AS "Citadele banka"

# Annual report

for the 6 month period
ended 31 december 2010

together with independent
auditors' report

Translation from Latvian original*

* This version of financial statements is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of financial statements takes precedence over this translation.

Citadele

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# Citadele Bank’s activity in 2010 is characterized by stability and development

Citadele Bank was founded on 30 June 2010; and launched its activities on 1 August 2010 following the successful restructuring of Parex Banka.

The aim of Citadele Bank is to become the most valuable financial group in the Baltic States; and to inspire people and companies to growth and enhancement of regional development. Regardless of the losses in banking sector during the last years in Latvia, Citadele Bank is working purposefully in order for its activity to generate profit.

2010 was the year of stabilising and building Citadele Bank’s business. The Bank has worked to develop services for clients and repay funds invested in the Bank’s activity by the State as soon as possible. Along with development of services in 2010, the Bank has been working at improving operational efficiency, eliminating functions that generate losses and optimising resources.

According to December 2010 public data, Citadele Bank is the largest local bank in Latvia with branch offices in other countries; it is the third largest bank in Latvia in terms of deposits (10.4% market share), the fifth largest bank according to the amount of assets (6.9% market share) and loans issued (5.2% market share). The Bank’s liquidity is stable and it significantly exceeds minimum requirements.

## Bank Ownership

Citadele, the Latvian Privatisation Agency and the European Bank for Reconstruction and Development signed an agreement on 30 July 2010, whereby the EBRD took a shareholding of 25 % of share capital plus 1 voting share.

The new Supervisory Board was elected on 11 August 2010. The following members were appointed – Klāvs Vasks, Juris Vaskāns, Ģirts Freibergs, Laurence Philip Adams and Geoffrey Dunn. Juris Jākobsons, a professional in the finance field and experienced in the banking sector was nominated as Chairman of the Executive Board.

## The Bank’s Services for Clients Re-launched

In 2010, during the first five months of its activity, the Bank re-launched and developed three main segments: services for retail customers and small and medium enterprises in our branch office network and services for large enterprises and private wealth management.

Citadele offers loan services for enterprises, paying special attention to small and medium enterprise (SME) segment. Similarly, mortgage loans, consumption loans and provision of overdraft products for retail customers are offered in Latvia, Lithuania and Estonia. In order to practice responsible lending, the Bank introduced new procedures for mortgage loans and risk assessment.

Citadele Leasing and Factoring, the Bank’s subsidiary, offers leasing services in the Baltic States, and factoring services for clients in Latvia.

The Bank’s subsidiary Citadele Open Pension Fund provides management of private pension plans, achieving profitability results that were among the best in Latvia.

The Citadele Life subsidiary provides life insurance with savings, and the Citadele Asset Management subsidiary provides private capital management services.

During the first five months of activity, IPAS Citadele Asset Management introduced “Investment Gold”, a new product which generated larger than anticipated interest.

The Company has also received very good references from clients on the quality of the new Bank’s development process.

## Business Results of the Bank and Its Group in 2010

Following the restructuring process on August 1st, Citadele Bank and its subsidiaries main goals were to relaunch the activities of its businesses.

In common with the whole banking sector in Latvia, Citadele Bank finished 2010 with losses. The loss of 19.4 million Lats (the Group – 18.8 million Lats) was broadly in line with the Restructuring Plan. The major reasons for this result were due to the slower than anticipated economic upturn and prudent provisioning as expected in the Bank's plans.

Earning clients' trust was one of the most important tasks of the new Bank. From August to December 2010, over 6,000 new clients chose Citadele Bank: Citadele has acquired over 4,900 new clients in retail and SME segment in Latvia, over 350 new clients in Estonia, and more than 600 new clients in the private capital management sector.

From August until December 2010, clients' deposit portfolio with Citadele Bank increased by 5.6% or 52.4 million Lats. The Bank's loan portfolio was 691.1 million Lats (the group – 794.3 million Lats) and the amount of capital and reserves was 84 million Lats (the Group – 82 million Lats). The total amount of deposits with Citadele Bank reached 1.1 billion Lats (the Group – 1.29 billion Lats) at the end of 2010. Total assets of Citadele Bank were 1.44 billion Lats (the Group – 1.61 billion Lats) at the end of 2010, slightly exceeding the planned amount.

During the period from August until December 2010, Citadele issued 24,918 new payment cards. Turnover in American Express credit cards per client per month increased as well; turnover in American Express Gold credit cards increased by 13% and in American Express BLUE – by 16%. By focusing on its strategic alliance with American Express and maintaining a high focus on loyal credit card customers, Citadele has secured the leading position in the Latvian market for cards with attached credit limits.

Despite some reductions in interest rates, the deposit portfolio in the corporate banking sector remained stable and in fact saw some growth between August and December.

In 2010, Citadele Leasing and Factoring Ltd succeeded at decreasing its short-term liabilities by almost 27.9 million Lats, compared to 2009, and the Company plans to finish 2011 with profit.

IPAS Citadele Asset Management, the Bank's subsidiary company, finished 2010 with a profit of 420 thousand Lats which is an increase by 135% percent comparing to 2009.

3rd level pension plans offered by Citadele Open Pension Fund, the Bank's subsidiary company, have reached the highest profitability in Latvia since they were launched. As a result, the value of pension plan assets has increased by over 157 thousand Lats comparing to 2009.

AAS Citadele Life, the Bank's subsidiary, has expanded its sales channel network in 2010, reaching a twice as large the amount of new premiums than in 2009. This enabled the Company to be placed among the most rapidly developing life insurance companies in Latvia by new insurance premiums received.

## Improvement of Efficiency

Along with working on business development, Citadele Bank has worked purposefully on improving efficiency of processes by optimizing resources and reducing administrative costs.

On 31 August 2010, the Bank had 1,411 active members of staff. By year end, the results of its optimisation efforts caused this number to reduce to 1,329.

In 2010, active centralization of the Bank was completed as a result of which the area necessary for archives and archive maintenance costs were reduced. Maintenance costs of branch offices have been reduced and the use of motor vehicles has seen significant optimisation.

In 2010, an IT project on data connection change for branch offices was introduced which resulted in significant decrease of data transfer costs.

Also, in 2010, the Bank has put stationary goods supply process in order by centralising placement of orders and delivery of goods. The Bank has also acquired additional income and decreased warehouse maintenance costs by selling such furniture, office equipment and other equipment in open auctions which are not necessary for ensuring the Bank's activity.

## Repayment of State-Invested Funds and the Bank's Investment in Latvia's Economy

Highly appreciating the support provided by Latvian government, one of Citadele Bank's key priorities are repayment of State-invested funds within the shortest period of time possible and encouragement of Latvia's economic activity. As early as in September 2010, during the second month of its activity, Citadele Bank paid back loans made by the Ministry of Finance of the republic of Latvia totalling of 12.1 million Lats. In 2010, in five months, Citadele has paid the State 9.2 million Lats in interest payments for the support received. A further repayment of 32.8 million Lats was made earlier than scheduled in January 2011.

