory Council and the Management Board of the Bank during the period from 1 January 2009 through to the date of the approval of these financial statements.

# STATEMENT OF MANAGEMENT'S RESPONSIBILITIES

Riga 27 March 2009

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and give a true and fair view of the state of the Bank's affairs as at 31 December 2008, and of the results of its operations and its cash flows for the year ended 31 December 2008.

The 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 financial statements for the period from 1 January 2008 to 31 December 2008 set out on pages 33 to 88. The management also confirms that applicable International Financial Reporting Standards have been used in the preparation of the financial statements and that these financial statements have been prepared on a going concern basis and comply with the Financial and Capital Market Commission Regulations on the Annual Reports of Credit Institutions in all material respects.

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

On behalf of the Management of the Bank:

Leonid Kramnoy
Chairman of the Council

Ilona Gulchak
Chairperson of the Board

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Vesetas iela 7
Riga LV-1013
Latvia

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www.kpmg.lv

**TO THE SHAREHOLDERS OF JSC "BALTIC INTERNATIONAL BANK"**

## Report on the Financial Statements

We have audited the accompanying financial statements of JSC "Baltic International Bank" ("the Bank"), which comprise the balance sheet as at 31 December 2008, and the income statement, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 33 to 88.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

*Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the JSC "Baltic International Bank" as at 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

## Report on Other Legal and Regulatory Requirements

In addition, our responsibility is to assess whether the accounting information included in the Management Report, as set out on pages 27 to 28, the preparation of which is the responsibility of management, is consistent with the financial statements. Our work with respect to the Management Report was limited to the aforementioned scope and did not include a review of any information other than drawn from the financial statements of the Bank. In our opinion, the Management Report is consistent with the financial statements.

**KPMG Baltics SIA**
License No 55

Ondrej Fikrle
Partner pp KPMG Baltics SIA

Inga Lipsane
Sworn Auditor
Certificate No. 112

Riga, Latvia
27 March 2009

# INCOME STATEMENT
## for the year ended 31 December 2008

| | Notes | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|---|
| Interest income | 4 | 7 631 663 | 5 627 953 |
| Interest expense | 5 | (2 730 735) | (1 702 636) |
| **Net interest income** | | **4 900 928** | **3 925 317** |
| | | | |
| Fee and commission income | 6 | 2 953 073 | 2 799 470 |
| Fee and commission expense | 7 | (632 043) | (910 861) |
| **Net fee and commission income** | | **2 321 030** | **1 888 609** |
| | | | |
| Dividend income | | 5 183 | 8 708 |
| Net trading (loss)/income | 8 | (2 875 779) | 33 014 |
| Net foreign exchange income | 8 | 1 698 636 | 761 350 |
| Other operating income | 9 | 100 067 | 182 379 |
| **Total operating income** | | **6 150 065** | **6 799 377** |
| | | | |
| Administrative expenses | 10 | (5 496 808) | (4 480 830) |
| Amortisation and depreciation | 23, 24 | (418 011) | (519 479) |
| Other operating expenses | 11 | (113 512) | (242 663) |
| | | | |
| Net impairment gain/(loss) on doubtful debts | 12 | 417 524 | (114 792) |
| (Loss)/gain on revaluation of investment property | 25 | (148 646) | 298 398 |
| **Profit before income tax** | | **390 612** | **1 740 011** |
| Income tax expense | 13 | (343 176) | (244 081) |
| **Profit for the period** | | **47 436** | **1 495 930** |

The accompanying notes on pages 38 to 88 are an integral part of these financial statements.

The financial statements on pages 33 to 88 have been authorised for issue by the Council and the Board on 27 March 2009, and signed on their behalf by:

Leonid Kramnoy
Chairman of the Council

Ilona Gulchak
Chairperson of the Board

# BALANCE SHEET AND OFF-BALANCE SHEET ITEMS
as of 31 December 2008

| ASSETS | Notes | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|---|
| Cash and balances with Bank of Latvia | 15 | 8 658 964 | 8 425 788 |
| Due from credit institutions | 17 | 89 351 976 | 49 954 497 |
| Financial assets held-for-trading | | 1 165 250 | 6 301 396 |
| *Securities held-for-trading* | *18* | *373 141* | *5 561 934* |
| *Derivative financial instruments* | *19* | *792 109* | *739 462* |
| Securities available-for-sale | 20 | 173 631 | 173 631 |
| Securities held-to-maturity | 21 | 11 832 825 | 4 332 116 |
| Loans | 22 | 40 980 064 | 34 558 351 |
| Intangible assets | 23 | 1 155 852 | 765 241 |
| Property and equipment | 24 | 10 722 908 | 7 636 158 |
| Investment property | 25 | 1 317 528 | 1 573 938 |
| Investments in associates | 26 | 429 009 | 429 009 |
| Overpaid corporate income tax | | - | 195 159 |
| Deferred expenses and accrued income | 27 | 900 407 | 716 918 |
| Other assets | 28 | 635 432 | 1 507 265 |
| **Total assets** | | **167 323 846** | **116 569 467** |

*(Continued on next page)*

The accompanying notes on pages 38 to 88 are an integral part of these financial statements.

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Chairperson of the Board

# BALANCE SHEET AND OFF-BALANCE SHEET ITEMS
## as of 31 December 2008

*(Concluded. Started on page 34)*

| LIABILITIES | Notes | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|---|
| Due to credit institutions | 29 | 589 291 | 3 136 260 |
| Deposits | 30 | 151 173 224 | 96 925 378 |
| Debt securities in issue | 31 | 843 801 | 803 171 |
| Derivative financial instruments | 19 | 321 684 | 740 557 |
| Accrued expenses, provisions and deferred income | 32 | 597 863 | 609 731 |
| Corporate income tax liabilities | | 32 701 | - |
| Deferred tax liabilities | 13 | 267 796 | 232 480 |
| Other liabilities | 33 | 1 195 954 | 1 869 545 |
| Subordinated liabilities | 34 | 24 570 | 22 819 |
| **Total liabilities** | | **155 046 884** | **104 339 941** |
| **SHAREHOLDERS' EQUITY** | | | |
| Share capital | 35 | 7 611 285 | 7 611 285 |
| Reserve capital | 35 | 545 024 | 545 024 |
| Retained earnings | | 4 120 653 | 4 073 217 |
| *Retained earnings for the previous years* | | *4 073 217* | *2 577 287* |
| *Profit for the current year* | | *47 436* | *1 495 930* |
| **Total shareholders' equity** | | **12 276 962** | **12 229 526** |
| **Total liabilities and shareholders' equity** | | **167 323 846** | **116 569 467** |
| **OFF-BALANCE SHEET ITEMS** | | | |
| Sureties (guarantees) | 36 | 1 117 613 | 587 389 |
| Commitments to customers | 36 | 4 932 184 | 4 334 703 |
| **Total off-balance sheet items** | | **6 049 797** | **4 922 092** |

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Ilona Gulchak
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# STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
for the year ended 31 December 2008

| | Share capital LVL | Reserve capital LVL | Retained earnings LVL | TOTAL LVL |
|---|---|---|---|---|
| **Balance as of 31 December 2006** | **7 611 285** | **545 024** | **2 577 287** | **10 733 596** |
| Profit for the year | - | - | 1 495 930 | 1 495 930 |
| **Balance as of 31 December 2007** | **7 611 285** | **545 024** | **4 073 217** | **12 229 526** |
| Profit for the year | - | - | 47 436 | 47 436 |
| **Balance as of 31 December 2008** | **7 611 285** | **545 024** | **4 120 653** | **12 276 962** |

The accompanying notes on pages 38 to 88 are an integral part of these financial statements.

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# STATEMENT OF CASH FLOWS
## for the year ended 31 December 2008

| CASH FLOW FROM OPERATING ACTIVITIES | Notes | 2008<br>LVL | 2007<br>LVL |
|---|---|---|---|
| Profit before income tax | | 390 612 | 1 740 011 |
| Amortisation and depreciation | 23, 24 | 418 011 | 519 479 |
| (Decrease)/ increase in inpairment allowance | | (417 524) | 114 792 |
| Unrealised loss/ (gain) on revaluation of investment property | | 148 646 | (298 398) |
| Gain on disposal of property and equipment and intangible assets | 9, 11 | (12 045) | (172 290) |
| **Increase in cash and cash equivalents from operating activities before changes in assets and liabilities** | | **527 700** | **1 903 594** |
| Increase in loans | | (5 967 624) | (3 246 820) |
| Decrease in due from credit institutions | | 124 088 | 78 767 |
| Decrease in financial assets held-for-trading | | 5 136 146 | 1 195 939 |
| Increase in deferred expenses and accrued income | | (185 816) | (62 094) |
| Decrease in other assets | | 975 252 | 1 051 961 |
| Decrease in due to credit institutions | | (492 078) | (37 602) |
| Increase in deposits | | 54 247 846 | 33 938 199 |
| (Decrease)/ increase in derivative financial instruments | | (418 873) | 683 836 |
| Decrease in accrued expenses, provisions and deferred income | | (11 868) | (214 543) |
| (Decrease)/ increase in other liabilities | | (673 591) | 1 081 631 |
| **Increase in cash and cash equivalents resulting from operating activities** | | **53 261 182** | **36 372 868** |
| Corporate income tax paid | | - | (367 803) |
| **Increase in cash and cash equivalents from operating activities** | | **53 261 182** | **36 005 065** |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | |
| Acquisition of property and equipment and intangible assets | 23,24 | (4 087 051) | (4 430 583) |
| Proceeds from sale of property and equipment, intangible assets and investment property | | **128 096** | 786 689 |
| Purchase or transfer of securities held-to-maturity | | (7 537 301) | (2 737 567) |
| **Decrease in cash and cash equivalents as a result of investing activities** | | **(11 496 256)** | **(6 381 461)** |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | | |
| Subordinated liabilities | | 1 751 | - |
| Cash paid out to repay subordinated debt | | - | (30 798) |
| Issuance of debt securities | | 40 630 | 803 171 |
| Buyback of debt securities | | - | (1 044 252) |
| **Decrease in cash and cash equivalents as a result of financing activities** | | **42 381** | **(271 879)** |
| **Increase in cash and cash equivalents** | | **41 807 307** | **29 351 725** |
| Cash and cash equivalents at the beginning of the year | 16 | 54 628 470 | 25 276 745 |
| **Cash and cash equivalents at the end of the year** | **16** | **96 435 777** | **54 628 470** |

The accompanying notes on pages 38 to 88 are an integral part of these financial statements.

The financial statements on pages 33 to 88 have been authorised for issue by the Council and the Board on 27 March 2009, and signed on their behalf by:

Leonid Kramnoy
Chairman of the Council

Ilona Gulchak
Chairperson of the Board

## 1. GENERAL INFORMATION

JSC "Baltic International Bank" is a joint stock company registered in the Republic of Latvia. The registered office address is: Kalēju iela 43, Riga, LV-1050, Latvia. On 8 April 1993, the Bank of Latvia approved Baltic International Bank as a credit institution and issued Banking Licence No. 103.

Established to cater to the needs of both individuals and corporate customers, JSC "Baltic International Bank" (hereinafter referred to as the Bank) provides a comprehensive range of financial services: personal and corporate loans, acceptance of money deposits and other funds, funds transfers, treasury and capital market services carried out according to customer instructions and for the Bank's own trading purposes.

The Financial and Capital Market Commission (referred to herein as the Commission) is an integrated financial supervisory institution for all financial services including banking, the stock-market, and insurance. The aim of the Commission is to provide protection for the interests of investors and depositors and to ensure development and stability of the financial and capital market.

## 2. ACCOUNTING POLICIES AND THE PRINCIPLES OF ASSESSMENT

**Statement of Compliance**

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (the EU) and in accordance with the requirements of the Latvian Financial and Capital Market Commission in force as at the reporting date. The local accounting legislation requires the Bank to prepare separate financial statements in accordance with IFRS as adopted by the European Union. The financial statements were authorised for issue by the Bank's Board on 27 March 2009. The financial statements may be amended by the shareholders and re-issue of the statements required.

**Use of estimates and judgements**

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period, in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

**Key sources of estimation uncertainty:**

*Allowances for credit losses*

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Risk Management Department.

*Valuation of financial instruments*

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

*Impairment of financial instruments*

The determination of impairment indication is based on comparison of the financial instrument's carrying value and fair value. Due to downturns on financial and capital markets, the market price is not always a reliable source for impairment indication. The Bank uses valuation models based on quoted market prices of similar products.

For the purposes of impairment loss measurement, the Bank's management makes estimates of any expected changes in future cash flows from a specific financial instrument based on analysis of financial position of the issuer of the financial instrument.

*Valuation of investment property*

Investment property is stated at its fair value with all changes in fair value recorded to profit and loss. When measuring the fair value of the investment property, the management relies on external valuations and assesses the reliability of such valuation in light of the current market situation.

*Current market situation*

The ongoing global liquidity crisis which commenced in the middle of 2007 resulted in, among other things, lower liquidity levels in financial and real estate markets, lower level of capital market funding and lower liquidity across the banking sector. In addition, Latvia has been experiencing an economic downturn which has affected, and may continue to affect, the activities of enterprises operating in this environment. The accompanying financial statements reflect management's assessment of the impact of the Latvian and global business environment on the operations and the financial position of the Bank. The future developments in the business environment may differ from management's assessment.

*Provisions*

The carrying amount of provisions is estimated based on assumptions about such items as the risk adjustment to cash flows or discount rates used, future changes in prices and estimates of costs. Bank reviews these assumptions regularly. However, a change in estimates could have a material impact on the carrying amount of these provisions.

*Fair value of collateral*

In determining the fair value of collateral, management relies on external valuations and assesses the reliability of those valuations in the light of the current market situation. To determine the fair value of the collaterals for which an observable market price is unavailable requires the use of valuation techniques as described in the accounting policy. The fair value of the collaterals is less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific collateral.

**Basis of preparation**

The financial statements are presented in Latvian lats, unless indicated otherwise. The functional currency of the Bank is Latvian lat.

The financial statements have been prepared on the historical cost basis for assets and liabilities except for the following:

- investment property is stated at fair value;
- non-hedging derivative financial instruments are stated at fair value;
- financial assets and liabilities at fair value through profit or loss are stated at fair value; and
- available for sale assets are stated at fair value, except those whose fair value cannot be reliably estimated.

Other financial assets and liabilities are carried at amortised cost using the effective interest rate method.

The financial statements have been prepared using accounting principles consistent with those used in the prior year.

**Foreign currency translation**

Transactions denominated in foreign currencies are translated into the functional currency (Latvian lat) at the official Bank of Latvia exchange rate prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Latvian lats according to the official Bank of Latvia exchange rates prevailing at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value or cost are retranslated at the exchange rate at the date that the fair value or cost was determined.

Profit or loss relating to fluctuations in the exchange rate on monetary assets and liabilities denominated in a foreign currency is recognised in the income statement in the period in which the fluctuation occurs. Foreign currency differences arising on retranslation are recognised in the income statement, except differences arising on the retranslation of available-for-sale instruments that are recognised in equity. The applicable rates for the principal currencies held by the Bank were as follows:

| Currency name | | 31.12.2008 | 31.12.2007 |
|---|---|---|---|
| 1 BYR | = | LVL 0.000225 | LVL 0.000225 |
| 1 EUR | = | LVL 0.702804 | LVL 0.702804 |
| 1 GBP | = | LVL 0.728000 | LVL 0.963000 |
| 1 RUB | = | LVL 0.017100 | LVL 0.019700 |
| 1 USD | = | LVL 0.495000 | LVL 0.484000 |

**Income and expense recognition**

With the exception of financial assets held-for-trading and other financial instruments at fair value through profit or loss, interest income and expense are recognised in the income statement using the effective interest method. Interest income on financial assets held-for-trading and on other financial instruments at fair value through profit or loss comprises coupon interest only.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract, transaction costs and all other premiums or discounts that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Loan origination fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related direct costs, are deferred and amortised to the interest income over the estimated life of the financial instrument using the effective interest rate method.

Other fees, commissions and other income and expense items are recognised when the corresponding service has been provided/received.

Dividend income is recognised in the income statement on the date that the dividend is declared.

**Financial instruments**

Financial instruments aquired by the Bank are categorised into portfolios in accordance with the Bank's intent at the time of the acquisition of the securities and pursuant to the Bank's investment strategy. The Bank developed a security investment strategy and, reflecting the intent of the acquisition, allocated securities to “Securities held-to-maturity”, "Financial assets at fair value through profit or loss", “Securities held-for-trading” and “Securities available-for-sale”.

All financial instruments held by the Bank are recognised at trade date and are initially measured at fair value plus for instruments not at fair value through profit or loss any directly attributable transaction cost.

**Financial assets and liabilities at fair value through profit or loss**

Financial assets and liabilities at fair value through profit or loss are those that have been designated by the Bank at inception as at fair value through profit or loss and those classified as held-for-trading. Held-for-trading instruments are securities and shares that the Bank principally holds for the purpose of reselling and generating a profit from short-term fluctuations in the prices of the instruments.

**Financial assets held-for-trading**

Held-for-trading instruments are securities and shares that the Bank principally holds for the purpose of reselling and generating a profit as net trading income or net trading loss, respectively. Securities held-for-trading are subsequently re-measured to fair value based on market prices. Realised and unrealised gains or losses are recorded as net trading income or net trading loss, respectively.

Derivatives are also categorised as held-for-trading unless they are designated as hedging instruments for hedge accounting purposes. During 2008 and 2007, the Bank did not apply hedge accounting.

Derivatives may be embedded in another contractual arrangement (a "host contract"). The Bank accounts for an embedded derivative separately from the host contract when the host contract is not itself carried at fair value through profit or loss.

The terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract and the economic characteristics and risks of the embedded derivative were not closely related to the economic characteristics and risks of the host contract.

**Non-hedging derivative financial instruments**

Derivative financial instruments including foreign exchange contracts, currency and interest rate swaps and other derivative financial instruments are subsequently recognised in the balance sheet at their value. Attributable transaction costs are recognised in the profit or loss when incurred. Fair value is obtained from quoted market prices and discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

**Securities available-for-sale**

Securities available-for-sale are acquired to be held for an indefinite period of time. Securities, whose quoted market value is not determined in an active market and whose fair value cannot be reliably measured, are carried at acquisition cost. All other securities available-for-sale are carried at fair value. Gains or losses resulting from the change in fair value of available-for-sale securities are recognised directly in equity, except for impairment losses until the financial asset is derecognised; thereafter, the cumulative gain or loss previously recognised in equity is recognised in profit or loss. Securities available-for-sale are initially measured at its fair value plus transaction costs that are directly attributable to the acquisition of the financial asset.

**Securities held-to-maturity**

Securities held-to-maturity include government securities and corporate bonds which after initial recognition at fair value are recognised at amortised cost and are securities with respect to which the Bank has a positive intent and ability to hold to maturity. Securities held-to-maturity are accounted for using a trade date basis for purchases. Subsequently the effective interest rate method is applied for amortising discounts over the term to maturity.

***Change in accounting policy***

In October 2008 the IASB issued Reclassification of Financial Assets (Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures). The amendments permit an entity to reclassify non-derivative financial assets, other than those designated at fair value through profit or loss upon initial recognition, out of the fair value through profit or loss (i.e., trading) category if they are no longer held for the purpose of being sold or repurchased in the near term, as follows:

- If the financial asset would have met the definition of loans and receivables, if the financial asset had not been required to be classified as held-for-trading at initial recognition, then it may be reclassified if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
- If the financial asset would not have met the definition of loans and receivables, then it may be reclassified out of the trading category only in 'rare circumstances'.

The amendment to IAS 39 also permits an entity to transfer from the available-for-sale category to the loans and receivables category a non-derivative financial asset that otherwise would have met the definition of loans and receivables if the entity has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

The amendment to IFRS 7 introduces additional disclosure requirements if an entity has reclassified financial assets in accordance with the amendment to IAS 39. The amendments are effective retrospectively from 1 July 2008.

The Bank reclassified certain non derivative financial assets during the year. For further details see Note 18.

**Loans**

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Bank intends to sell immediately or in the short-term, (b) those that the Bank upon initial recognition designates as at the fair value through profit or loss or as available-for-sale; or (c) those for which the holder may not recover substantially all of its initial investments, other than because of credit deterioration.

After initial recognition at fair value, loans are measured at amortised cost using the effective interest rate method.

When a loan is considered to be uncollectible it is written off against the related impairment allowance; subsequent recoveries are credited to the impairment loss expense in the income statement.

**Impairment**

*Financial assets*

At each balance sheet date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower or issuer, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

All loans and receivables from customers and held-to-maturity investment securities are assessed for specific impairment. Accordingly, the Bank does not set aside a collective impairment allowance on loans and receivables from customers and held-to-maturity investment securities.

Loans and receivables are stated in the balance sheet at amortised cost, less any impairment allowances. Impairment losses and recoveries are recognised monthly based on regular loan reviews. Allowances during the period are reflected in the income statement.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables or held to maturity financial investments. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss that has been recognised directly in equity to profit or loss. The cumulative loss that is removed from equity and recognised in profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale assets increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity.

*Non-financial assets*

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

**Derecognition**

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or when the Bank transfers substantially all of the risks and rewards of ownership of the financial asset. Any rights or obligations created or retained in the transfer are recognised separately as assets or liabilities. A financial liability is derecognised when it is extinguished.

**Offsetting**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

**Off-balance sheet exposures**

As a part of its routine business function, the Bank engages in off-balance sheet arrangements associated with lending, issuing bank guarantees and opening letters of credit. These financial transactions are disclosed in the financial statements as at the effective date of the relevant agreement.

**Intangible assets**

The Bank's intangible assets comprise software, which allow the Bank to carry on banking business, and computer software. The intangible assets are accounted for at their historical cost less amortisation and impairment, if any. The intangible asset"s amortisation term is determined by the Bank based on the intangible asset's useful life, if any; in the event that such a term is not stated, the Bank amortises the intangible asset over a period of 5 years. The Bank applies the straight-line method of amortisation of intangible assets.

**Property and equipment**

Property and equipment are recorded in the Bank's financial statements at their historical cost less accumulated depreciation and impairment, if any.

Depreciation periods for individual categories of assets are as follows:

| | |
|---|---|
| Buildings | 50 years |
| Machinery | 5 years |
| Motor vehicles | 5 years |
| Other tangible fixed assets | 10 years |
| Computers | 5 years |

Land and assets under construction are not depreciated. Costs relating to the maintenance and repair of the Bank's property and equipment are included in the income statement when they arise. Whenever a complete repair and renovation prolong the asset's useful life (change the value of the asset), then the repair and renovation expenditure amount is added to the fixed asset's carrying amount.

Depreciation methods, useful lives and residual values are reviewed annually.

**Investment property**

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the supply of services or for administrative purposes.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

Investment property is initially recognised in the balance sheet at its acquisition cost. Subsequently, the investment property is revalued and accounted for at its fair value based on its market price. Fair market value for land plots, buildings and other real property items is determined on the basis of annual property appraisals from certified appraisers. Gain or loss from the change in the value is recorded in the income statement and reported under the item "Gain or loss on revaluation of investment property".

**Associates**

Associates are those enterprises or the entity in which the Bank has significant influence, but not control, over the financial and operating policies. In the Bank's financial statements investments in associates are accounted for using the equity method and are intially recognised at cost. The investment includes goodwill identified on acquisition, net of any accumulated impairment losses.

**Repo operations (repos)**

Securities sold under sale and repurchase ("repo") agreements are accounted for as secured financing transactions, with the securities retained in the balance sheet and the counterparty liability included in amounts payable under repo transactions. The difference between the sale and repurchase price represents the interest expense and is recognised in the income statement over the term of the repo agreement using the effective interest rate method.

Securities purchased under agreements to resell ("reverse repo") are recorded as amounts receivable under reverse repo transactions. The differences between the purchase and resale prices are treated as interest income and accrued over the term of the reverse repo agreement using the effective interest method.

If assets purchased under agreement to resell are sold to third parties, the obligation to return securities is recorded as a trading liability and measured at fair value.

**Cash and cash equivalents**

Cash and cash equivalents comprises cash and deposits with the Bank of Latvia and other credit institutions with a maturity of less than 3 months, less balances due to the Bank of Latvia and credit institutions with a maturity of less than 3 months.

**Debt securities in issue**

Debt securities in issue include bills of exchange/promissory notes issued by the Bank. Debt securities are initially measured at fair value of consideration received less transaction costs, and subsequently measured at their amortised cost using the effective interest method.

**Due to credit institutions**

Due to credit institutions comprise all liabilities resulting form transactions with domestic and foreign credit institutions as well as liabilities to the Bank of Latvia and other central banks, including (int.all.) vostro balances due to credit institutions, due to credit institutions for outstanding foreign exchange deals and interbank loans.

Due to credit institutions initially measured at fair value, subsequently are carried at amortised cost using effective interest rate method.

**Deposits**

Deposits are liabilities carried at amortized cost and include current accounts and deposits from customers and deposits and balances from credit institutions.

**Corporate income tax**

Corporate income tax comprises current and deferred tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Corporate income tax in the Republic of Latvia is a direct tax based on the taxable profit reported for the taxation period at the rate of 15%. Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The amount of deferred tax recognised is based on the expected manner of realisation as settlement of the carrying amount of assets and liabilities using tax rates enacted or substantively enacted at the balance sheet date. The principal temporary differences arise from the differing rates and methods used for accounting and tax depreciation on property and equipment, intangible assets, accruals and investment property. Deferred tax assets are only recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

**Provisions**

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for restructuring is recognised when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

**Short-term employee benefits**

Short-term employee benefits are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid under short-term cash bonus of profit sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The provision for employee holiday pay is calculated for each Bank employee based on the total number of holidays earned but not taken, multiplied by the average daily remuneration expense for the preceding six months, to which the relevant social security expense is added.

**Fair value measurement of financial assets and financial liabilities**

A number of the Bank's accounting policies and disclosures require the determination of fair value for financial assets and liabilities. The methods described below have been used for the determination of fair values. When applicable, further information about the assumptions made in determining fair values is disclosed in the respective notes.

*Due from other credit institutions*

The fair value of placements on demand, overnight deposits and floating rate placements is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

*Loans to customers*

The estimated fair value of loans represents the discounted amount of estimated future cash flows expected to be received. The interest rates used to discount estimated cash flows are based on the prevailing money-market interest rates curve plus an adequate credit spread.

*Shares and other securities with non-fixed income*

The fair value of shares and other securities with non-fixed income is determined by reference to their quoted bid price at the reporting date, if available. For a non-material amount of non-listed shares, where disposal is limited, the assumption was made that the reliable estimate of fair value is not possible.

The fair value of S.W.I.F.T shares was determined based on the "transfer amount" approved for the respective year by the shareholders' meeting, that represents the price for new share allocation and participants quit price.

*Derivative financial instruments*

The fair value of currency swaps is estimated by discounting the contractual cash flows to be received and to be paid in appropriate foreign currencies for the residual maturity, and translating the difference of the discounted cash flows into lats, applying the exchange rate set by Bank of Latvia. EURIBOR and LIBOR interest rates are used as benchmark for risk-free interest rate for discounting purposes.

*Due to other credit institutions and customers*

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of overnight deposits is their carrying amount. The estimated fair value of fixed interest-bearing deposits not quoted in the active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

*Credit related commitments*

In the normal course of business, the Bank enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Allowances for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and allowances for other credit related commitment are included within other liabilities.

**Dividends**

The Bank receives dividends from the equity instruments which are recognised when the right to receive payment is established.

Proposed dividends are recognised in the financial statements only when approved by shareholders.

**New standards and interpretations not yet effective**

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2008, and have not been applied in preparing these financial statements:

IFRIC 13 Customer Loyalty Programmes addresses the accounting by entities that operate or otherwise participate in customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC becomes mandatory for the entity's 2009 financial statements and will be applicable retrospectively. The interpretation is not relevant to the Bank.

The amendment to IFRS 2 Share-based Payment – Vesting Conditions and Cancellations clarifies the definition of vesting conditions, introduces the concept of non-vesting conditions, requires non-vesting conditions to be reflected in grant-date fair value and provides the accounting treatment for non-vesting conditions and cancellations. The amendment is not relevant to the Bank.

The revised IFRS 3 Business Combinations (2008) incorporate the following changes:

- the definition of a business has been broadened;
- contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss
- transaction cost, other than share and debt issue costs, will be expensed as incurred;
- any pre-existing interest in an acquiree will be measured at fair value, which the related gain or loss recognised in profit or loss;
- any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of and acquiree, on a transaction-by-transaction basis.

The revised IFRS 3, which becomes mandatory for the Bank's 2010 financial statements, will be applied prospectively and therefore there will be no impact on prior periods in the financial statements.

IFRS 8 Operating Segments introduces the "management approach" to segment reporting. The Bank does not have to disclose reporting according to segment. Therefore, the new standard is not applicable to its financial statements.

The revised IAS 1 Presentation of Financial Statements (2007) introduces the term "total comprehensive income," which represents changes in equity during a period other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income may be presented in either a single statement of comprehensive income (effectively combining both the income statement and all non-owner changes in equity in a single statement), or in an income statement and a separate statement of comprehensive income. The Bank will apply this amendment from the annual period beginning 1 January 2009.

The revised IAS 23 Borrowing Costs removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised IAS 23 will become mandatory for the Bank's 2009 financial statements and will constitute a change in accounting policy for the Bank. In accordance with the transitional requirements, the Bank will apply the revised IAS 23 to qualifying assets for which capitalisation of borrowing costs commences on or after the effective date. Therefore there will be no impact on prior periods in the Bank's 2009 financial statements.

The amended IAS 27 Consolidated and Separate Financial Statements (2008) requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When the Bank loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss. The amendments to IAS 27, which become mandatory for the Bank's 2010 financial statements, do not have a significant impact on these financial statements.