Citadele has invested funds in Latvia's economy in the shape of loan funds issued to enterprises. Also, it has enhanced acquisition of resources from EU structural funds in Latvia – a significant part of enterprises that Citadele has issued funding to were companies, which needed funding for implementing projects co-funded by the European Union.

## Activities of Citadele Bank and its Subsidiaries Have Been Appraised Internationally

Moody's, international rating agency, rated Citadele Bank as BA3 in long-term rating in 2010. This rating is higher than the euro obligation rating B2 given to Parex Banka before Citadele launched its activity. All ratings given to Citadele Bank provide a "stable" development prognosis.

Citadele Eastern Europe Balanced Fund was acknowledged the best balanced fund in 2010 in a poll named "Best Funds in Central and Eastern European Countries" which was conducted by European business magazine Business New Europe. Standard & Poor's Fund Services announced granting "A" quality rating in fund management to Citadele's Russian Equity Fund. SPEAR'S Russia Wealth Management Awards 2010 brought forward Citadele Bank for "Best Bank in Baltic and CIS Countries in Provision of Capital Management Services for Clients in Russia" nomination. Citadele Asset Management, a subsidiary company of the Bank, was nominated for the Annual Wealth Management Prize 2011 by World Finance, an international finance journal, as the most professional wealth management company in the Baltic States.

## The Bank is Developing in Order to Work With Profit

In 2011, Citadele Bank expects to move into profitability and thus increase the Bank's worth. The Bank's business results in the first quarter show positive signs – the Bank has been adjusting and renegotiating its deposit interest rates resulting in positive net interest income.

In order to facilitate economic growth of Latvia, Citadele Bank plans to issue significant funding to Latvian companies and retail customers in 2011, paying special attention to Latvian companies with local capital. In 2011, the Bank has started working on offering unique products. Citadele Bank is working purposefully in order for its activity to generate profit.

| | |
|---|---|
| Juris Jākobsons<br>Chairman of the Management Board | Klāvs Vasks<br>Chairman of the Council |

Riga,
16 May 2011

## Council of the Bank

| Name | Position |
|---|---|
| Klāvs Vasks | Chairman of the Council |
| Juris Vaskāns | Deputy chairman of the Council |
| Ģirts Freibergs | Member of the Council |
| Laurence Philip Adams | Member of the Council |
| Geoffrey Dunn | Member of the Council |

## Management Board of the Bank

| Name | Position |
|---|---|
| Juris Jākobsons | Chairman of the Management Board, p.p. |
| Guntis Beļavskis | Member of the Management Board, p.p. |
| Valters Ābele | Member of the Management Board |
| Kaspars Cikmačs | Member of the Management Board |
| Philip Nigel Allard | Member of the Management Board |

According to AS Citadele Banka (thereon Citadele) founder’s VAS Privatizācijas Aģentūra bank’s establishment resolution Juris Vaskāns, Klāvs Vasks and Andžs Ūbelis were included in the Citadele’s Council and Juris Jākobsons, Guntis Beļavskis un Valters Ābele in the Management Board of the Bank. Citadele was registered in the Register of Enterprises of the Republic of Latvia on 30 June 2010. With the Bank’s Council’s decision date 5 July 2010 Juris Jākobsons was elected as a Chairman of the Management Board of the Bank.

A new Council of Citadele was elected in an extraordinary shareholders meeting held on 11 August 2010. The following members were elected – Klāvs Vasks, Juris Vaskāns, Ģirts Freibergs, Laurence Philip Adams and Geoffrey Dunn. With Bank’s Council’s resolution dated 16 August 2010 Klāvs Vasks was elected as chairman of the council and Juris Vaskāns as deputy chairman of the council.

On 15 September 2010 the Council of the Bank made a decision, effective from 21 September 2010, to expand the Executive Board by appointing two new board members – Kaspars Cikmačs and Philip Nigel Allard.

Changes in management bodies during the reporting year and until the signing of these financial statements:

| Name | Position | Date of changes | Type of changes |
|---|---|---|---|
| Kaspars Cikmačs | Member of the Management Board | 15.09.2010 (effective from 21.09.2010) | Appointed |
| Philip Nigel Allard | Member of the Management Board | 15.09.2010 (effective from 21.09.2010) | Appointed |
| Klāvs Vasks | Chairman of the Council | 11.08.2010 | Appointed |
| Juris Vaskāns | Deputy chairman of the Council | 11.08.2010 | Appointed |
| Ģirts Freibergs | Member of the Council | 11.08.2010 | Appointed |
| Laurence Philip Adams | Member of the Council | 11.08.2010 | Appointed |
| Geoffrey Dunn | Member of the Council | 11.08.2010 | Appointed |
| Juris Vaskāns | Member of the Council | 11.08.2010 | Removed |
| Klāvs Vasks | Member of the Council | 11.08.2010 | Removed |
| Andžs Ūbelis | Member of the Council | 11.08.2010 | Removed |
| Juris Jākobsons | Chairman of the Management Board | 07.07.2010 | Appointed |
| Juris Jākobsons | Member of the Management Board | 30.06.2010 | Appointed |
| Guntis Beļavskis | Member of the Management Board | 30.06.2010 | Appointed |
| Valters Ābele | Member of the Management Board | 30.06.2010 | Appointed |
| Juris Vaskāns | Member of the Council | 30.06.2010 | Appointed |
| Klāvs Vasks | Member of the Council | 30.06.2010 | Appointed |
| Andžs Ūbelis | Member of the Council | 30.06.2010 | Appointed |

The Management of AS Citadele Banka (hereinafter – the Bank) are responsible for the preparation of the financial statements of the Bank as well as for the preparation of the consolidated financial statements of the Bank and its subsidiaries (hereinafter – the Group).

The financial statements set out on pages 8 to 68 are prepared in accordance with the source documents and present fairly the financial position of the Bank and the Group as at 31 December 2010 and the results of their operations, changes in shareholders' equity and cash flows for the six month period then ended. The management report set out on pages 3 to 5 presents fairly the financial results of the reporting period and future prospects of the Bank and the Group.

The financial statements are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board as adopted by the European Union on a going concern basis. Appropriate accounting policies have been applied on a consistent basis. Prudent and reasonable judgments and estimates have been made by the Management in the preparation of the financial statements.

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

| | |
|---|---|
| Juris Jākobsons<br>Chairman of the Management Board | Klāvs Vasks<br>Chairman of the Council |

Riga,
16 May 2011

| | Notes | LVL 000's<br>2010<br>Group | <br>2010<br>Bank |
|---|---|---|---|
| Interest income | 4 | 25,695 | 22,379 |
| Interest expense | 4 | (26,366) | (24,852) |
| Net interest expense | | (671) | (2,473) |
| | | | |
| Commission and fee income | 5 | 11,201 | 8,290 |
| Commission and fee expense | 5 | (3,422) | (2,898) |
| Net commission and fee income | | 7,779 | 5,392 |
| | | | |
| Gain on transactions with financial instruments, net | 6 | 2,504 | 1,770 |
| | | | |
| Other income | 7 | 3,754 | 2,742 |
| Other expense | | (2,227) | (2,153) |
| | | | |
| Administrative expense | 8,9 | (18,016) | (13,398) |
| Amortisation and depreciation charge | 19,20 | (3,299) | (1,167) |
| | | | |
| Impairment charges and reversals, net | 10 | (9,973) | (10,712) |
| | | | |
| Gain on disposal of assets held for sale, net | | 857 | - |
| | | | |
| Loss before taxation | | (19,292) | (19,999) |
| | | | |
| Corporate income tax | 11 | 481 | 572 |
| | | | |
| Net loss for the period | | (18,811) | (19,427) |
| | | | |
| Attributable to: | | | |
| Equity holders of the Bank | | (18,811) | (19,427) |
| Minority interest | | - | - |
| | | (18,811) | (19,427) |

The notes on pages 13 to 68 are an integral part of these financial statements.

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Net loss for the period | (18,811) | (19,427) |
| Other comprehensive income: | | |
| *Fair value revaluation reserve: held-to-maturity securities* | | |
| Amortisation | 363 | 357 |
| Deferred income tax charged directly to equity | (38) | (35) |
| *Fair value revaluation reserve: available-for-sale securities* | | |
| Impairment of securities | 357 | 357 |
| Fair value revaluation reserve charged to statement of income | 493 | 595 |
| Change in fair value of available for sale securities | 3,472 | 3,247 |
| Deferred income tax charged directly to equity | (78) | (51) |
| *Other reserves* | | |
| Foreign exchange revaluation reserve | 678 | - |
| Other comprehensive income for the period | 5,247 | 4,470 |
| Total comprehensive loss for the period | (13,564) | (14,957) |
| Attributable to: | | |
| Equity holders of the Bank | (13,564) | (14,957) |
| Minority interest | - | - |
| | (13,564) | (14,957) |

The notes on pages 13 to 68 are an integral part of these financial statements.

| | Notes | 31/12/2010 Group (LVL 000's) | 31/12/2010 Bank (LVL 000's) |
|---|---|---|---|
| Assets | | | |
| Cash and deposits with central banks | 12 | 187,220 | 177,348 |
| Balances due from credit institutions | 13 | 219,624 | 211,608 |
| Securities held for trading: | | | |
| - fixed income | 16 | 140 | 4 |
| - shares and other non-fixed income | 17 | 34 | - |
| Derivative financial instruments | 29 | 2,670 | 2,716 |
| Financial assets designated at fair value through profit and loss | | 3,318 | - |
| Available-for-sale securities: | | | |
| - fixed income | 16 | 187,524 | 143,498 |
| - shares and other non-fixed income | 17 | 9,467 | 9,429 |
| Loans and receivables to customers | 14,15 | 794,329 | 691,098 |
| Held-to-maturity securities | 16 | 127,572 | 117,280 |
| Current income tax assets | 11 | 195 | - |
| Non-current assets and disposal groups classified as held for sale | 21 | 3,289 | - |
| Fixed assets | 20 | 38,072 | 3,910 |
| Goodwill and intangible assets | 19 | 2,060 | 1,256 |
| Investments in subsidiaries | 18 | - | 43,839 |
| Investment property | | 904 | - |
| Deferred income tax assets | 11 | 30,100 | 29,980 |
| Other assets | 22 | 5,991 | 3,936 |
| Total assets | | 1,612,509 | 1,435,902 |
| Liabilities | | | |
| Derivative financial instruments | 29 | 644 | 702 |
| Financial liabilities designated at fair value through profit and loss | | 1,484 | - |
| Financial liabilities measured at amortised cost: | | | |
| - balances due to credit institutions and central banks | 24 | 70,559 | 82,175 |
| - deposits from customers | 25 | 1,294,335 | 1,117,274 |
| - issued debt securities | 23 | 91,485 | 91,557 |
| - other financial liabilities | | 7,333 | - |
| Current income tax liabilities | 11 | 188 | - |
| Deferred income tax liabilities | 11 | 491 | - |
| Other liabilities | 26 | 12,728 | 8,919 |
| Subordinated liabilities | 27 | 51,235 | 51,235 |
| Total liabilities | | 1,530,482 | 1,351,862 |
| Equity | | | |
| Paid-in share capital | 28 | 103,000 | 103,000 |
| Reserves | | (2,162) | 467 |
| Accumulated losses | | (18,811) | (19,427) |
| Total shareholders' equity attributable to the shareholders of the Bank | | 82,027 | 84,040 |
| Minority interest | | - | - |
| Total equity | | 82,027 | 84,040 |
| Total liabilities and equity | | 1,612,509 | 1,435,902 |

The notes on pages 13 to 68 are an integral part of these financial statements.

Changes in the Group’s equity are as follows:

| | LVL 000’s | | | | | | |
|---|---|---|---|---|---|---|---|
| | Attributable to equity holders of the Bank | | | | | | |
| | Issued share capital | Fair value revaluation reserve, attributable to: Held-to-maturity securities | Fair value revaluation reserve, attributable to: Available-for-sale securities | Foreign exchange reserve | Restructuring reserve* | Accumulated losses | Total equity |
| **Balance as at 30 June 2010** | **4,000** | **-** | **-** | **-** | **-** | **-** | **4,000** |
| Issue of new shares | 99,000 | - | - | - | - | - | 99,000 |
| Restructuring (Note 2) | - | (2,031) | (1,985) | 168 | (3,561) | - | (7,409) |
| Net loss for the period | - | - | - | - | - | (18,811) | (18,811) |
| Other comprehensive income for the period | - | 325 | 4,244 | 678 | - | - | 5,247 |
| **Balance as at 31 December 2010** | **103,000** | **(1,706)** | **2,259** | **846** | **(3,561)** | **(18,811)** | **82,027** |

* When determining the assets and liabilities that were eligible for the transfer of undertaking that took place on 1 August 2010, the composition of assets and liabilities were determined on the parent bank’s, i.e. AS Parex Banka stand-alone accounts basis. Any differences in the value of investments in subsidiaries that were transferred to AS Citadele Banka and their net equity as at the date of the transfer, are treated as restructuring reserves in the consolidated financial statements of AS Citadele Banka.