Amendments to IAS 32 and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation require puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity if certain conditions are met. The amendments, which become mandatory for the Bank's 2009 financial statements with retrospective application required, are not expected to have any significant impact on the financial statements.

Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items clarify the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments will become mandatory for the Bank's 2010 financial statements, with retrospective application required. The Bank is currently in the process of evaluating the potential effect of this amendment.

IFRIC 15 Agreements for the Construction of Real Estate clarifies that revenue arising from agreements for the construction of real estate is recognised by reference to the stage of completion of the contract activity in the following cases:

- the agreement meets the definition of a construction contract in accordance with IAS 11.3;
- the agreement is only for the rendering of services in accordance with IAS 18 (e.g., the entity is not required to supply construction materials); and
- the agreement is for the sale of goods but the revenue recognition criteria of IAS 18.14 are met continuously as construction progresses.

In all other cases, revenue is recognised when all of the revenue recognition criteria of IAS 18.14 are satisfied (e.g., upon completion of construction or upon delivery). IFRIC 15 is not relevant to the Bank's operations as the Bank does not provide real estate construction services or develop real estate for sale.

IFRIC 16 Hedges of a Net Investment in a Foreign Operation clarifies that:

- net investment hedging can be applied only to foreign exchange differences arising between the functional currency of a foreign operation and the parent entity's functional currency and only in an amount equal to or less than the net assets of the foreign operation;
- the hedging instrument may be held by any entity within the group except the foreign operation that is being hedged;
- on disposal of a hedged operation, the cumulative gain or loss on the hedging instrument that was determined to be effective is reclassified to profit or loss.

The Interpretation allows an entity that uses the step-by-step method of consolidation an accounting policy choice to determine the cumulative currency translation adjustment that is reclassified to profit or loss on disposal of a net investment as if the direct method of consolidation had been used. IFRIC 16, which becomes mandatory for the Bank's 2009 financial statements, applies prospectively to the Bank's existing hedge relationships and net investments. The Bank is currently in the process of evaluating the potential effect of this Interpretation.

IFRIC 17 Distributions of Non-cash Assets to Owners applies to non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners and is effective prospectively for annual periods beginning on or after 15 July 2009. In accordance with the Interpretation a liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity and shall be measured at the fair value of the assets to be distributed. The carrying amount of the dividend payable shall be remeasured at each reporting date, with any changes in the carrying amount recognised in equity as adjustments to the amount of the distribution. When the dividend payable is settled the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable shall be recognised in profit or loss.

As the Interpretation is applicable only from the date of application, it will not impact on the financial statements for periods prior to the date of adoption of the interpretation. Further, since it relates to future dividends that will be at the discretion of the board of directors/shareholders it is not possible to determine the effects of application in advance.

### 3. RISK MANAGEMENT

The Bank's activities expose it to a variety of financial and non-financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risks is core to the financial business, and these risks are an inevitable consequence of being in business. The Bank's strategic aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effect on the Bank's financial performance.

The risk management system, being an integral part of internal control system of the Bank, is based on the principal requirements of effective supervision of banks by Financial Anda the Capital Market Commission and the Basel Committee on Banking Supervision.

The most important types of risk are reputational risk, credit risk, liquidity risk, interest rate risk, foreign exchange risk and operational risk. The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Risk management in the Bank is centralised and is carried out by the Board under policies approved by Supervisory Council. Risk management polices are subject to yearly review. There are three committees in the Bank responsible for risk management - the Credit Committee, the Resources Supervision Committee and Customer Due Diligence Committee. In addition, internal audit is responsible for the independent review of risk management and control environment.

The Bank's risk management policies are designed to identify, analyse and measure significant risks, to set appropriate risk limits and controls, and to monitor the risk and adherence to limits by means of reliable and up-to-date management information system. As of 1 January 2009, the Bank has implemented the EU Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and the EU Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions relating to the improvement of the internal control system and risk management, as well as implemented Basel II Accord requirements introduced by the Basel Committee on Banking Supervision.

**Reputational risk**

Banks are inherently at risk for potential money laundering and the financing of terrorism, and this factor poses a serious threat to corporate reputation, unless banks ensure an adequate level of due diligence to be able to identify, monitor and avoid reputational risk. The Bank therefore develops and consequently implements its internal policies and procedures in order to comply with the guidelines and requirements outlined in international and domestic regulatory documents:

1. Valid laws and legislative decrees of the Republic of Latvia.
2. Guidelines and recommended standards adopted by the Financial and Capital Market Commission and the Association of Latvian Commercial Banks.
3. Global Anti-Money Laundering/Counter-Financing of Terrorism (AML/CFT) policies and regulations
4. International best practices.

The Bank's AML/CFT and Know Your Customer (KYC) policies and procedures provide guidelines for:

1. Performing customer due diligence (CDD) through identification and verification processes.
2. On-going supervision and monitoring of customer's business activities.
3. Carrying out customer's business process analysis (BPA).
4. Identifying suspicious and unusual financial transactions; filing suspicious activity reports (SARs) to investigative, law enforcement and judicial authorities.
5. Retaining of the information concerning Bank's customers and their business and financial activity
6. Employee training sessions.

**Credit risk**

The Bank takes on exposures to credit risk, which is the risk that counterparty will cause a financial loss for the bank by failing to discharge a contractual obligation. Credit risk is the most significant risk for the Bank's business and therefore exposures to credit risk are subject to careful management.

*Sources of credit risk*

Credit risk of the Bank arises principally from the placements with credit institutions as well from lending activities and transactions in derivative financial instruments. There is also credit risk in off-balance sheet financial instruments such as letters of credit, guarantees and payment cards' overdraft commitments. There is a delivery risk in relation to foreign exchange transactions.

For the Bank as a payment bank, exposure to credit risk may interfere with liquidity management activities as the Bank should maintain sufficient funds on accounts with principal correspondents to provide necessary customers' payments, which sometimes causes significant concentrations with particular counterparties.

*Management and control of credit exposures*

The Bank manages, limits and controls concentrations of credit risk whenever they are identified, in particular, to individual counterparties and groups, and to industries and countries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one counterparty, or group of counterparties, and to geographical and industry segments. Such limits are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary.

Exposures to credit risk are managed through regular analysis of the ability of the existing and potential borrowers and counterparties to meet interest and principal repayment obligations and by changing lending limits where appropriate. The financial analysis, the analysis of external ratings and analysis of business environment of borrowers and counterparties is taken into consideration for such decision-making.

The Bank uses different credit risk management techniques for credit institutions and non-banks, but techniques are applied consistently to all financial instruments used, including both balance-sheet and off-balance sheet exposures with particular counterparty or group of related counterparties, as well as delivery risk in relation to foreign exchange transactions.

Limits on exposures to credit institutions are set by Resources Supervision Committee and approved by the Management Board. Limits on exposures to non-banks are considered by Credit Committee and approved by the Management Board or Supervisory Council according to the approval authorities.

Exposures to related groups of counterparties and counterparties related to the Bank are also subject to regulatory requirements.

According to regulations, any credit risk exposure to a non-related counterparty may not exceed 25% of the Bank's equity. Regulation states though that some exposures, such as due from credit institutions with maturity up to 1 year, are not considered to be credit risk exposures for regulatory requirements noted above.

According to regulations the total credit risk exposures to parties related to Bank shall not exceed 15% of the Bank's equity.

*Credit risk mitigation policies*

The Bank employs a range of credit risk mitigation techniques. The most traditional of these is taking security for funds disbursements, which is common practice. The bank implements guidelines on the criteria for specific classes of collateral taken.

The amount of collateral required may vary depending on the type of exposure but usually it is set at least to cover principal amount of the outstanding debt.

The Bank's exposures to credit institutions are usually unsecured.

*Quantitative disclosures*

Further quantitative disclosures in respect of credit risk are presented in Note 47.

**Liquidity risk**

Liquidity risk is the risk that the Bank will encounter difficulty in raising funds to meet its commitments. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions, including the Bank. It is unusual for financial institutions ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

*Liquidity risk management process*

The Bank maintains liquidity management with the objective of ensuring that funds will be available at all times to honor all cash flow obligations as they become due.

The Bank seeks to actively support a diversified and stable funding base comprising debt securities in issue, long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

The Bank's liquidity policy is reviewed and approved by the Management Board. The policy states that the Bank is obliged to hold sufficient liquid assets reserve to meet its financial commitments, however not less than 30% of the Bank's total current liabilities.

The Bank calculates the mandatory liquidity ratio on a daily basis in accordance with the requirements of the Financial and Capital Market Commission. The Bank was in compliance with the ratio during the twelve-month period ended 31 December 2008.

The Bank's liquidity ratio as at 31 December 2008 was 76.87%, compared to 69.5% as at 31 December 2007.

The liquidity management policy of the Bank requires:

- projecting cash flows by major currencies and considering the level of liquid assets necessary in relation thereto;
- maintaining a diverse range of funding sources;
- managing the concentration and profile of debts;
- maintaining debt financing plans;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any interruption to cash flow;
- maintaining liquidity and funding contingency plans;
- monitoring balance sheet liquidity ratios against regulatory requirements.

Monitoring and reporting take the form of cash flow measurement and projections for the next day and month respectively, as these are key periods for liquidity management. The starting point for these projections is an analysis of the contractual maturity of the financial liabilities and the expected collection data of the financial assets.

The Treasury Department receives information from business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. The Treasury Department then provides for an adequate portfolio of short-term liquid assets to be maintained, largely made up of short-term liquid trading securities, loans to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

Daily projections are based on assets and liabilities contractual maturities monitoring and analysis of information concerning customers' incoming and outgoing payments. Monthly projections are based on assets and liabilities term structure analysis.

The daily liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Treasury Department. Under the normal market conditions, liquidity reports covering the liquidity position of the Bank are presented to senior management on a weekly basis. Decisions on the Bank's liquidity management are made by the Treasury Committee and implemented by the Treasury Department.

*Quantitative disclosures*

Further quantitative disclosures in respect of liquidity risk are presented in Note 42.

**Currency (foreign exchange) risk**

Foreign exchange risk relates to the effects of fluctuations in the prevailing foreign currency exchange rates on the Bank's financial position and cash flows.

The Bank has assets and liabilities denominated in several foreign currencies. Foreign currency risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liabilities in that currency. For further information on the Bank's exposure to currency risk at year end refer to Notes 18, 19 and 43.

An analysis of sensitivity of the Bank's net income for the year and equity to changes in the foreign currency exchange rates based on positions existing as at 31 December 2008 and 2007 and a simplified scenario of a 10% drop in the value of the Latvian lats versus other currencies is shown in Note 43.

*Foreign exchange risk management process*

Currency risk management policy determines and regulates risk control and regulatory principles related to the currency exchange transactions that help the Bank in controlling its foreign currency open positions.

Limits on open foreign currency positions in a single currency and aggregate open foreign currency position are set for both overnight and intra-day positions, which are monitored daily.

The Credit Institution Law states that the open position in each separate currency must not exceed 10% of the Bank's equity and the aggregate open position in all foreign currencies must not exceed 20% of the Bank's equity.

*Quantitative disclosures*

Further quantitative disclosures in respect of foreign exchange risk are presented in Note 43.

**Interest rate risk**

Interest rate risk represents the risk that there may be changes in the future cash flows connected with financial instruments (cash flow interest rate risk) or fair value of financial instruments (fair value interest rate risk) resulting from changes in the interest rates on the market. The period when interest rate of the financial instruments is constant determines how it is exposed to the interest rate risk.

*Sources of interest rate risk*

Interest rate risk arises when the actual or forecasted assets of a given maturity period are either greater or less than the actual or forecasted liabilities in that maturity period.

The Bank is exposed to the cash flow interest rate risk which represents the effect of changes in the interest rates on the Bank's net interest margin and the amount of net interest income due to an inadequate term structure of interest rate sensitive assets and liabilities. The Bank is not exposed to interest rate risk of the fair value of financial instruments.

*Interest risk management process*

Interest rate risk management policy states the management principles, methodology and types of interest rate risk management.

*Quantitative disclosures*

An analysis of sensitivity of the net income for the year and equity as a result of changes in fair value of financial instruments at fair value though profit or loss and financial assets available-for-sale due to changes in the interest rates based on positions existing as at 31 December 2008 and 2007 and a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves is shown in Note 44.

**Capital management**

The bank's objectives when managing capital, which is a broader concept than the "equity" on the face of the balance sheet, are:

- To comply with the capital regulatory requirements.
- To safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders.
- To maintain the strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Community directives, as implemented by the Financial and Capital Market Commission. The required information is filed with the Financial and Capital Market Commission on a monthly basis.

The Credit Institution Law and regulations developed by the Financial and Capital Market Commission for the application of the norms of this law, require Latvian banks to maintain a capital adequacy ratio of 8%, i.e., the Bank's capital ratio against the risk weighted assets and memorandum items and the sum of notional risk weighted assets and memorandum items.  The sum of notional risk weighted assets and memorandum items is determined as the sum of capital requirements of market risks, multiplied by 12.5.

The guidelines of the Financial and Capital Market Commission for calculation of capital adequacy basically agree with the recommendations under the Basle Capital Accord and amendments thereto. According to the Basle Capital Accord, the capital adequacy ratio should be at least 8%.

*Quantitative disclosures*

Further quantitative disclosures in respect of capital management are presented in Note 41.

**Market risk**

The Bank focuses a lot of attention on the monitoring and analysis of market risk. The Bank has adopted its Trading Portfolio Policy designed to define the structure of the Bank's trading portfolio and to set out the maximum effective open position transacted with an individual issuer and the limits by the maturity profile of the securities. The Resources Supervision Committee is charged with the responsibility of implementing the Trading Portfolio Policy. The Internal Audit Department is charged with a continuing control function.

**Price risk**

Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or factors affecting all instruments traded in the market. Price risk arises when the Bank takes a long or short position in a financial instrument.

An analysis of sensitivity of the Bank's net income for the year and equity to changes in securities prices based on positions existing as at 31 December 2008 and 2007 and a simplified scenario of a 5% change in all securities prices is as follows:

| | 2008<br>Net income<br>LVL | 2007<br>Net income<br>LVL |
|---|---|---|
| 5% increase in securities prices | 18 657 | 278 097 |
| 5% decrease in securities prices | (18 657) | (278 097) |

**Operational risk**

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events - various types of human (staff members) or technical (software and hardware failures) errors, contingencies, fire and other factors of this sort. To prevent losses caused by operational risk, the Bank has adopted internal guidance documents, such as the internal by-law, fire safety regulations, technical system and facility safety regulations, information classification rules and other rules, regulations and directives. The Bank's Board has appointed a task force whose task is to ensure the implementation of the regulatory requirements set forth in the aforesaid internal guidance documents.

## 4. INTEREST INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Loans | 3 883 201 | 3 023 953 |
| *Loans* | *3 848 727* | *3 005 948* |
| *Payment cards* | *34 474* | *18 005* |
| Due from Bank of Latvia | 307 486 | 125 509 |
| Due from credit institutions | 2 138 285 | 1 862 585 |
| Securities held-to-maturity | 653 717 | 251 660 |
| Securities held-for-trading | 648 974 | 364 246 |
| | **7 631 663** | **5 627 953** |

## 5. INTEREST EXPENSE

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Liabilities at amortised cost | | |
| *Deposits* | *2 612 117* | *1 455 040* |
| *Due to credit institutions* | *78 291* | *192 427* |
| *Debt securities* | *39 630* | *54 667* |
| *Subordinated liabilities* | *697* | *502* |
| | **2 730 735** | **1 702 636** |

## 6. FEE AND COMMISSION INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Servicing of transactions | 2 342 787 | 2 308 946 |
| Forex transactions | 181 899 | 99 628 |
| Fees and commissions from banks | 131 729 | 108 454 |
| Payment cards | 117 206 | 125 416 |
| Trust operations | 65 705 | 65 370 |
| Securities accounts administration charges | 45 633 | 19 877 |
| Cash operations | 28 487 | 18 070 |
| Guarantees | 28 012 | 46 244 |
| Letters of credit | 11 615 | 7 465 |
| | **2 953 073** | **2 799 470** |

## 7. FEE AND COMMISSION EXPENSE

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Services of correspondent banks | 501 573 | 734 875 |
| Payment cards | 68 058 | 62 017 |
| Securities-based transactions | 36 957 | 24 951 |
| Services of agents and brokers | 18 349 | 66 795 |
| Other | 7 106 | 22 223 |
| | **632 043** | **910 861** |

## 8. NET TRADING (LOSS)/INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Gain on foreign exchange operations | 2 440 792 | 456 341 |
| (Loss)/ gain on revaluation of positions in foreign currency | (742 156) | 305 009 |
| | **1 698 636** | **761 350** |
| (Loss)/ gain on trading in financial instruments | (2 429 464) | 268 609 |
| Loss on revaluation of financial instruments | (446 315) | (235 595) |
| | **(2 875 779)** | **33 014** |
| | **(1 177 143)** | **794 364** |

## 9. OTHER OPERATING INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Penalty amounts received | 71 376 | - |
| Gain on sale of property and equipment and investment property | 12 045 | 173 252 |
| Other | 16 646 | 9 127 |
| | **100 067** | **182 379** |

## 10. ADMINISTRATIVE EXPENSES

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Staff salaries | 2 505 034 | 2 079 276 |
| Social insurance payments | 499 297 | 399 444 |
| Professional services | 494 257 | 462 303 |
| Representation expenses | 444 358 | 170 796 |
| Non-deductible input VAT | 276 035 | 365 307 |
| Lease, renovation and maintenance of property and equipment | 256 646 | 256 260 |
| Business trips | 243 380 | 131 264 |
| Communication | 215 317 | 204 487 |
| Stationary goods and household equipment | 134 481 | 67 323 |
| Taxes paid overseas | 95 086 | 26 456 |
| Motor vehicles | 62 368 | 61 955 |
| Payment cards-related expenses | 18 245 | 29 770 |
| Security | 8 007 | 7 271 |
| Real estate tax | 7 374 | 20 987 |
| Land-rent tax | 4 839 | 949 |
| Other | 232 084 | 196 982 |
| | **5 496 808** | **4 480 830** |

## 11. OTHER OPERATING EXPENSES

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Association membership fees | 75 310 | 78 274 |
| Advertising and publicity | 29 674 | 156 730 |
| Penalties paid | 166 | 1 089 |
| Loss from sale of property and equipment | - | 962 |
| Other | 8 362 | 5 608 |
| | **113 512** | **242 663** |

## 12. ANALYSIS OF CHANGES IN IMPAIRMENT LOSS ALLOWANCE FOR ASSETS AND OFF-BALANCE SHEET EXPOSURES

| | Allowances for securities held to maturity LVL | Allowances for loans LVL | Allowances for claims on the credit institutions LVL | Allowances for other assets LVL | Allowances for off-balance sheet exposures LVL | Total LVL |
|---|---|---|---|---|---|---|
| **Allowances as of 31 December 2006** | **-** | **1 212 665** | **105** | **34 555** | **37 200** | **1 284 525** |
| Amounts written-off | - | (1 880) | (100) | (34 759) | - | (36 739) |
| Increase in allowances | - | 208 672 | - | 14 986 | - | 223 658 |
| Release from allowances | - | (71 666) | - | - | (37 200) | (108 866) |
| Difference due to fluctuations in foreign exchange rates | - | (47 006) | (5) | 204 | - | (46 807) |
| **Allowances as of 31 December 2007** | **-** | **1 300 785** | **-** | **14 986** | **-** | **1 315 771** |
| Amounts written-off | - | (136 723) | - | (8 380) | - | (145 103) |
| Increase in allowances | 36 592 | 599 775 | - | 1 406 | - | 637 773 |
| Release from allowances | - | (45 557) | - | (1 433) | - | (46 990) |
| Sales of loans | | (1 008 307) | - | - | - | (1 008 307) |
| Difference due to fluctuations in foreign exchange rates | - | 32 724 | - | - | - | 32 724 |
| **Allowances as of 31 December 2008** | **36 592** | **742 697** | **-** | **6 579** | **-** | **785 868** |

## 13. CORPORATE INCOME TAX

**a) Income tax charge**

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Corporate income tax expense | 329 761 | 253 100 |
| Prior year tax adjustment for income tax paid abroad | (21 901) | (27 879) |
| Deferred income tax expense | 35 316 | 18 860 |
| | **343 176** | **244 081** |

The Bank's applicable tax rate for current and deferred tax is 15% (2007: 15%).

**b) Reconciliation between tax expense and accounting profit**

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Profit before income tax | 390 612 | 1 740 011 |
| Theoretically calculated tax at tax rate of 15% | 58 592 | 261 002 |
| Non-deductible costs/(non-taxable income) | 306 485 | 10 958 |
| Prior year tax adjustment for income tax paid abroad | (21 901) | (27 879) |
| **Income tax expense** | **343 176** | **244 081** |

**c) Deferred taxes**

These deductible temporary differences, which have no expiry dates, are listed below at their tax effected accumulated values:

| | Assets 31.12.2008 LVL | Assets 31.12.2007 LVL | Liabilities 31.12.2008 LVL | Liabilities 31.12.2007 LVL | Net 31.12.2008 LVL | Net 31.12.2007 LVL |
|---|---|---|---|---|---|---|
| Financial instruments at fair value through profit or loss | 113 459 | 6 799 | - | - | 113 459 | 6 799 |
| Property and equipment | - | - | (420 209) | (269 913) | (420 209) | (269 913) |
| Other assets | - | - | (152) | (129) | (152) | (129) |
| Other liabilities | 39 106 | 30 763 | - | - | 39 106 | 30 763 |
| **Recognised net deferred tax assets/(liabilities)** | **152 565** | **37 562** | **(420 361)** | **(270 042)** | **(267 796)** | **(232 480)** |

## 14. TAXES AND SOCIAL INSURANCE PAYMENTS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Social tax | 746 967 | 554 343 |
| Personnel income tax | 532 901 | 422 873 |
| Corporate tax withheld from non-residents | 53 972 | 18 154 |
| Real property tax | 7 368 | 25 873 |
| Enteprise risk duty | 608 | 534 |
| **Total taxes paid** | **1 341 816** | **1 021 777** |

## 15. CASH AND BALANCES WITH BANK OF LATVIA

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Cash | 860 206 | 886 375 |
| Balance with the Bank of Latvia | 7 793 511 | 7 536 493 |
| Accrued income on balance with Bank of Latvia | 5 247 | 2 920 |
| | **8 658 964** | **8 425 788** |

The Bank is required to ensure that the monthly average balance (in lats) with the Bank of Latvia exceeds the statutory reserve requirement ratio for commercial banks. As at the reporting date the Bank has complied with the reserve requirements of the Bank of Latvia.
The monthly average reserve requirement for period from 24 December 2008 to 24 January 2009 amounted to LVL 7 869 993 (2007: LVL 6 569 011).
The reserve requirement is compared to the Bank's average monthly correspondent account balance in LVL.

## 16. CASH AND CASH EQUIVALENTS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Cash | 860 206 | 886 375 |
| Balance with the Bank of Latvia | 7 793 511 | 7 536 493 |
| | **8 653 717** | **8 422 868** |
| Due from other credit institutions with up to 3 months remaining maturity | 88 361 359 | 48 839 792 |
| Due to other credit institutions with up to 3 months remaining maturity | (579 299) | (2 634 190) |
| | **96 435 777** | **54 628 470** |

## 17. DUE FROM CREDIT INSTITUTIONS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Repayable on demand | 45 159 037 | 43 514 183 |
| Other deposits | 44 192 939 | 6 440 314 |
| | **89 351 976** | **49 954 497** |

The table below shows the geographical concentration of claims on credit institutions:

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Due from credit institutions incorporated in the Republic of Latvia | 354 759 | 3 031 301 |
| Due from credit institutions incorporated in OECD countries | 79 573 472 | 41 820 006 |
| Due from credit institutions incorporated in other countries | 9 423 745 | 5 103 190 |
| | **89 351 976** | **49 954 497** |

**Concentration of placements with banks and other financial institutions**

As at 31 December 2008 and 2007, the Bank had one and two banks and financial institutions, respectively, whose balances exceeded 10% of total placements with banks and other financial institutions. The gross value of these balances as of 31 December 2008 and 2007 were LVL 71 752 151 and LVL 37 192 301, respectively.

## 18. SECURITIES-HELD-FOR TRADING

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Total debt securities | 33 177 | 4 280 772 |
| *Government treasury bills* | *-* | *110 175* |
| *Bonds of other issuers and other fixed-income securities* | *33 177* | *4 170 597* |
| Shares and other variable income securities | 339 964 | 1 281 162 |
| | **373 141** | **5 561 934** |

The table below shows the securities recorded by issuer profile:

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Debt securities of financial institutions | 23 202 | 3 143 763 |
| Debt securities of credit institutions | 9 975 | 811 203 |
| Debt securities of private enterprises | - | 215 631 |
| Debt securities of central governments | - | 110 175 |
| **Total debt securities** | **33 177** | **4 280 772** |
| | | |
| Shares of private enterprises | 250 622 | 938 579 |
| Shares of credit institutions | 86 359 | 310 011 |
| Shares of financial institutions | 2 983 | 32 572 |
| **Total shares** | **339 964** | **1 281 162** |
| | **373 141** | **5 561 934** |

The table below shows the geographical concentration of securities:

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Debt securities of EU countries | - | 2 901 516 |
| Debt securities of OECD countries | 33 177 | 1 251 627 |
| Debt securities of other countries | - | 127 629 |
| **Total debt securities** | **33 177** | **4 280 772** |
| | | |
| Shares of Republic of Latvia | 62 647 | 279 677 |
| Shares of other EU countries | - | 33 259 |
| Shares of OECD countries | 48 094 | 138 105 |
| Shares of other countries | 229 223 | 830 121 |
| **Total shares** | **339 964** | **1 281 162** |
| | **373 141** | **5 561 934** |

### Reclassification out of held-for-trading financial instruments

Pursuant to the amendments to IAS 39 and IFRS 7 (described in Note 2), the Bank reclassified certain trading assets to held-to-maturity financial instruments. The Bank identified financial assets eligible under the amendments, for which it had changed its intent such that it no longer held these financial assets for the purpose of selling in the short term. The Bank had the intention and ability to hold them for the foreseeable future or until maturity. For the trading assets identified for reclassification, the Bank determined that the deterioration of the financial markets during the third quarter of 2008 constituted rare circumstances that permit reclassification out of the trading category.

Under IAS 39 as amended, the assets were reclassified with effect from 1 July 2008 at fair value at that date. The table below sets out the financial assets reclassified and their carrying and fair values:

| | 01.07.2008 Carrying value LVL | 01.07.2008 Fair value LVL | 31.12.2008 Carrying value LVL | 31.12.2008 Fair value LVL |
|---|---|---|---|---|
| Trading financial instruments reclassified to held-to-maturity financial instruments | 6 755 009 | 6 755 009 | 6 073 642 | 5 513 709 |
| | **6 755 009** | **6 755 009** | **6 073 642** | **5 513 709** |

The fair value of the financial instruments reclassified to held-to-maturity financial instruments is measured at quoted market price as of the date of reclassification and as at 31 December 2008.

The table below sets out the amounts actually recognised in profit or loss during 2008 in respect of financial assets reclassified out of trading assets:

| | Profit LVL |
|---|---|
| **Period before reclassification** | |
| Gain from revaluation of trading financial instruments reclassified to held-to-maturity financial instruments | 1 253 478 |
| | **1 253 478** |

The table below sets out the amounts that would have been recognised in the period following reclassification during 2008 if the reclassifications had not been made:

| | Loss LVL |
|---|---|
| **Period after reclassification** | |
| Net loss on financial instruments reclassified to held-to-maturity financial instruments | (1 241 300) |
| | **(1 241 300)** |

As at 1 July 2008, the effective interest rates on trading assets reclassified to held-to-maturity investments ranged from 6.2 percent to 9.2 percent.

### Reclassification out of held-to-maturity financial instruments

The Bank has sold certain held-to-maturity assets.

The Bank identified held-to-maturity assets whose deterioration was attributable to an isolated event that is beyond the Bank's control, is non-recurring and could not have been reasonably anticipated by the Bank. The deterioration of the world's financial markets that has occurred during the third quarter of 2008 year is a example of isolated event cited in IFRS amendments. The Bank has determined that this deterioration evokes the necessity to reclassify held-to-maturity financial instruments to securities held for trading and sell them.

During the period from 16 April 2008 to 29 October 2008 the above mentioned held-to-maturity financial instruments have been reclassified to held-for-trading financial instruments and subsequently sold at fair value at that date. The table below sets out the held-to-maturity financial instruments reclassified and sold and their carrying and fair values at the respective sales dates.

| | Carrying value at sales date LVL | Fair value at sales date LVL |
|---|---|---|
| Reclassified and sold held-to-maturity financial instruments | 3 413 500 | 2 902 417 |
| | **3 413 500** | **2 902 417** |

The fair value of the financial instruments at sales date are measured at sales price.