Changes in the Bank’s equity are as follows:

| | LVL 000’s | | | | |
|---|---|---|---|---|---|
| | Attributable to equity holders of the Bank | | | | |
| | Issued share capital | Fair value revaluation reserve, attributable to: Held-to-maturity securities | Fair value revaluation reserve, attributable to: Available-for-sale securities | Accumulated losses | Total equity |
| **Balance as at 30 June 2010** | **4,000** | **-** | **-** | **-** | **4,000** |
| Issue of new shares | 99,000 | - | - | - | 99,000 |
| Restructuring (Note 2) | - | (2,031) | (1,972) | - | (4,003) |
| Net loss for the period | - | - | - | (19,427) | (19,427) |
| Other comprehensive income for the period | - | 322 | 4,148 | - | 4,470 |
| **Balance as at 31 December 2010** | **103,000** | **(1,709)** | **2,176** | **(19,427)** | **84,040** |

The notes on pages 13 to 68 are an integral part of these financial statements.

| | Notes | LVL 000’s 2010 Group | LVL 000’s 2010 Bank |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Loss before tax | | (19,292) | (19,999) |
| Amortisation of intangible assets, depreciation of fixed assets and investment property | | 3,299 | 1,167 |
| Change in impairment allowances and other provisions | | 21,165 | 21,904 |
| Other non-cash items | | 939 | 3,739 |
| **Cash generated before changes in assets and liabilities** | | **6,111** | **6,811** |
| Change in derivative financial instruments | | (1,638) | (1,576) |
| (Increase)/ decrease in other assets | | 600 | (1,034) |
| Increase in other liabilities | | 3,917 | 2,979 |
| (Increase)/ decrease in trading investments | | (73) | 1 |
| (Increase)/ decrease in balances due from credit institutions | | (12,587) | 4,640 |
| (Increase) / decrease in loans and receivables to customers | | 61,606 | 51,026 |
| Increase / (decrease) in balances due to credit institutions and central banks | | (25,601) | (28,276) |
| Increase in deposits from customers | | 60,270 | 52,216 |
| **Cash generated from operating activities before corporate income tax** | | **92,605** | **86,787** |
| Corporate income tax | | (8) | - |
| **Net cash flow generated from operating activities** | | **92,597** | **86,787** |
| **Cash flows from investing activities** | | | |
| (Purchase) of intangible and fixed assets | | (930) | (520) |
| Proceeds from disposal of intangible and fixed assets | | 76 | 41 |
| (Purchase) of held-to-maturity securities, net | | (229) | - |
| (Purchase) of available-for-sale securities | | (74,290) | (57,122) |
| Cash inflows from available-for-sale securities | | 23,610 | 13,034 |
| Increase in cash and cash equivalents as a result of restructuring | | 206,217 | 186,977 |
| Increase in cash and cash equivalents as a result of subsidiary acquisition | | 6,313 | - |
| **Net cash flow from investing activities** | | **160,767** | **142,410** |
| **Cash flows from financing activities** | | | |
| Repurchase of debt securities | | (22,347) | (22,347) |
| Issue of new shares | | 99,000 | 99,000 |
| **Net cash flow from financing activities** | | **76,653** | **76,653** |
| **Net cash flow for the period** | | **330,017** | **305,850** |
| **Cash and cash equivalents at the beginning of the period** | | **4,000** | **4,000** |
| **Cash and cash equivalents at the end of the period** | 32 | **334,017** | **309,850** |

The Group as a result of subsidiary acquisition received LVL 155 million of loans and receivables, LVL 27 million of other assets that are not cash or cash equivalents, LVL 123 million of customer deposits and LVL 34 million of other liabilities that are not cash or cash equivalents.

Amounts of interest income and (expense) received/ (paid) are as follows:

| | LVL 000’s 2010 Group | LVL 000’s 2010 Bank |
|---|---|---|
| Interest income received during the period | 24,923 | 21,695 |
| Interest expense paid during the period | (26,168) | (24,382) |

The notes on pages 13 to 68 are an integral part of these financial statements.

*If not mentioned otherwise, referral to Group’s policies and procedures should be also considered as referral to the respective Bank’s policies and procedures.*

## AUTHORISATION OF THE FINANCIAL STATEMENTS

These financial statements have been authorised for issuance by the Management on 16 May 2011. In accordance with the Commercial Law of the Republic of Latvia, the shareholders’ meeting has the right to make the decision on the approval of the financial statements.

## NOTE 1. GENERAL INFORMATION

AS Citadele Banka (hereinafter – the Bank) was registered as a joint stock company on 30 June 2010. The Bank commenced its operations on 1 August 2010.

The Bank’s head office is located in Riga, Latvia. The legal address of the Bank is Republikas laukums 2a, Riga, LV-1010. As at 31 December 2010, the Bank was operating a total of 44 branches and client service centres in Riga and throughout Latvia. The Bank has 7 foreign branches and client service centres – in Tallinn (Estonia), Narva (Estonia), Hamburg (Germany), Munich (Germany), Stockholm (Sweden) and Goteborg (Sweden). The Bank owns directly and indirectly 19 subsidiaries, which operate in various financial markets sectors. The Bank is the parent company of the Group.

The Group’s main areas of operation include accepting deposits from customers, granting short-term and long-term loans to a wide range of customers and servicing payment cards, dealing with finance lease and foreign exchange transactions. The Bank offers its clients also trust management and private banking services, performs local and international payments, as well as provides a wide range of other financial services.

As at 31 December 2010, the Group had 1,762 full time employees and the Bank had 1,329 full time employees.

## NOTE 2. RESTRUCTURING

On 30 June 2010 AS Citadele Banka was registered in the commercial registry of the Republic of Latvia and on the same date it received banking licence from the Financial and Capital Market Commission (FCMC). AS Citadele Banka was established as a result of implementation of AS Parex Banka’s restructuring plan, which was approved by the Cabinet of Ministers in the spring of 2010 and pursuant to which AS Citadele Banka was to take over from AS Parex Banka certain assets and liabilities and other items, i.e. an undertaking.

The transfer of undertaking from AS Parex Banka to AS Citadele Banka took place on 1 August 2010. The transfer of undertaking was performed under Article 59.2 of the Latvian Law on Credit Institutions (further also – CIL). Legal definition of undertaking is given in the same Article 59.2 of CIL. Transfer of undertaking is a civil law transaction between two parties: the transferor, AS Parex Banka, and the transferee, AS Citadele Banka, whereby the transferee acquires title to the transferred undertaking. The transferred undertaking, i.e. the components thereof, is agreed by both banks and defined in the agreement on transfer of undertaking, which was entered into on 28 July 2010.