The table below sets out the revaluation result recognised in net expense during 2008 in respect of reclassified and sold held-to-maturity financial instruments.

| | Loss LVL |
|---|---|
| Loss on revaluation of held-to-maturity financial instruments reclassified to held-for-trading category | (511 083) |
| | **(511 083)** |

## 19. DERIVATIVE CONTRACTS

The table below summarises the contractual amounts of the Bank's forward exchange contracts outstanding at 31 December 2008. The foreign currency amounts presented below are translated at rates ruling at the balance sheet date. The resultant unrealised gains and losses on these unmatured contracts, along with the amounts payable and receivable on the matured but unsettled contracts, have been recognised in the income statement and in financial instruments at fair value through profit or loss, as appropriate.

| | 31.12.2008 Assets LVL | 31.12.2008 Liabilities LVL | 31.12.2007 Assets LVL | 31.12.2007 Liabilities LVL |
|---|---|---|---|---|
| **Notional amount** | | | | |
| Foreign currency exchange SWAP transactions | 83 120 051 | 82 646 906 | 161 066 322 | 161 072 420 |
| | **83 120 051** | **82 646 906** | **161 066 322** | **161 072 420** |
| **Fair value** | | | | |
| Foreign currency exchange SWAP transactions | 792 109 | 321 684 | 739 462 | 740 557 |
| | **792 109** | **321 684** | **739 462** | **740 557** |

The table below shows the geographical concentration of foreign currency exchange SWAP transactions:

| | 31.12.2008 Assets LVL | 31.12.2008 Liabilities LVL | 31.12.2007 Assets LVL | 31.12.2007 Liabilities LVL |
|---|---|---|---|---|
| Foreign currency exchange SWAP transactions with Latvian banks | 49 758 251 | 49 742 028 | 65 080 921 | 64 588 630 |
| Foreign currency exchange SWAP transactions with other countries banks | 12 799 570 | 12 836 950 | - | - |
| Foreign currency exchange SWAP transactions with other customers | 20 562 230 | 20 067 928 | 95 985 401 | 96 483 790 |
| | **83 120 051** | **82 646 906** | **161 066 322** | **161 072 420** |

The table below summarises, by major currency, the contracted average exchange rates applied to the Bank's forward exchange contracts unsettled at 31 December 2008:

| EUR/LVL | EUR/GBP | EUR/USD | USD/LVL | USD/CHF | USD/CAD | USD/NOK | USD/BYR | RUR/USD |
|---|---|---|---|---|---|---|---|---|
| 0,7083 | 0,9737 | 1,4086 | 0,5017 | 1,0543 | 1,2157 | 5,2300 | 2 449,9900 | 29,3500 |

## 20. SECURITIES AVAILABLE-FOR-SALE

| Company | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| JSC "Capital" | 127 111 | 127 111 |
| S.W.I.F.T. SCRL | 42 520 | 42 520 |
| LLC "BIB REAL ESTATE" | 4 000 | 4 000 |
| | **173 631** | **173 631** |

## 21. SECURITIES HELD-TO-MATURITY

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Bonds of other issuers and other fixed-income securities | 11 869 417 | 4 332 116 |
| | **11 869 417** | **4 332 116** |
| Allowances (Note 12) | (36 592) | - |
| | **11 832 825** | **4 332 116** |

The following table shows the distribution of securities held-to-maturity by issuer profile:

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Debt securities of credit institutions | 7 136 885 | 3 242 967 |
| Debt securities of private enterprises | 3 147 005 | 600 686 |
| Debt securities of financial institutions | 1 585 527 | 488 463 |
| | **11 869 417** | **4 332 116** |
| Allowances (Note 12) | (36 592) | - |
| | **11 832 825** | **4 332 116** |

## 22. LOANS

| **(a) Loans by type** | **31.12.2008 LVL** | **31.12.2007 LVL** |
|---|---|---|
| Mortgage loans | 19 365 025 | 16 895 462 |
| Commercial loans | 13 838 160 | 11 494 775 |
| Industrial loans | 4 432 843 | 2 337 589 |
| Overdrafts | 1 425 544 | 1 609 713 |
| Reverse repos | 808 066 | 809 466 |
| Consumer loans | 759 086 | 1 477 425 |
| Financial intermediation | 383 446 | - |
| Trade finance | 328 356 | - |
| Payment cards | 107 320 | 69 911 |
| Finance leasing | 4 892 | 4 892 |
| Other | 270 023 | 1 159 903 |
| | **41 722 761** | **35 859 136** |
| Allowances (Note 12) | (742 697) | (1 300 785) |
| | **40 980 064** | **34 558 351** |

| **(b) Loans by customer profile** | **31.12.2008 LVL** | **31.12.2007 LVL** |
|---|---|---|
| Loans to corporates | 35 161 049 | 28 647 338 |
| Loans to individuals | 4 413 937 | 4 980 600 |
| Loans to senior management and staff members | 1 141 729 | 917 581 |
| Loans to financial institutions | 1 006 046 | 1 313 617 |
| | **41 722 761** | **35 859 136** |
| Allowances (Note 12) | (742 697) | (1 300 785) |
| | **40 980 064** | **34 558 351** |

| **(c) Industry analysis of the loan portfolio** | **31.12.2008 LVL** | **31.12.2007 LVL** |
|---|---|---|
| Real estate | 15 121 717 | 7 906 951 |
| Trade | 11 066 468 | - |
| Manufacturing | 3 718 602 | 2 515 549 |
| Finance | 2 573 912 | 1 745 782 |
| Information and communication services | 2 538 217 | 71 231 |
| Mining/metallurgy | 141 865 | 1 100 226 |
| Agriculture, forestry and timber | 1 124 | 30 198 |
| Other | 1 005 190 | 16 591 018 |
| Loans to individuals | 5 555 666 | 5 898 181 |
| | **41 722 761** | **35 859 136** |
| Allowances (Note 12) | (742 697) | (1 300 785) |
| | **40 980 064** | **34 558 351** |

| (d) Loans by terms of maturity | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Up to 1 month (inclusive) | 3 120 262 | 3 557 701 |
| 1 to 3 months | 1 068 | 95 612 |
| 3 to 6 months | - | 26 353 |
| 6 to 12 months | 1 347 294 | 2 438 921 |
| 1 to 5 years | 30 622 190 | 25 550 458 |
| More than 5 years | 6 631 947 | 4 190 091 |
| | **41 722 761** | **35 859 136** |
| Allowances (Note 12) | (742 697) | (1 300 785) |
| | **40 980 064** | **34 558 351** |

In the table above loans are grouped by their contractual maturities as at agreement date. For the summary of loans by their remaining earliest possible contractual maturities at the reporting date, refer to Note 43.

**(e) Breakdown of delinquent loans by groups of delayed payments and non-delinquent loans**

The following table provides information on the credit quality of the loan portfolio:

| | Loans 31.12.2008 LVL | Allowances (Note 12) 31.12.2008 LVL | Net loans 31.12.2008 LVL | Collateral 31.12.2008 LVL |
|---|---|---|---|---|
| Non-delinquent loans | 30 282 822 | (155 915) | 30 126 907 | 71 719 967 |
| Up to 1 month (inclusive) | 4 666 551 | - | 4 666 551 | 5 383 131 |
| 1 to 3 months | 2 305 214 | - | 2 305 214 | 2 926 352 |
| 3 to 6 months | 642 569 | (58 316) | 584 253 | 1 663 315 |
| 6 to 12 months | 3 075 454 | (362 606) | 2 712 848 | 4 896 434 |
| More than 12 months | 750 151 | (165 860) | 584 291 | 742 655 |
| | **41 722 761** | **(742 697)** | **40 980 064** | **87 331 854** |

| | Loans 31.12.2007 LVL | Allowances (Note 12) 31.12.2007 LVL | Net loans 31.12.2007 LVL | Collateral 31.12.2007 LVL |
|---|---|---|---|---|
| Non-delinquent loans | 34 060 330 | (529 832) | 33 530 498 | 57 582 478 |
| Up to 1 month (inclusive) | 581 389 | (20 433) | 560 956 | 918 149 |
| 1 to 3 months | 139 338 | (7 906) | 131 432 | 214 776 |
| 3 to 6 months | 234 764 | (4 335) | 230 429 | 324 062 |
| 6 to 12 months | 72 090 | (12 439) | 59 651 | 53 669 |
| More than 12 months | 771 225 | (725 840) | 45 385 | 1 546 240 |
| | **35 859 136** | **(1 300 785)** | **34 558 351** | **60 639 374** |

The Bank has estimated loan impairment for commercial loans based on an analysis of the future cash flows for impaired loans and based on its past loss experience for portfolios of loans for which no indications of impairment has been identified.

Movements in the loan impairment allowance for the year ended 31 December 2008 and 2007 are disclosed in Note 12.

**(f) Restructured loans**

2 loans were restructured in 2008 (2007: 0). Carrying amount for such loans was LVL 550 820 (2007: 0).

**(g) Analysis of collateral**

The following table provides the analysis of the loan portfolio by collateral types as at 31 December 2008:

| | Net loans 31.12.2008 LVL | % of loan portfolio 31.12.2008 LVL | Net loans 31.12.2007 LVL | % of loan portfolio 31.12.2007 LVL |
|---|---|---|---|---|
| Real estate | 29 973 696 | 73,15% | 17 743 200 | 51,35% |
| Commercial pledge | 5 385 038 | 13,14% | 5 071 050 | 14,67% |
| Deposits | 1 610 382 | 3,93% | 1 195 483 | 3,46% |
| Traded securities | 808 066 | 1,97% | 853 462 | 2,47% |
| Motor vehicles | 772 012 | 1,88% | 1 602 529 | 4,64% |
| Other collateral | 104 043 | 0,25% | 5 053 463 | 14,62% |
| No collateral | 2 326 827 | 5,68% | 3 039 164 | 8,79% |
| | **40 980 064** | **100%** | **34 558 351** | **100%** |

The amounts shown in the table above represent the carrying value of the loans, and do not necessarily represent the fair value of the collateral.
Mortgage loans are secured by underlying housing real estate. Auto loans are secured by underlying vehicle. Credit card overdrafts are secured by deposits and guarantees. Consumer loans are secured by other types of collateral.
The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees.
During the year ended 31 December 2008 the Bank did not obtain any assets by taking control of collateral accepted as security for commercial loans (31 December 2007: nil).

**(h) Significant credit exposures**

As at 31 December 2008 and 2007 the Bank had no borrowers or Banks acting as borrowers or the Bank-related parties whose outstanding loan balances exceeded 10% of loans to customers.
According to regulatory requirements, the Bank is not allowed to have a credit exposure to one client or a group of related clients of more than 25% of its equity. As at 31 December 2008 the Bank was in compliance with this requirement.

## 23. INTANGIBLE ASSETS

| Acquisition cost | Software LVL |
|---|---|
| **As of 31 December 2006** | **345 067** |
| Additions | 600 149 |
| Disposals | (80 940) |
| **As of 31 December 2007** | **864 276** |
| Additions | 613 478 |
| Disposals | (83 111) |
| Reclassification to other assets | (180 269) |
| **As of 31 December 2008** | **1 214 374** |

| Amortisation | Software LVL |
|---|---|
| **As of 31 December 2006** | **(134 462)** |
| Amortisation | (45 513) |
| Disposals | 80 940 |
| **As of 31 December 2007** | **(99 035)** |
| Amortisation | (42 598) |
| Disposals | 83 111 |
| **As of 31 December 2008** | **(58 522)** |

| Net book value | Software LVL |
|---|---|
| **As of 31 December 2006** | **210 605** |
| **As of 31 December 2007** | **765 241** |
| **As of 31 December 2008** | **1 155 852** |

## 24. PROPERTY AND EQUIPMENT

| | Buildings and land (in own use) LVL | Leasehold improvements LVL | Motor vehicles LVL | Office equipment LVL | Construction in progress LVL | Total LVL |
|---|---|---|---|---|---|---|
| Acquisition cost | | | | | | |
| **As of 31 December 2006** | **2 435 508** | **482 134** | **256 982** | **934 747** | **694 849** | **4 804 220** |
| Additions | - | - | - | 966 995 | 2 863 439 | **3 830 434** |
| Disposals | - | - | (89 661) | (88 646) | - | **(178 307)** |
| Reclassification (Note 25) | 130 000 | - | - | - | - | **130 000** |
| **As of 31 December 2007** | **2 565 508** | **482 134** | **167 321** | **1 813 096** | **3 558 288** | **8 586 347** |
| Additions | 1 541 751 | - | 67 674 | 603 885 | 1 257 756 | **3 471 066** |
| Disposals | - | (256 249) | (41 512) | (271 305) | - | **(569 066)** |
| Reclassification to other assets | - | - | - | - | (3 123) | **(3 123)** |
| Reclassification | 4 905 240 | (225 885) | 46 163 | 33 781 | (4 759 299) | - |
| **As of 31 December 2008** | **9 012 499** | - | **239 646** | **2 179 457** | **53 622** | **11 485 224** |
| Depreciation | | | | | | |
| **As of 31 December 2006** | **(34 628)** | - | **(118 349)** | **(486 918)** | - | **(639 895)** |
| Depreciation | (40 891) | (241 067) | (45 043) | (146 965) | - | **(473 966)** |
| Disposals | - | - | 75 155 | 88 517 | - | **163 672** |
| **As of 31 December 2007** | **(75 519)** | **(241 067)** | **(88 237)** | **(545 366)** | - | **(950 189)** |
| Depreciation | (64 642) | (15 182) | (45 172) | (250 417) | - | **(375 413)** |
| Disposals | - | 256 249 | 38 083 | 268 954 | - | **563 286** |
| **As of 31 December 2008** | **(140 161)** | - | **(95 326)** | **(526 829)** | - | **(762 316)** |
| Net book value | | | | | | |
| **As of 31 December 2006** | **2 400 880** | **482 134** | **138 633** | **447 829** | **694 849** | **4 164 325** |
| **As of 31 December 2007** | **2 489 989** | **241 067** | **79 084** | **1 267 730** | **3 558 288** | **7 636 158** |
| **As of 31 December 2008** | **8 872 338** | - | **144 320** | **1 652 628** | **53 622** | **10 722 908** |

## 25. INVESTMENT PROPERTY

During 2008, Bank has sold real property objects in Riga: buildings and plots of land at Ieriķu iela 15 for the amount totalling LVL 110 271. The sale profit totalled LVL 9 429.

| | LVL |
|---|---|
| **As of 31 December 2006** | **2 005 304** |
| Revaluation | 298 398 |
| Sale | (599 764) |
| Reclassification* | (130 000) |
| **As of 31 December 2007** | **1 573 938** |
| Additions | 2 507 |
| Revaluation | (148 646) |
| Sale | (110 271) |
| **As of 31 December 2008** | **1 317 528** |

* The reclassification represents the effect of a decision by management to use certain assets (the bank-owned five-storey office building in Rīga, Grēcinieku iela 6 and residential apartment in Rīga, Kalēju iela 45-47, 1) previously recognised as investment property, for the Bank's own use, and have therefore been transferred to property and equipment.

## 26. INVESTMENTS IN ASSOCIATES

| | Ownership % | Country of incorporation | Purpose | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|---|---|---|
| LLC "Komunikācijas un projekti" | 25 | Latvia | Investments | 429 009 | 429 009 |
| | | | | **429 009** | **429 009** |

As at 31 December 2008 SIA "Komunikacijas un projekti" assets amounted to LVL 22 719, liabilities amounted to LVL 17 351, and losses for 2007 comprised LVL 4 650.
Investment is recognized based on cost method as the Bank believes there is no readily available active market to detemine the fair value. Discounted cash flows analysis shows that the investment in "Komunikācijas un Projekti" is not impaired.

## 27. DEFERRED EXPENSES AND ACCRUED INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Deferred expenses | 744 678 | 662 562 |
| Other accrued interest and other income | 155 729 | 54 356 |
| | **900 407** | **716 918** |

## 28. OTHER ASSETS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Unsettled spot forex transactions | 340 227 | 1 102 371 |
| VAT pre-payments | 149 034 | 81 244 |
| Other accounts receivable | 89 701 | 187 116 |
| Money in transit (replenishment of a correspondent account) | 25 043 | 5 953 |
| Other overpaid taxes | 13 313 | 75 865 |
| Pre-tax payment | 11 043 | - |
| Funds placed in guarantee funds | 9 654 | 15 743 |
| Precious metals | 3 996 | 3 839 |
| Others | - | 50 120 |
| Allowances (Note 12) | (6 579) | (14 986) |
| | **635 432** | **1 507 265** |

## 29. DUE TO CREDIT INSTITUTIONS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Repayable on demand | 579 307 | 150 217 |
| Term balances | 9 984 | 2 986 043 |
| | 589 291 | 3 136 260 |

The table below shows geographical concentration:

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Credit institutions incorporated in the Republic of Latvia | 3 352 | 2 596 416 |
| Credit institutions incorporated in OECD countries | - | 391 935 |
| Credit institutions incorporated in non-OECD countries | 585 939 | 147 909 |
| | **589 291** | **3 136 260** |

## 30. DEPOSITS

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| **Repayable at call** | | |
| Corporates | 87 557 076 | 56 360 275 |
| Individuals | 4 144 480 | 2 882 773 |
| Financial institutions | 604 996 | 579 653 |
| State-owned companies | 49 166 | 134 571 |
| Public organisations | 871 | 1 044 |
| | **92 356 589** | **59 958 316** |
| **Term deposits** | | |
| Corporates | 53 485 573 | 26 774 462 |
| Individuals | 5 218 513 | 9 731 268 |
| Financial institutions | 112 549 | 461 332 |
| | **58 816 635** | **36 967 062** |
| **Total deposits** | **151 173 224** | **96 925 378** |

### Blocked accounts

As of 31 December 2008, the Bank maintained customer deposit balances of LVL 1 740 757 (2007: LVL 1 458 351) which were blocked by the Bank as collateral for loans and off-balance sheet credit instruments granted by the Bank.

### Concentrations of current accounts and customer deposits

As of 31 December 2008, the Bank had one client whose account balance exceeded 10% of the total of all customer account balances. As of 31 December 2008, these balances totalled LVL 52 128 792. As of 31 December 2007, the Bank had no clients whose account balance exceeded 10% of the total of all customer account balances.

### 31. DEBT SECURITIES IN ISSUE

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Bills of exchange | 842 774 | 803 171 |
| Certificates of deposit | 1 027 | - |
| | **843 801** | **803 171** |

In 2008, an average annual interest rate of 5.00% was applied to the debt securities in issue (2007: 5.55%).

| Notional amount | Coupon Rate | Maturity Date | Book value, LVL |
|---|---|---|---|
| 1 127 000 EUR | 5% | 20.09.2009 | 842 774 |
| 1 000 LVL | 6,5% | 01.08.2009 | 1 027 |

### 32. ACCRUED EXPENSES, PROVISIONS AND DEFERRED INCOME

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Provision for unused vacation | 260 707 | 205 088 |
| Other accrued expense | 202 573 | 293 496 |
| Accrued interest payable to the Deposit Guarantee Scheme (DGS) | 80 526 | 38 883 |
| Deferred income | 54 057 | 72 264 |
| | **597 863** | **609 731** |

### 33. OTHER LIABILITIES

| | 31.12.2008 LVL | 31.12.2007 LVL |
|---|---|---|
| Money in transit | 637 058 | 707 983 |
| Unsettled spot forex transactions | 461 981 | 837 467 |
| Other accounts payable | 96 915 | 324 095 |
| | **1 195 954** | **1 869 545** |

## 34. SUBORDINATED LIABILITIES

Subordinated deposits have a fixed term of seven years at their origination, and are repayable before maturity only on after winding up or bankruptcy of the Bank and rank before shareholders claims.

| Depositor | Currency | Amount in currency | Interest rate | Repayment date | Amount in LVL, 2008 | Amount in LVL, 2007 |
|---|---|---|---|---|---|---|
| Belokon Holdings | EUR | 18 995 | 8,00% | 20.10.2015 | 13 350 | 12 100 |
| Valeri Belokon | LVL | 11 220 | 7,00% | 26.02.2009 | 11 220 | 10 719 |
| **Total** | | | | | **24 570** | **22 819** |

## 35. SHAREHOLDERS' EQUITY

The total authorised and paid-in share capital remained unchanged from 2007, and at the end of 2008 was represented by 1 522 257 (One million five hundred twenty two thousand two hundred fifty seven) ordinary voting shares.

These are registered shares. Each share carries the right to one vote at the meetings of shareholders, a right to receive dividends as declared from time to time and a right to residual assets. Each share has a par value of LVL 5 (five lats). The total par value of the shares equals LVL 7 611 thousand. Of the Bank's 98 shareholders, 28 are legal entities and 70 are individuals.

Reserve capital totalling LVL 545 thousand is formed from the contributions made by the Bank's shareholders. The bank's General Meeting of Shareholders makes the decision concerning further usage of reserve capital. Reserve capital can be used to:

– cover losses;
– increase the share capital;
– pay dividends.

Listed below are the shareholders who control more than 10 percent of the shares in the shareholders' equity:

| | 31.12.2008 | 31.12.2007 |
|---|---|---|
| Valeri Belokon | 42,67% | 40,87% |
| Viacheslav Kramnoy | 27,97% | 27,97% |
| Vilori Belokon | 12,25% | 12,17% |

### 36. OFF-BALANCE SHEET ITEMS

Sureties and guarantees, which represent irrevocable assurances and promise that the Bank will make payments to the beneficiary (third party) in the event that the obligor (customer) fails to honor his/her obligations to third parties, carry the same credit risk as loans.

Commitments to extend credit and liabilities for credit cards represent unused portions of authorisations to extend credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments.

| | 31.12.2008<br>LVL | 31.12.2007<br>LVL |
|---|---|---|
| **Sureties and guarantees** | **1 117 613** | **587 389** |
| **Commitments to customers** | **4 932 184** | **4 334 703** |
| Commitments to extend credit | 4 523 776 | 3 969 455 |
| Unused creditcard limits | 408 408 | 348 218 |
| Other | - | 17 030 |
| | **6 049 797** | **4 922 092** |

### 37. TRUST AGREEMENTS

The Bank enters into trust agreements with private individuals and legal entities, residents and non-residents of the Republic of Latvia. The Bank accepts no risk for its trust operations; all risk is retained by its clients. As of 31 December 2008, the Bank's administered assets totaled LVL 55 807 525. As of 31 December 2007, the Bank's administered assets stood at LVL 31 332 156.

### 38. LITIGATION

Two claims were lodged against the Bank as at 31 December 2008 (no claims as at 31 December 2007). Based on professional advice, the Bank's management considered it unlikely that a loss could eventuate. No claims loss provision was made.

### 39. INFORMATION ON BANK'S STAFF AND REMUNERATION OF THE MANAGEMENT

In 2008, the Bank's average staff count increased to 206 (2007: 179). Remuneration to the Bank's Council and Board members amounted to:

| | 31.12.2008<br>LVL | 31.12.2007<br>LVL |
|---|---|---|
| Council members | 138 451 | 102 923 |
| Board members | 328 273 | 304 151 |
| | **466 724** | **407 074** |

## 40. RELATED PARTY TRANSACTIONS

Related parties are defined as shareholders who have significant influence over the Bank, companies in which they have a controlling interest, members of the Council and Board of Directors, key management personnel, their close relatives and companies in which they have a controlling interest, as well as associated companies.

The outstanding balances and the related average interest rates as of 31 December 2008 and related income statement amounts of transactions for the year ended 31 December 2008 with other related parties are as follows:

| Assets | Average interest rate | Amount LVL | Off-balance sheet items LVL | Total 31.12.2008 LVL | Total 31.12.2007 LVL |
|---|---|---|---|---|---|
| Loans, net | - | 1 652 120 | 32 510 | **1 684 630** | **949 788** |
| *Bank-related undertakings and individuals* | *5,52%* | *1 332 488* | *4 781* | ***1 337 269*** | ***627 693*** |
| *Council and Board* | *5,57%* | *446 192* | *24 892* | ***471 084*** | ***359 600*** |
| *Other senior executives* | *10,00%* | *356* | *2 837* | ***3 193*** | ***570*** |
| *Allowances for losses on loans and advances* | - | *(126 916)* | - | ***(126 916)*** | ***(38 075)*** |
| Securities available-for-sale | - | 4 000 | - | **4 000** | **4 035** |
| Investments in associates | - | 429 009 | - | **429 009** | **429 009** |
| Other assets | - | 37 474 | - | **37 474** | **161 132** |
| **Total assets and off-balance sheet liabilities** | - | 2 122 603 | 32 510 | **2 155 113** | **1 543 964** |
| **Liabilities** | | | | | |
| Deposits deposited by related parties | 2,49% | 1 968 155 | - | **1 968 155** | **1 823 513** |
| Due to credit institutions | 1,00% | 283 187 | - | **283 187** | **22 819** |
| Subordinated liabilities | 7,65% | 24 570 | - | **24 570** | - |
| **Total liabilities** | - | **2 275 912** | - | **2 275 912** | **1 846 332** |
| **Income** | | | | | |
| Interest income | | | | 95 679 | 95 139 |
| Interest expense | | | | (81 504) | (68 704) |
| **Result income** | | | | **14 175** | **26 435** |

All related party transactions are at arm's length.

## 41. CAPITAL ADEQUACY CALCULATION

The Finance and Capital Market Commission sets forth capital requirements for the Bank as a whole and supervises the adherence to the requirements.

The Bank's capital adequacy ratio reflects the capital level required for hedging against credit risk and market risk which the Bank's assets and off-balance sheet liabilities are exposed to. Therefore, to comply with the Financial and Capital Market Commission's regulatory requirements, the capital adequacy ratio may not be less than 8 percent.

The Bank also monitors its capital adequacy levels calculated in accordance with the requirements of the New Basel Capital Accord, commonly known as Basel II.

The following table shows the composition of the Bank's capital position calculated in accordance with the requirements of the Basle Accord, as at 31 December 2008:

| | LVL |
|---|---|
| **Total equity capital** | **10 619 545** |
| Paid-in share capital | 7 611 285 |
| Reserve capital and other reserves | 545 024 |
| Retained earnings | 4 073 217 |
| Profit for the current year | 47 436 |
| Intangible assets | (1 155 852) |
| Less revaluation of investment property | (514 915) |
| **Tier 1 Core Capital** | **10 606 195** |
| Subordinated liabilities | 13 350 |
| **Tier 2 Supplementary Capital** | **13 350** |
| **Total capital charge** | **8 149 873** |
| Total capital charge for credit risk, counterparty credit risk, dilution risk and risk of unsettled deliveries | 7 125 844 |
| Total capital charge for position, foreign exchange and commodity risks | 104 779 |
| Capital charge for operational risk | 919 250 |
| **CAPITAL ADEQUACY RATIO** | |
| **as of 31 December 2008** | **10,42%** |
| CAPITAL ADEQUACY RATIO | |
| **as of 31 December 2007** | **15,47%** |

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

The Bank is subject to minimum capital adequacy requirements calculated in accordance with the Basle Accord established by covenants under liabilities incurred by the Bank. The Bank has complied with all externally imposed capital requirements during the years ended 31 December 2008 and 31 December 2007.

## 42. MATURITIES OF ASSETS AND LIABILITIES

The following tables show the discounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The total gross amount (inflow)/ outflow disclosed in the table is the contractual, discounted cash flow on the financial liability or commitment. The Bank's expected cash flows on these financial liabilities and unrecognised loan commitments vary significantly from this analysis.

**As of 31 December 2008**

| ASSETS | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **1 to 5 years** | **5 years and more** | **Overdue** | **No maturity date** | **Pledged** | **TOTAL** |
| Cash and balances with bank of Latvia | 8 653 717 | 5 247 | - | - | - | - | - | - | - | - | **8 658 964** |
| Due from credit institutions | 45 148 720 | 42 156 611 | 1 092 145 | 563 936 | - | 390 564 | - | - | - | - | **89 351 976** |
| Financial assets held-for-trading | 310 494 | 296 741 | 492 610 | - | - | 2 758 | 62 647 | - | - | - | **1 165 250** |
| *Securities held-for-trading* | *310 494* | - | - | - | - | - | *62 647* | - | - | - | ***373 141*** |
| *Derivative financial instruments* | - | *296 741* | 492 610 | - | - | 2 758 | - | - | - | - | ***792 109*** |
| Securities available-for-sale | - | - | - | - | - | - | 173 631 | - | - | - | **173 631** |
| Securities held-to-maturity | 1 043 | 1 035 926 | 677 956 | 2 448 523 | 3 807 034 | 3 810 998 | 51 345 | - | - | - | **11 832 825** |
| Loans | 2 875 541 | 2 743 329 | 2 231 917 | 1 149 717 | 12 712 694 | 15 280 678 | 2 593 435 | 1 392 753 | - | - | **40 980 064** |
| Intangible assets | - | - | - | - | - | - | 1 155 852 | - | - | - | **1 155 852** |
| Property and equipment | - | - | - | - | - | - | - | - | 10 722 908 | - | **10 722 908** |
| Investment property | - | - | - | - | - | - | - | - | 1 317 528 | - | **1 317 528** |
| Investments in associates | - | - | - | - | - | - | - | - | 429 009 | - | **429 009** |
| Deferred expenses and accrued income | 15 013 | 148 858 | 35 923 | 13 193 | 134 148 | 553 257 | 15 | - | - | - | **900 407** |
| Other assets | - | 328 494 | - | - | - | - | - | - | 306 938 | - | **635 432** |
| **Total assets** | **57 004 528** | **46 715 206** | **4 530 551** | **4 175 369** | **16 653 876** | **20 038 255** | **4 036 925** | **1 392 753** | **12 776 383** | **-** | **167 323 846** |

*(Continued on nex page)*

*(Concluded. Started on page 80)*

**As of 31 December 2008**

| LIABILITIES | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 to 6 months** | **6 to 12 months** | **1 to 5 years** | **5 years and more** | **Overdue** | **No maturity date** | **Pledged** | **TOTAL** |
| Due to credit institutions | 579 307 | - | - | - | 9 984 | - | - | - | - | - | **589 291** |
| Deposits | 92 630 927 | 26 200 394 | 17 779 096 | 8 954 604 | 4 822 229 | 785 974 | - | - | - | - | **151 173 224** |
| Debt securities in issue | - | - | - | - | 843 801 | - | - | - | - | - | **843 801** |
| Derivative financial instruments | - | 321 684 | - | - | - | - | - | - | - | - | **321 684** |
| Accrued expenses, provisions and deferred income | 339 704 | 5 438 | 80 788 | 122 914 | 13 253 | 34 733 | 1 033 | - | - | - | **597 863** |
| Corporate income tax liabilities | - | - | - | 32 701 | - | - | - | - | - | - | **32 701** |
| Deferred tax liabilities | 267 796 | - | - | - | - | - | - | - | - | - | **267 796** |
| Other liabilities | 1 195 954 | - | - | - | - | - | - | - | - | - | **1 195 954** |
| Subordinated liabilities | - | - | 11 220 | - | - | - | 13 350 | - | - | - | **24 570** |
| Shareholders' equity | - | - | - | - | - | - | - | - | 12 276 962 | - | **12 276 962** |
| **Total liabilities** | **95 013 688** | **26 527 516** | **17 871 104** | **9 110 219** | **5 689 267** | **820 707** | **14 383** | **-** | **12 276 962** | **-** | **167 323 846** |
| Off-balance sheet liabilities* | 4 968 169 | - | - | - | - | - | - | - | - | - | 4 968 169 |
| **Maturity gap** | (42 977 329) | 20 187 690 | (13 340 553) | (4 934 850) | 10 964 609 | 19 217 548 | 4 022 542 | x | x | x | x |

**As of 31 December 2007**

| | Demand | Less than 1 month | 1 to 3 months | 3 to 6 months | 6 to 12 months | 1 to 5 years | 5 years and more | Overdue | No maturity date | Pledged | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Assets | 62 512 052 | 8 427 915 | 3 298 111 | 3 901 141 | 10 299 352 | 14 991 247 | 3 218 093 | 256 548 | 9 210 096 | 454 912 | **116 569 467** |
| Liabilities | 62 603 401 | 29 739 934 | 5 047 582 | 1 673 787 | 4 010 893 | 879 249 | 12 230 648 | - | - | 383 973 | **116 569 467** |
| Off-balance sheet liabilities* | 4 353 658 | - | 17 030 | - | - | - | - | - | - | - | **4 370 688** |
| **Maturity gap** | (4 445 007) | (21 312 019) | (1 766 501) | 2 227 354 | 6 288 459 | 14 111 998 | (9 012 555) | 256 548 | x | x | **x** |

*Off- balance sheet liabilities are diminished by the amount of the issued guarantees, which are secured by the deposits deposited with the Bank and totalling LVL 1 081 628.