The steps, which according to law need to be taken in order to execute transfer of undertaking of a credit institution differ from those needed to be taken when doing general reorganisation. The reason for that is that the transfer of credit institution’s undertaking is not a type of general reorganisation of a credit institution and different provisions of legal enactments have to be applied and complied with when doing one or the other. One of the most distinct differences and features is the fact that a credit institution is entitled not to seek consent of any creditor or other party in order to transfer its undertaking. The only permission/approval, which needs to be received, is from Financial and Capital Markets Commission as stipulated by Article 59.2 of CIL.

The steps and legal documentation in regard to the transfer of undertaking, i.e. restructuring, were as follows:

(a) The credit institution (according to its corporate procedures) takes a decision to implement a transfer of undertaking (i.e. a transfer of property and/or assets and/or liabilities);

*On 28 July 2010 the Management Boards of AS Parex Banka and AS Citadele Banka passed the decisions, whereby both banks decided to enter into an agreement on transfer of undertaking from AS Parex Banka to AS Citadele Banka. Approvals from supervisory board of each bank were received also on the same date. AS Parex Banka in addition to entering into the agreement on transfer of undertaking decided to submit to the FCMC proposal for transfer of undertaking in accordance with the agreement on transfer of undertaking.*

(b) An agreement regarding the transfer, and any other required document depending on the exact content of undertaking, to be transferred, are drafted;

*The business transfer agreement (In Latvian: Līgums par uzņēmuma pāreju) was signed by and between both banks on 28 July 2010.*

(c) A proposal for the transfer of undertaking, together with an evaluation of the ordinary value, in the conditions of a functioning market, of the assets and liabilities included in the undertaking, made by an eligible expert no more than 30 days before the proposal, is submitted to the FCMC;

*On 28 July 2010 AS Parex Banka submitted to FCMC proposal for transfer of undertaking together with a copy of the signed business transfer agreement and an evaluation of the ordinary value, in the conditions of a functioning market, of the assets and liabilities included in the undertaking, made by SIA KPMG Baltics and dated 26 July 2010.*

(d) The FCMC, upon a review of proposal and the evaluation, and any other facts and information it considers relevant, takes a decision either permitting the transfer of undertaking or not permitting it;

*On 30 July 2010 FCMC, namely its council, passed a decision No.213 to permit the transfer of undertaking to occur.*

(e) If the FCMC has decided to permit the transfer of undertaking, the credit institution and the transferee concerned can proceed with the transfer;

*On 30 July 2010 after receipt of the above referred FCMC decision both banks signed a certificate acknowledging that all conditions precedent set forth in the business transfer agreement in order for the transfer to take place on 1 August 2010 did occur and that the transfer is to be done. On 1 August 2010 transfer of undertaking took place in accordance with the concluded agreement.*

(f) In the course of the transfer, or once the relevant asset or liability has been transferred to the transferee, the transferee (and, if needed, the transferor) notify the relevant counterparties thereof so that the contractual relationships can continue without disturbance;

*AS Citadele Banka started to send out notifications to clients on 1 August 2010.*

(g) Any applicable public registration or similar procedures need to be implemented (for example, in respect of particular types of assets), either during the transfer or afterwards, as appropriate;

*Registrations in public registries in order to perfect the transfer of undertaking have been taking place since 1 August 2010 and according to plan should have been gradually finished by the end of 2010. At the date of signing these financial statements, some registration procedures still continue. However, the management of the Bank strongly believe that any outstanding procedures will not impact the Bank's ability to continue servicing the clients.*

(h) Any applicable consents from governmental authorities that are needed under the relevant applicable laws must also be obtained as required by those laws;

*Consents, where necessary, have been obtained. In order to thoroughly identify the necessary consents and approvals and to receive them as required, the bank received legal opinions and legal assistance from reputable lawyers in each of the jurisdictions of its operations and assets.*

Process of perfection of title over the transferred undertaking has been taking place ever since 1 August 2010 and is expected to be finalised during the first half of 2011. For the purposes of perfection not only Latvian law is applicable, but also law of each jurisdiction which is applicable to the component of undertaking in question.

## Restructuring implications

The Bank's establishment and future operations are part of the restructuring plan of AS Parex Banka that was approved by European Commission (further EC). On 15 September 2010, EC adopted the decision *On the State Aid C 26/2009 (ex N 289/2009)* that the restructuring aid which Latvia implements for AS Parex Banka and AS Citadele Banka is found to be compatible with the internal market within the meaning of Article 107(3)(b) of the Treaty on the Functioning of the European Union. To comply with the aforementioned requirements, the Bank has undertaken certain commitments in relation to the future business operations. The commitments have been taken into account, when preparing the long-term business plan of the Bank. During 2010, the Bank has complied with the commitments.

## Impact of financial crisis on the Group and Bank

The collapse of Lehman Brothers in mid-September 2008 and the unprecedented events in subsequent weeks intensified the turmoil in global financial markets leading to increased public uncertainty. Even though in 2010 global and Latvian economy experienced en economic upturn, there still remains uncertainty about the economic development in the future.

Borrowers of the Group and liquidity of certain types of assets may be affected by the financial crisis. This has been properly reflected by the management of the Bank in its estimates of expected future cash flows in asset impairment assessments.

## NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Certain new standards and interpretations have been published that are mandatory for the Group’s accounting periods beginning on or after 1 January 2011 or later periods and which the Group has early adopted:***

***Amendment to IAS 24, Related Party Disclosures, issued in November 2009*** (effective for annual periods beginning on or after 1 January 2011). The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. As a result the Bank and Group does not disclose transactions with government – related entities that are part of the Group’s normal business.

***Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2010 or later periods and which are not relevant to the Group or are not yet endorsed by the EU:***

- Classification of Rights Issues - Amendment to IAS 32 (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010).
- IFRS 9, Financial Instruments Part 1: Classification and Measurement (not yet endorsed by the EU).
- IFRS 9 adoption is required starting 1 January 2013, yet earlier application is also allowed, not yet endorsed by the EU.
- IFRIC 19, Extinguishing financial liabilities with equity instruments (effective for annual periods beginning on or after 1 July 2010).
- Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 (effective for annual periods beginning on or after 1 January 2011).
- Limited exemption from comparative IFRS 7 disclosures for first-time adopters - Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2010).
- Improvements to International Financial Reporting Standards, issued in May 2010 effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011; the improvements have not yet been adopted by the EU).
- Disclosures—Transfers of Financial Assets – Amendments to IFRS 7(effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU)
- Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12 (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU).
- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendment to IFRS 1. (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU.

The Group is in the process of evaluating the potential effect if any of these new standards and interpretations.

### *a) Basis of preparation*

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union on a going concern basis. The financial statements are prepared under the historical cost convention, except for available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss, trading securities and all derivative contracts, which have been measured at fair value.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on Management’s best knowledge of current events and actions, actual results ultimately may differ from those estimates.

### *b) Functional and Presentation Currency*

The functional currency of each of the Group’s consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of the Bank and its Latvian subsidiaries, and the Group’s presentation currency, is the national currency of the Republic of Latvia, Latvian lats (“LVL”). The accompanying financial statements are presented in thousands of Lats (LVL 000’s).

### *c) Accounting for restructuring/ transfer of undertaking*

When determining the assets and liabilities that were eligible for the transfer of undertaking that took place at the beginning of 1 August 2010, the composition of assets and the liabilities were determined on the parent bank’s, i.e. AS Parex Banka stand-alone accounts basis. Any differences in the carrying value of investments in subsidiaries that were transferred to AS Citadele Banka and their net equity as at the date of transfer, are treated as restructuring reserves in the consolidated financial statements of AS Citadele Banka. Group’s financial statements incorporate the transferred subsidiaries’ results only from the date on which the restructuring between entities under common control occurred, i.e. 1 August 2010.

The carrying amount of net assets that were transferred to the Bank equalled zero. Since the carrying value of net assets was zero and any possible impairment could not reduce the value of net assets below zero, the fair value less costs to sell of the net assets transferred to the Bank equalled the carrying amount of those net assets. The transfer transaction was accounted using predecessor accounting i.e. the transferred assets and liabilities were initially recognised at their carrying amount as in the predecessor bank.

### *d) Basis of Consolidation*

As at 31 December 2010, the Bank had a number of investments in subsidiaries, in which the Bank held directly and indirectly more than 50% of the shares and voting rights, and accordingly, had the ability to exercise control. The investments in the subsidiaries are presented in the Bank’s financial statements at acquisition cost. More detailed information on the Group’s subsidiaries is presented in Note 18.

The financial statements of AS Citadele Banka and its subsidiaries are consolidated in the Group’s financial statements on a line by line basis by adding together like items of assets and liabilities as well as income and expenses. For the purposes of consolidation, intra-group balances and intra-group transactions, including interest income and expense as well as unrealised profits and loss resulting from intra-group transactions, are eliminated in the Group’s financial statements. However, intra-group losses may indicate an impairment that requires recognition in the Group’s financial statements.

### *e) Income and Expense Recognition*

Interest income and expense items are recognised on an accrual basis using the effective interest rate.

Commissions in respect of the acquisition of financial assets or the issue of financial liabilities that are not at fair value through profit or loss are deferred and recognised as an adjustment to the effective yield on the respective asset or liability. Other commissions and fees are credited and/ or charged to the statement of income as services are provided or on the execution of a significant act, as applicable, under the line “commission and fee income” or “commission and fee expense”, as appropriate.

Penalty income is recognised on cash-received basis.

### *f) Foreign Currency Translation*

Transactions denominated in foreign currencies are recorded in Lats at actual rates of exchange effective at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency, such as investments in equity instruments, are translated using the exchange rates at the date, when the fair value was determined and the impact from changes in foreign exchange rates are treated as foreign exchange gain/loss in the income statement. Monetary assets and liabilities denominated in foreign currencies are translated into Lats at the official rate of exchange prevailing at the end of the year. Any gain or loss resulting from a change in rates of exchange subsequent to the date of the transaction is included in the statement of income as a profit or loss from revaluation of foreign currency positions.

The results and financial position of all the Group’s entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions).
- all resulting exchange differences are recognised as other comprehensive income.

### *g) Taxation*

For the year period 31 December 2010 corporate income tax is applied at the rate of 15% on taxable income generated by the Bank for the taxation period.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

The carrying amount of deferred corporate income tax asset, if any, is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. The future taxable profits and the amount of tax benefits that are probable in the future are based on a medium term financial forecast prepared by management and extrapolated results thereafter. The financial forecast is based on management expectations that are believed to be reasonable under the circumstances.

### *h) Financial instruments*

The Group recognises financial asset on its balance sheet when, and only when, the Group becomes a party to the contractual provisions of the instrument.

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. At initial recognition, the financial assets are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable incremental transaction costs. The classification of investments between the categories is determined at acquisition based on the guidelines established by the Management.

All “regular way” purchases and sales of investments are recognised using settlement date accounting. The settlement date is the date when an asset is delivered to or by the Group. Settlement date accounting refers to the recognition of an asset on the day it is transferred to the Group and to the derecognition of an asset, on the day that it is transferred by the Group.

#### Financial assets and liabilities held for trading

Financial assets and liabilities classified as held for trading are included in the category “financial assets/ liabilities at fair value through profit or loss”. Financial assets and/ or liabilities are classified as held for trading if they are either acquired for generating a profit from short-term fluctuations in price or dealer’s margin, or are included in a portfolio in which a pattern of short-term profit taking exists.  Held for trading financial assets and liabilities are subsequently re-measured at fair value based on available market prices or quotes of brokers. The result of re-measuring trading financial assets and liabilities at fair value is charged directly to the statement of income.

#### Financial assets/ liabilities designated at fair value through profit and loss

Included in this category are (a) unit-linked investment contract liabilities and respective investments and (b) certain securities, which are managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. According to unit-linked investment contract term, the credit risk associated with the investments made by the insurance underwriter is fully attributable to the counterparty entering the insurance agreement and not the underwriter. As such, by designating both assets acquired and liabilities undertaken at fair value through profit and loss, potential accounting mismatch is avoided.

Excluding interest on interest rate swaps, interest on financial assets at fair value through profit or loss held on own account is included in net interest income. Revaluation and trading gains and losses arising from changes in fair value of the respective assets, as well as interest on interest rate swaps are included directly in the income statement’s line “(Loss)/gain on transactions with financial instruments, net”.

#### Held to maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity if the Group has both the positive intent and ability to hold these investments to maturity.  Held-to-maturity financial assets are carried at amortised cost using the effective interest rate method, less any allowance for impairment.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of the impairment loss for assets carried at amortised cost is calculated as the difference between the asset’s carrying amount and the present value of expected future cash flows discounted at the financial instrument’s original effective interest rate.

When available-for-sale assets are reclassified to held-to-maturity category, the fair value of the reclassified available-for-sale asset as at the date of reclassification further becomes the amortised cost. The fair value as of the date of reclassification is the deemed cost of the reclassified assets. The fair value revaluation reserve attributable to reclassified assets are amortised until the asset’s maturity using effective interest rate method. If there is objective evidence that the value of reclassified assets has been impaired, the unamortised negative fair value revaluation reserve that has been recognised directly in equity is charged to the statement of income.

Available for sale financial assets

Available for sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. The Group's available for sale financial assets are intended to be held for an undefined period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available for sale financial assets are subsequently re-measured at fair value based on available market prices or quotes of brokers. The result of fair value revaluation of available for sale securities is recognised in other comprehensive income statement. The difference between the initial carrying amount and amortised cost determined by the effective interest rate method is treated as interest income. Dividends on available-for-sale equity instruments are recognised in the income statement. When the securities are disposed of, the related accumulated fair value revaluation is included in the statement of income as profit/ (loss) from sale of securities available for sale.