## 43. ANALYSIS OF ASSETS AND LIABILITIES BY CURRENCY PROFILE

**As of 31 December 2008**

| ASSETS | LVL | EUR | USD | RUB | BYR | Other currencies | TOTAL LVL |
|---|---|---|---|---|---|---|---|
| Cash and balances with bank of Latvia | 6 941 897 | 1 453 224 | 257 619 | - | - | 6 224 | 8 658 964 |
| Due from credit institutions | 40 501 | 3 404 595 | 82 275 302 | 728 811 | 112 321 | 2 790 446 | 89 351 976 |
| Financial assets held-for-trading | 854 756 | - | 274 263 | - | - | 36 231 | 1 165 250 |
| *Securities held-for-trading* | *62 647* | - | *274 263* | - | - | *36 231* | *373 141* |
| *Derivative financial instruments* | *792 109* | - | - | - | - | - | *792 109* |
| Securities available-for-sale | 131 111 | 42 520 | - | - | - | - | 173 631 |
| Securities held-to-maturity | 1 078 | - | 11 831 747 | - | - | - | 11 832 825 |
| Loans | 3 670 153 | 18 420 268 | 18 879 897 | 8 081 | - | 1 665 | 40 980 064 |
| Intangible assets | 1 155 852 | - | - | - | - | - | 1 155 852 |
| Property and equipment | 10 722 908 | - | - | - | - | - | 10 722 908 |
| Investment property | 1 317 528 | - | - | - | - | - | 1 317 528 |
| Investments in associates | 429 009 | - | - | - | - | - | 429 009 |
| Deferred expenses and accrued income | 659 765 | 228 | 240 308 | 2 | - | 104 | 900 407 |
| Other assets | 565 409 | 9 219 | 33 808 | 23 169 | - | 3 827 | 635 432 |
| **Total assets** | **26 489 967** | **23 330 054** | **113 792 944** | **760 063** | **112 321** | **2 838 497** | **167 323 846** |
| **LIABILITIES** | | | | | | | |
| Due to credit institutions | 593 | 131 326 | 454 027 | 693 | - | 2 652 | 589 291 |
| Deposits | 1 031 147 | 22 175 880 | 124 939 596 | 86 688 | 126 519 | 2 813 394 | 151 173 224 |
| Debt securities in issue | 1 027 | 842 774 | - | - | - | - | 843 801 |
| Derivative financial instruments | 321 684 | - | - | - | - | - | 321 684 |
| Accrued expenses, provisions and deferred income | 500 162 | 31 444 | 42 992 | 23 035 | - | 230 | 597 863 |
| Corporate income tax liabilities | 32 701 | - | - | - | - | - | 32 701 |
| Deferred tax liabilities | 267 796 | - | - | - | - | - | 267 796 |
| Other liabilities | 553 362 | 114 861 | 522 841 | 4 084 | 491 | 315 | 1 195 954 |
| Subordinated liabilities | 11 220 | 13 350 | - | - | - | - | 24 570 |
| **Total liabilities** | **2 719 692** | **23 309 635** | **125 959 456** | **114 500** | **127 010** | **2 816 591** | **155 046 884** |
| **Shareholders' equity** | **12 276 962** | - | - | - | - | - | **12 276 962** |
| Share capital | 7 611 285 | - | - | - | - | - | 7 611 285 |
| Reserve capital | 545 024 | - | - | - | - | - | 545 024 |
| Retained earnings | 4 120 653 | - | - | - | - | - | 4 120 653 |
| *Retained earnings for the previous years* | *4 073 217* | - | - | - | - | - | *4 073 217* |
| *Profit for the current year* | *47 436* | - | - | - | - | - | *47 436* |
| **Total liabilities and shareholders' equity** | **14 996 654** | **23 309 635** | **125 959 456** | **114 500** | **127 010** | **2 816 591** | **167 323 846** |
| **BALANCE POSITION** | **11 493 313** | **20 419** | **(12 166 512)** | **645 563** | **(14 689)** | **21 906** | |
| Unsettled spot forex contracts | (10 128 815) | 1 170 169 | 3 853 592 | (632 700) | - | 5 616 000 | |
| Forward contracts | (1 276 200) | (1 518 263) | 8 604 437 | - | 12 916 | (5 349 745) | |
| **NET POSITION** | **88 298** | **(327 675)** | **291 517** | **12 863** | **(1 773)** | **288 161** | |
| Ratio to the shareholders' equity (%)* | | -3,09% | 2,75% | 0,12% | -0,02% | | |

The sum of overall foreign exchange exposure and the net position in gold stood at 2.48% the Bank's equity as of 31 December 2008 (2007: 12.3%).

* Equity (net worth) totalling LVL 10 619 545 (2007: 11 465 719) as of 31 December 2008.

**Figure shows that a 10 percent strengthening of the Latvian Lat against other currencies may have a material impact on the bank's profit:**

| | 31.12.2008 EUR | 31.12.2008 USD | 31.12.2007 EUR | 31.12.2007 USD |
|---|---|---|---|---|
| Rate valid: | 0,702804 | 0,495 | 0,702804 | 0,484 |
| Foreign currency position: | (327 675) | 291 517 | 317 839 | 721 554 |
| Profit: | (23 029) | 14 576 | 22 338 | 34 635 |

**As of 31 December 2007**

| | LVL | EUR | USD | RUB | BYR | Other currencies | TOTAL LVL |
|---|---|---|---|---|---|---|---|
| Assets | 26 224 083 | 18 429 772 | 69 172 220 | 616 168 | 233 283 | 1 893 941 | **116 569 467** |
| Liabilities | 19 387 799 | 17 168 519 | 78 168 685 | 466 699 | 228 651 | 1 149 114 | **116 569 467** |
| **Balance position** | **6 836 284** | **1 261 253** | **(8 996 465)** | **149 469** | **4 632** | **744 827** | |
| **Net position** | **(1 151 091)** | **317 839** | **721 554** | **149 469** | **4 632** | **216 403** | |

## 44. REPRICING MATURITIES OF ASSETS AND LIABILITIES

**As of 31 December 2008**

| ASSETS | Up to 1 month (inclusive) LVL | 1 to 3 months LVL | 3 to 6 months LVL | 6 to 12 months LVL | One year and more LVL | Non interest bearing LVL | TOTAL LVL |
|---|---|---|---|---|---|---|---|
| Cash and balances with bank of Latvia | 6 709 523 | - | - | - | - | 1 949 441 | **8 658 964** |
| Due from credit institutions | 87 143 935 | 1 089 000 | 563 936 | - | 390 564 | 164 541 | **89 351 976** |
| Financial assets held-for-trading | - | - | - | - | 32 751 | 1 132 499 | **1 165 250** |
| *Securities held-for-trading* | - | - | - | - | *32 751* | *340 390* | ***373 141*** |
| *Derivative financial instruments* | - | - | - | - | - | *792 109* | ***792 109*** |
| Securities available-for-sale | - | - | - | - | - | 173 631 | **173 631** |
| Securities held-to-maturity | 987 183 | 615 368 | 2 358 621 | 3 807 034 | 3 862 343 | 202 276 | **11 832 825** |
| Loans | 4 227 013 | 2 969 008 | 2 036 610 | 14 284 890 | 13 956 324 | 3 506 219 | **40 980 064** |
| Intangible assets | - | - | - | - | - | 1 155 852 | **1 155 852** |
| Property and equipment | - | - | - | - | - | 10 722 908 | **10 722 908** |
| Investment property | - | - | - | - | - | 1 317 528 | **1 317 528** |
| Investments in associates | - | - | - | - | - | 429 009 | **429 009** |
| Deferred expenses and accrued income | - | - | - | - | - | 900 407 | **900 407** |
| Other assets | - | - | - | - | - | 635 432 | **635 432** |
| **Total assets** | **99 067 654** | **4 673 376** | **4 959 167** | **18 091 924** | **18 241 982** | **22 289 743** | **167 323 846** |
| **LIABILITIES** | | | | | | | |
| Due to credit institutions | 252 002 | - | - | 9 900 | - | 327 389 | **589 291** |
| Deposits | 104 963 604 | 17 605 808 | 8 854 679 | 4 752 405 | 759 554 | 14 237 174 | **151 173 224** |
| Debt securities in issue | - | - | - | 793 060 | - | 50 741 | **843 801** |
| Derivative financial instruments | - | - | - | - | - | 321 684 | **321 684** |
| Accrued expenses, provisions and deferred income | - | - | - | - | - | 597 863 | **597 863** |
| Corporate income tax liabilities | - | - | - | - | - | 32 701 | **32 701** |
| Deferred tax liabilities | - | - | - | - | - | 267 796 | **267 796** |
| Other liabilities | - | - | - | - | - | 1 195 954 | **1 195 954** |
| Subordinated liabilities | 7 168 | - | - | - | 13 142 | 4 260 | **24 570** |
| Shareholders' equity | - | - | - | - | - | 12 276 962 | **12 276 962** |
| **Total liabilities and shareholders' equity** | **105 222 774** | **17 605 808** | **8 854 679** | **5 555 365** | **772 696** | **29 312 524** | **167 323 846** |
| **Balance sheet sensitivity to interest rate risk** | **(6 155 120)** | **(12 932 432)** | **(3 895 512)** | **12 536 559** | **17 469 286** | **(7 022 781)** | |
| **Effect on annual net interest income** | **(58 984)** | **(107 770)** | **(24 347)** | **31 341** | | | **(159 760)** |

A 100 basis point decrease/increase in interest rates is likely to have effect (decrease/increase) on the Bank's annual net interest income to the amount of LVL 160 000 (2007: LVL 114 000).

**As of 31 December 2007**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Assets | 58 393 646 | 3 904 965 | 6 854 988 | 11 493 625 | 18 686 454 | 17 235 789 | **116 569 467** |
| Liabilities | 74 797 625 | 4 940 739 | 1 505 580 | 3 963 237 | 810 446 | 30 551 840 | **116 569 467** |
| **Balance sheet sensitivity to interest rate risk** | **(16 403 979)** | (1 035 774) | **5 349 408** | **7 530 388** | **17 876 008** | **(13 316 051)** | |

## 45. GEOGRAPHICAL CONCENTRATION OF ASSETS AND LIABILITIES

**As of 31 December 2008**

| ASSETS | Latvia LVL | Other EU Member States LVL | Other OECD countries LVL | CIS countries LVL | Others LVL | TOTAL LVL |
|---|---|---|---|---|---|---|
| Cash and balances with bank of Latvia | 8 658 964 | - | - | - | - | **8 658 964** |
| Due from credit institutions | 354 759 | 79 572 383 | 14 596 | 9 410 238 | - | **89 351 976** |
| Financial assets held-for-trading | 315 635 | 1 399 | 590 682 | 249 705 | 7 829 | **1 165 250** |
| *Securities held-for-trading* | *62 647* | - | *81 270* | *227 204* | *2 020* | ***373 141*** |
| *Derivative financial instruments* | *252 988* | *1 399* | *509 412* | *22 501* | *5 809* | ***792 109*** |
| Securities available-for-sale | 131 111 | 42 520 | - | - | - | **173 631** |
| Securities held-to-maturity | 1 078 | 8 792 504 | - | 3 039 243 | - | **11 832 825** |
| Loans | 25 821 994 | 4 367 197 | 6 002 262 | 2 949 176 | 1 839 435 | **40 980 064** |
| Intangible assets | 1 155 852 | - | - | - | - | **1 155 852** |
| Property and equipment | 10 722 908 | - | - | - | - | **10 722 908** |
| Investment property | 1 317 528 | - | - | - | - | **1 317 528** |
| Investments in associates | 429 009 | - | - | - | - | **429 009** |
| Deferred expenses and accrued income | 109 766 | 18 813 | 614 864 | - | 156 964 | **900 407** |
| Other assets | 192 437 | 207 939 | 75 902 | 24 933 | 134 221 | **635 432** |
| **Total assets** | **49 211 041** | **93 002 755** | **7 298 306** | **15 673 295** | **2 138 449** | **167 323 846** |
| **LIABILITIES** | | | | | | |
| Due to credit institutions | 3 352 | - | - | 537 403 | 48 536 | **589 291** |
| Deposits | 6 569 813 | 9 811 551 | 47 440 433 | 3 954 072 | 83 397 355 | **151 173 224** |
| Debt securities in issue | 843 801 | - | - | - | - | **843 801** |
| Derivative financial instruments | 225 443 | - | 34 229 | 62 012 | - | **321 684** |
| Accrued expenses, provisions and deferred income | 510 276 | 36 295 | 13 518 | 36 585 | 1 189 | **597 863** |
| Corporate income tax liabilities | 32 701 | - | - | - | - | **32 701** |
| Deferred tax liabilities | 267 796 | - | - | - | - | **267 796** |
| Other liabilities | 869 604 | 124 847 | 17 867 | 331 | 183 305 | **1 195 954** |
| Subordinated liabilities | 24 570 | - | - | - | - | **24 570** |
| **Total liabilities** | **9 347 356** | **9 972 693** | **47 506 047** | **4 590 403** | **83 630 385** | **155 046 884** |
| **Shareholders' equity** | **9 564 742** | **1 935** | **25** | **2 710 165** | **95** | **12 276 962** |
| Share capital | 4 899 065 | 1 935 | 25 | 2 710 165 | 95 | **7 611 285** |
| Reserve capital | 545 024 | - | - | - | - | **545 024** |
| Retained earnings | 4 120 653 | - | - | - | - | **4 120 653** |
| *Retained earnings for the previous years* | *4 073 217* | - | - | - | - | ***4 073 217*** |
| *Profit for the current year* | *47 436* | - | - | - | - | ***47 436*** |
| **Total liabilities and shareholders' equity** | **18 912 098** | **9 974 628** | **47 506 072** | **7 300 568** | **83 630 480** | **167 323 846** |

*(Continued on next page)*

*(Concluded. Started on page 84)*

| OFF-BALANCE SHEET ITEMS | Latvia LVL | Other EU Member States LVL | Other OECD countries LVL | CIS countries LVL | Others LVL | TOTAL LVL |
|---|---|---|---|---|---|---|
| Sureties (guarantees) | 163 621 | 953 992 | - | - | - | **1 117 613** |
| Commitments to customers | 1 801 330 | 1 460 896 | 1 547 167 | 56 164 | 66 627 | **4 932 184** |
| **Total off-balance sheet items** | **1 964 951** | **2 414 888** | **1 547 167** | **56 164** | **66 627** | **6 049 797** |

**As of 31 December 2007**

| | | | | | | |
|---|---|---|---|---|---|---|
| Assets | 48 721 673 | 51 275 646 | 6 626 460 | 8 225 703 | 1 719 985 | **116 569 467** |
| Liabilities | 26 579 264 | 19 623 542 | 16 911 788 | 7 874 672 | 45 580 201 | **116 569 467** |
| Off-balance sheet liabilities | 1 433 483 | 1 614 686 | 315 925 | 31 571 | 1 526 427 | **4 922 092** |

## 46. PRODUCTIVITY OF BANK'S BALANCE SHEET

| | 31.12.2008 | | | 31.12.2007 | | |
|---|---|---|---|---|---|---|
| **ASSETS** | **Average monthly balance LVL** | **Interest income/ expense LVL** | **Average interest rate %** | **Average monthly balance LVL** | **Interest income/ expense LVL** | **Average interest rate %** |
| Cash | 887 298 | - | 0,0% | 1 118 883 | - | 0,0% |
| Claims on Bank of Latvia payable on demand | 13 768 270 | 307 486 | 2,2% | 6 341 126 | 125 509 | 2,0% |
| Due from credit institutions | 75 234 226 | 2 138 285 | 2,8% | 38 377 002 | 1 862 585 | 4,9% |
| Loans, net | 40 633 092 | 3 883 201 | 9,6% | 34 853 627 | 3 023 953 | 8,7% |
| *Loans* | *41 799 184* | *3 883 201* | *9,3%* | *36 019 719* | *3 023 953* | *8,4%* |
| *Allowances for doubtful debts* | *(1 166 092)* | *-* | *0,0%* | *(1 166 092)* | *-* | *0,0%* |
| Debt securities | 15 611 371 | 1 302 691 | 8,3% | 7 958 559 | 615 906 | 7,7% |
| Other assets | 17 474 332 | - | 0,0% | 11 865 036 | - | 0,0% |
| **A. Total assets** | **163 608 589** | **7 631 663** | **4,7%** | **100 514 233** | **5 627 953** | **5,6%** |
| **LIABILITIES** | | | | | | |
| Due to credit institutions | 1 162 585 | 78 291 | 6,7% | 2 909 744 | 192 427 | 6,6% |
| Deposits | 144 929 710 | 2 612 117 | 1,8% | 80 237 628 | 1 455 040 | 1,8% |
| Debt securities in issue | 792 560 | 39 630 | 5,0% | 892 970 | 54 667 | 6,1% |
| Subordinated liabilities | 19 085 | 697 | 3,7% | 19 951 | 502 | 2,5% |
| Other liabilities | 4 201 665 | - | 0,0% | 4 730 483 | - | 0,0% |
| **B. Total liabilities** | **151 105 605** | **2 730 735** | **1,8%** | **88 790 776** | **1 702 636** | **1,9%** |
| Shareholders' equity | 12 502 984 | - | 0,0% | 11 723 457 | - | 0,0% |
| **C. Total liabilities and shareholders' equity** | **163 608 589** | **2 730 735** | **1,7%** | **100 514 233** | **1 702 636** | **1,7%** |
| **Net interest income** | | | | | | |
| **Interest spread % (A-B)** | | | **2,9%** | | | **3,7%** |
| **Investment spread % (A-C)** | | | **3,0%** | | | **3,9%** |

## 47. CREDIT RISK

The table below shows the maximum exposure to credit risk for the components of the balance-sheet, including derivatives. Exposures are based on net carrying amounts as reported in the balance sheet.

The maximum credit exposures are shown both gross, i.e. without taking into account any collateral and other credit enhancement, and net, i.e. after taking into account any collateral and other credit enhancement. The details on the type and amounts of collateral held are disclosed in the respective notes.

| | Gross maximum credit risk exposure 31.12.2008 LVL | Net maximum credit risk exposure 31.12.2008 LVL | Gross maximum credit risk exposure 31.12.2007 LVL | Net maximum credit risk exposure 31.12.2007 LVL |
|---|---|---|---|---|
| Cash and balances with bank of Latvia | 8 658 964 | 8 658 964 | 8 425 788 | 8 425 788 |
| Due from credit institutions | 89 351 976 | 89 351 976 | 49 954 497 | 49 954 497 |
| Financial assets held-for-trading | 1 165 250 | 1 165 250 | 6 301 396 | 6 301 396 |
| *Securities held-for-trading* | *373 141* | *373 141* | *5 561 934* | *5 561 934* |
| *Derivative financial instruments* | *792 109* | *792 109* | *739 462* | *739 462* |
| Securities available-for-sale | 173 631 | 173 631 | 173 631 | 173 631 |
| Securities held-to-maturity | 11 832 825 | 11 832 825 | 4 332 116 | 4 332 116 |
| Loans | 40 980 064 | 3 033 434 | 34 558 351 | 3 169 488 |
| Intangible assets | 1 155 852 | 1 155 852 | 765 241 | 765 241 |
| Property and equipment | 10 722 908 | 10 722 908 | 7 636 158 | 7 636 158 |
| Investment property | 1 317 528 | 1 317 528 | 1 573 938 | 1 573 938 |
| Investments in associates | 429 009 | 429 009 | 429 009 | 429 009 |
| Deferred expenses and accrued income | 900 407 | 900 407 | 716 918 | 716 918 |
| Other assets | 635 432 | 635 432 | 1 507 265 | 1 507 265 |
| **Total assets** | **167 323 846** | **129 377 216** | **116 569 467** | **85 180 604** |
| Sureties (guarantees) | 1 117 613 | 35 985 | 587 389 | 35 985 |
| Commitments to customers | 4 932 184 | 4 932 184 | 4 334 703 | 816 367 |
| **Total off-balance sheet items** | **6 049 797** | **4 968 169** | **4 922 092** | **852 352** |
| **Total maximum credit risk exposure** | **173 373 643** | **134 345 385** | **121 491 559** | **86 032 956** |

## 48. CLASSIFICATION OF ASSETS AND LIABILITIES

The estimated fair values of financial instruments at fair value through profit or loss, quoted available-for-sale assets, held-to-maturity investments and other borrowed funds are based on quoted market prices at the balance sheet date without any deduction for transaction costs.

The estimated fair values of all other financial assets and liabilities, except as described below, are calculated using discounted cash flow techniques based on estimated future cash flows and discount rates for similar instruments at the balance sheet date. As disclosed in Note 20 the fair value of unquoted equity securities available-for-sale with a carrying value of LVL 173 631 could not be determined.

The estimated fair value of the Bank's financial assets and liabilities, as required to be disclosed by IAS 32 Financial Instruments: Presentation, are as follows:

**As of 31 December 2008**

| ASSETS | Financial assets / liabilities at amortised cost LVL | Financial assets / liabilities at fair value through profit and loss LVL | Financial assets available-for-sale LVL | Non-financial assets / liabilities LVL | Total LVL | Fair value LVL |
|---|---|---|---|---|---|---|
| Cash and balances with bank of Latvia | 8 658 964 | - | - | - | **8 658 964** | **8 658 964** |
| Due from credit institutions | 89 351 976 | - | - | - | **89 351 976** | **89 369 794** |
| Financial assets held-for-trading | - | 1 165 250 | - | - | **1 165 250** | **1 165 250** |
| *Securities held-for-trading* | - | *373 141* | - | - | *373 141* | *373 141* |
| *Derivative financial instruments* | - | *792 109* | - | - | *792 109* | *792 109* |
| Securities available-for-sale | - | - | 173 631 | - | **173 631** | **173 631** |
| Securities held-to-maturity | 11 832 825 | - | - | - | **11 832 825** | **11 832 825** |
| Loans | 40 980 064 | - | - | - | **40 980 064** | **49 145 467** |
| Intangible assets | - | - | - | 1 155 852 | **1 155 852** | **1 155 852** |
| Property and equipment | - | - | - | 10 722 908 | **10 722 908** | **10 722 908** |
| Investment property | - | - | - | 1 317 528 | **1 317 528** | **1 317 528** |
| Investments in associates | - | - | - | 429 009 | **429 009** | **429 009** |
| Deferred expenses and accrued income | 900 407 | - | - | - | **900 407** | **900 407** |
| Other assets | 635 432 | - | - | - | **635 432** | **635 432** |
| **Total assets** | **152 359 668** | **1 165 250** | **173 631** | **13 625 297** | **167 323 846** | **175 507 067** |
| **LIABILITIES** | | | | | | |
| Due to credit institutions | 589 291 | - | - | - | **589 291** | **588 813** |
| Deposits | 151 173 224 | - | - | - | **151 173 224** | **150 924 950** |
| Debt securities in issue | 843 801 | - | - | - | **843 801** | **843 801** |
| Derivative financial instruments | - | 321 684 | - | - | **321 684** | **321 684** |
| Accrued expenses, provisions and deferred income | 597 863 | - | - | - | **597 863** | **597 863** |
| Corporate income tax liabilities | - | - | - | 32 701 | **32 701** | **32 701** |
| Deferred tax liabilities | - | - | - | 267 796 | **267 796** | **267 796** |
| Other liabilities | 1 195 954 | - | - | - | **1 195 954** | **1 195 954** |
| Subordinated liabilities | 24 570 | - | - | - | **24 570** | **24 570** |
| **Total liabilities** | **154 424 703** | **321 684** | **-** | **300 497** | **155 046 884** | **154 798 132** |

*(Continued on next page)*

*(Concluded. Started on page 87)*

| SHAREHOLDERS' EQUITY | Financial assets / liabilities at amortised cost LVL | Financial assets / liabilities at fair value through profit and loss LVL | Financial assets available-for-sale LVL | Non-financial assets / liabilities LVL | Total LVL | Fair value LVL |
|---|---|---|---|---|---|---|
| Share capital | - | - | - | 7 611 285 | **7 611 285** | **7 611 285** |
| Reserve capital | - | - | - | 545 024 | **545 024** | **545 024** |
| Retained earnings | - | - | - | 4 120 653 | **4 120 653** | **4 120 653** |
| *Retained earnings for the previous years* | - | - | - | *4 073 217* | ***4 073 217*** | ***4 073 217*** |
| *Profit for the current year* | - | - | - | *47 436* | ***47 436*** | ***47 436*** |
| **Total shareholders' equity** | **-** | **-** | **-** | **12 276 962** | **12 276 962** | **12 276 962** |
| **Total liabilities and shareholders' equity** | **154 424 703** | **321 684** | **-** | **12 577 459** | **167 323 846** | **167 075 094** |

**As of 31 December 2007**

| | Financial assets / liabilities at amortised cost LVL | Financial assets / liabilities at fair value through profit and loss LVL | Financial assets available-for-sale LVL | Non-financial assets / liabilities LVL | Total LVL | Fair value LVL |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and balances with bank of Latvia | 8 425 788 | - | - | - | **8 425 788** | **8 425 788** |
| Due from credit institutions | 49 954 497 | - | - | - | **49 954 497** | **49 909 575** |
| Financial assets held-for-trading | - | 6 301 396 | - | - | **6 301 396** | **6 301 396** |
| *Securities held-for-trading* | - | *5 561 934* | - | - | *5 561 934* | *5 561 934* |
| *Derivative financial instruments* | - | *739 462* | - | - | *739 462* | *739 462* |
| Securities available-for-sale | - | - | 173 631 | - | **173 631** | **173 631** |
| Securities held-to-maturity | 4 332 116 | - | - | - | **4 332 116** | **4 332 116** |
| Loans | 34 558 351 | - | - | - | **34 558 351** | **34 445 073** |
| Intangible assets | - | - | - | 765 241 | **765 241** | **765 241** |
| Property and equipment | - | - | - | 7 636 158 | **7 636 158** | **7 636 158** |
| Investment property | - | - | - | 1 573 938 | **1 573 938** | **1 573 938** |
| Investments in associates | - | - | - | 429 009 | **429 009** | **429 009** |
| Overpaid corporate income tax | 195 159 | - | - | - | **195 159** | **195 159** |
| Deferred expenses and accrued income | 716 918 | - | - | - | **716 918** | **716 918** |
| Other assets | 1 507 265 | - | - | - | **1 507 265** | **1 507 265** |
| **Total assets** | **99 690 094** | **6 301 396** | **173 631** | **10 404 346** | **116 569 467** | **116 411 267** |
| **LIABILITIES** | | | | | | |
| Due to credit institutions | 3 136 260 | - | - | - | **3 136 260** | **3 133 027** |
| Deposits | 96 925 378 | - | - | - | **96 925 378** | **97 639 526** |
| Debt securities in issue | 803 171 | - | - | - | **803 171** | **803 171** |
| Derivative financial instruments | - | 740 557 | - | - | **740 557** | **740 557** |
| Accrued expenses, provisions and deferred income | 609 731 | - | - | - | **609 731** | **609 731** |
| Deferred tax liabilities | - | - | - | 232 480 | **232 480** | **232 480** |
| Other liabilities | 1 869 545 | - | - | - | **1 869 545** | **1 869 545** |
| Subordinated liabilities | 22 819 | - | - | - | **22 819** | **22 819** |
| **Total liabilities** | **103 366 904** | **740 557** | **-** | **232 480** | **104 339 941** | **105 050 856** |
| **Shareholders' equity** | | | | | | |
| Share capital | - | - | - | 7 611 285 | **7 611 285** | **7 611 285** |
| Reserve capital | - | - | - | 545 024 | **545 024** | **545 024** |
| Retained earnings | - | - | - | 4 073 217 | **4 073 217** | **4 073 217** |
| *Retained earnings for the previous years* | - | - | - | *2 577 287* | ***2 577 287*** | ***2 577 287*** |
| *Profit for the current year* | - | - | - | *1 495 930* | ***1 495 930*** | ***1 495 930*** |
| **Total shareholders' equity** | **-** | **-** | **-** | **12 229 526** | **12 229 526** | **12 229 526** |
| **Total liabilities and shareholders' equity** | **103 366 904** | **740 557** | **-** | **12 462 006** | **116 569 467** | **117 280 382** |

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