If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement. However, interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the consolidated income statement.

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale 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 through the income statement.

Derivative Financial Instruments

In the ordinary course of business, the Group engages as a party to contracts for forward foreign exchange rate, currency and interest rate swap instruments and other derivative financial instruments. All derivatives are classified as held-for-trading.

Subsequent to initial recognition, outstanding forward foreign exchange rate contracts, currency swaps and other derivative financial instruments are carried in the balance sheet at their fair value. The fair value of these instruments is recognised on the balance sheet under designated assets and liabilities caption "Derivative financial instruments".

Gains or losses from changes in the fair value of outstanding forward foreign exchange rate contracts, currency and interest rate swaps and other derivative financial instruments are recognised in the statement of income as they arise.

*Own credit risk in valuations of derivative liabilities*

The Group's own credit changes are reflected in valuations of such derivative liabilities, where the Group's own credit risk would be considered by market participants and excludes derivatives for which it is established market practice not to include an entity-specific adjustment for own credit, also referred to as counterparty close out approach. This amount represents the estimated difference in the market value of identical obligations issued by a riskless intermediary, relative to the market value of those obligations issued by the Group, as judged from the perspective of the holders of those obligations. Own credit changes were calculated based on credit default swap spreads. At 31 December 2010, there are no material liabilities / assets arising from Group's own credit assessment.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Loans and receivables are recognised on drawdown. From the date of signing a contractual agreement till drawdown they are accounted for as loan commitments off balance sheet.

When the loans or receivables cannot be recovered, they are written-off and charged against impairment for credit losses. The management of the Group makes the decision on writing-off loans. Recoveries of loans previously written-off are credited to the statement of income.

Included in the category of "loans and receivables" are such financial instruments: a) cash and deposits with central banks, b) balances due from credit institutions and c) loans and receivables to customers.

Issued debt, subordinated debt and other borrowed funds

The Group recognises financial liabilities on its balance on drawdown.

After initial measurement, being fair value plus directly attributable transaction costs, debt issued, subordinated debt and borrowings are measured at amortised cost and any difference between net proceeds and value at redemption is recognised in the statement of income over the period of borrowings using the effective interest rate.

### *i) Sale and Repurchase Agreements*

These agreements are accounted for as financing transactions. Under sale and repurchase agreements, where the Group is the transferor, assets transferred remain on the Group's balance sheet and are subject to the Group's usual accounting policies, with the purchase price received included as a liability owed to the transferee. Assets in the balance sheet are shown separately from other assets when the transferee has the right by contract or custom to sell or repledge the collateral.

Where the Group is the transferee, the assets are not included in the Group's balance sheet, but the purchase price paid by it to the transferor is included as an asset. Interest income or expense arising from outstanding sale and repurchase agreements is recognised in the statement of income over the term of the agreement.

### *j) Derecognition of Financial Assets and Liabilities*

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Group either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/ or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions is not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

*k) Leases*

Finance leases – Group as lessor

Finance leases, which transfer substantially all the risks and rewards incidental to ownership of the assets, are recognised as assets at amounts equal at the inception of the lease to the net investment in the lease. The finance income is allocated to periods during the lease term to produce a constant periodic return on the net investments outstanding in respect of the finance leases.

For the purposes of these financial statements, finance lease receivables are included in loans and receivables to customers.

Operating leases – Group as lessor

The Group presents assets subject to operating leases in the balance sheets according to the nature of the asset. Lease income from operating leases is recognized in statement of income on a straight-line basis over the lease term as other income. The aggregate cost of incentives provided to lessees is recognized as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

The depreciation policy for depreciable leased assets is consistent with the lessor’s normal depreciation policy for similar assets, and depreciation is calculated in accordance with accounting policies, used for the Group’s property, plant and equipment.

Operating leases – Group as lessee

Leases of assets under which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into administrative expenses.

*l) Impairment of loans and receivables to customers*

The Group has granted commercial and consumer loans to customers throughout its market area. The economic conditions of the market the Group operates in may have an impact on the borrowers’ ability to repay their debts. The Management of the Group have considered both specific and portfolio-level risks in determining the balance of impairment allowance for incurred credit losses.

The Management of the Group assess at each balance sheet date whether there is objective evidence that a loan or portfolio of loans and receivables to customers is impaired. A loan or portfolio of loans and receivables to customers is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the loan and that loss event (or events) has had an impact such that the estimated present value of future cash flows is less than the current carrying value of the loan or portfolio of loans and receivables to customers, and can be reliably estimated.

Objective evidence that a loan or portfolio of loans and receivables to customers is potentially impaired includes the following observable data that comes to the attention of the Group:

- significant financial difficulty of the borrower;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the granting to the borrower of a concession, for economic or legal reasons relating to the borrower’s financial difficulty, that the Group would not otherwise consider;
- it becoming probable that the insolvency process may be initiated against the borrower, or the borrower will enter other financial reorganisation;
- the worsening of economic conditions in the market segment, where the borrower operates; or
- observable data indicating the there is a measurable decrease in the estimated future cash flows from a portfolio of loans and receivables to customers since the initial recognition of those of loans and receivables, although the decrease cannot yet be identified with the individual loans in the portfolio, including:
  - adverse changes in the payment status of borrowers in the portfolio; or
  - national or local economic conditions that correlate with defaults on the loans and receivables in the portfolio.

The Group first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, it includes that loan in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Collectively assessed impairment losses represent an interim step pending the identification of impairment losses on individual loans in a group of loans and receivables. As soon as information is available that specifically identifies losses on individually impaired loans in a group, those loans are removed from the group. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and receivables, the amount of impairment loss is measured as the difference between the loan’s carrying amount and the present value of estimated future cash flows discounted at the loan’s original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised loan reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. The amount of the loss is recognised in the statement of income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was initially recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of the impairment loss is recognised in the statement of income, to the extent that the carrying value of the loan does not exceed what its amortised cost would have been absent the impairment at the reversal date.

When a borrower fails to make a contractually due payment of interest or principal, but the Group believes that impairment is not appropriate on the basis of the level of security/ collateral available and/ or the stage of collections of amounts owed to the Group, the carrying amount of the loan is classified as past due but not impaired.

When loans and receivables cannot be recovered, they are written off and charged against impairment allowance. They are not written off until the necessary legal procedures have been completed and the amount of the loss is finally determined. Subsequent recoveries of amounts previously written off are reported in the statement of income as other operating income.

*m) Impairment of available-for-sale and held-to-maturity securities*

Evidence of impairment is assessed by reference to the most up to date market valuations, market depth of the respective security, past trading performance and all other available information. The determination of whether or not objective evidence of impairment is present requires the exercise of management judgement. If the Group does not have market valuations, the evidence of impairment is assessed based on credit risk triggers (event of insolvency, any delay of payments, restructuring of debt) and individual credit risk analysis of the issuer.

*n) Business combinations and goodwill*

Business combinations are accounted for using the purchase method of accounting, which, in essence, involves recognizing identifiable assets, liabilities and contingent liabilities of the acquired business at fair value. Any excess of the cost of acquisition over the fair value of identifiable net assets acquired is recognized as goodwill. If the cost of acquisition is less than fair value of the identifiable net assets acquired, the discount on acquisition is recognized in the income statement in the year of acquisition.

Following the initial recognition, in Group accounts the goodwill arising from the business combinations is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that the carrying amount of the goodwill may be impaired.

*o) Intangible Assets*

Intangible assets comprise software. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Subsequent the initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment loss.

Leasehold rights are amortised over the remaining lease contract on a straight-line basis. Annual amortisation rates applied on a straight-line basis to software and other intangible assets range from 7% to 50%. All intangible assets, except for goodwill, are with definite lives.

*p) Fixed Assets*

Fixed assets are recorded at historical cost less accumulated depreciation less any impairment losses. Fixed assets are periodically reviewed for impairment. If the recoverable value of a fixed asset is lower than its carrying amount, the respective asset is written down to its recoverable amount.

Depreciation is calculated using the straight-line method based on the estimated useful life of the asset. The following depreciation rates have been applied:

| Category | Annual depreciation rate |
|---|---|
| Buildings | 2% |
| Transport vehicles | 20% |
| Other fixed assets | 20% - 33% |

Leasehold improvements are capitalised and depreciated over the remaining lease contract period on a straight-line basis. Land and assets under construction are not depreciated.

Certain reconstruction and renovation costs of buildings, which improve their quality and performance, are capitalised and amortised over the estimated useful life on a straight-line basis.

Maintenance and repair costs are charged to the statement of income as incurred.

### *q) Assets held for sale*

The Group from time to time repossesses from its customers certain assets serving as collateral, when the customer cannot otherwise meet his payment obligations and other loan work-out measures have been unsuccessful. Such assets are classified as held for sale, because they are acquired primarily for the purpose of selling them in the near term. Assets classified as held for sale are stated at the lower of their carrying amount of the outstanding debt and fair value less costs to sell of the tangible asset. At least at each reporting date, the Group assesses, whether the value of the repossessed assets is impaired. The impairment loss reduces carrying amount of the asset and is included in the income statement's line "Impairment charges and reversals, net".

### *r) Provisions*

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

### *s) Off-balance Sheet Financial Commitments and Contingent Liabilities*

In the ordinary course of business, the Group is involved with off-balance sheet financial commitments and contingent liabilities comprising commitments to extend loans and receivables to customers, commitments for unutilised credit lines or credit card limits, financial guarantees and commercial letters of credit.

Such financial instruments are recorded in the financial statements as follows:
- commitment to extend loans and advances, credit card and overdraft facilities are recognized on drawdown; and
- financial guarantees and letters of credit are recognized when the related fee received as consideration is recognized.

Commitments to extend loans and receivables and commitments for unutilised credit lines or credit card limits represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

On initial recognition financial guarantee contracts are measured at fair value. Subsequently, they are carried at the higher of the amount initially recognised less cumulative amortisation over the life of the guarantee and the amount determined in accordance with the accounting policy for provisions when enforcement of the guarantee has become probable.

The methodology for provisioning against possible losses arising from off-balance sheet financial commitments and contingent liabilities is consistent with that described in paragraph *r)*.

### *t) Trust Activities*

Funds managed by the Group on behalf of individuals, corporate customers, trusts and other institutions are not regarded as assets of the Group and, therefore, are not separately included in the balance sheet. Funds under trust management are presented in these financial statements only for disclosure purposes.

*u) Fair Values of Financial Assets and Liabilities*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable and willing parties in an arm's length transaction. Where available and reasonably reliable, fair values are determined by reference to observable market prices. Where representative market prices are not available or are unreliable, fair values are determined by using valuation techniques which refer to observable market data. These include prices obtained from independent market surveys, comparisons with similar financial instruments, discounted cash flow analyses and other valuation techniques commonly accepted and used by market participants.

Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effect of any changes in estimates will be recorded in the financial statements, when determinable. Further, changes and movement in market conditions may affect accuracy of the fair value calculations so that the actual outcome of the transactions is different from the one reported in the financial statements. Also, when changed, management estimates used in preparing these financial statements could impact the reported result of the Group.

*v) Cash and Cash Equivalents*

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as the amounts comprising cash and demand deposits with central banks and other credit institutions with an insignificant risk of changes in value and a remaining maturity of not more 3 months from the date of acquisition, less demand deposits due to credit institutions.

*w) Offsetting*

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

*x) Staff costs and related contributions*

The Group and the Bank pays social security contributions to state pension insurance and to the state funded pension scheme in accordance with Latvian and relevant foreign regulations. In accordance with the Rules of the Cabinet of Ministers of Latvia circa 65% of the social insurance contributions are used to fund the state defined contribution pension system. State funded pension scheme is a defined contribution plan under which the Group and the Bank pay fixed contributions determined by law and will have no legal or constructive obligation to pay further contributions if the state pension insurance system or state funded pension scheme are not able to settle their liabilities to employees. The social security contributions are accrued in the year in which the associated services are rendered by the employees of the group.

*y) Events after the balance sheet date*

Post-year-end events that provide additional information about the Bank's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes if material.

*z) Use of estimates in the preparation of financial statements*

The preparation of financial statements in conformity with International Financial Reporting Standards as adopted by EU, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingencies. The management has applied reasonable and prudent estimates and judgments in preparing these financial statements. The significant areas of estimation used in the preparation of the accompanying financial statements relate to evaluation of impairment for financial assets losses, determining fair values of the financial assets and liabilities and estimating future periods' taxable profit in order to assess amount of deferred tax assets that can be utilised and, as such, recognised.

*Impairment of loans*

The Group regularly reviews its loans and receivables to assess impairment. The estimation of potential impairment losses is inherently uncertain and dependant upon many factors. On an on-going basis potential issues are identified promptly as a result of individual loans being regularly monitored. Impairment losses are calculated on an individual basis with reference to expected future cash flows including those arising from the realisation of collateral. The Group uses its experienced judgement to estimate the amount of any impairment loss considering matters such as future economic conditions and the resulting trading performance of the borrower and the value of collateral, for which there may not be a readily accessible market. As a result, the impairment losses can be subject to significant variation as time progresses and the circumstances become clearer. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In addition, the Group estimates collective impairment losses to cover losses inherent in the loan portfolio where there is objective evidence to suggest that it contains impaired loans, although the individual impaired loans cannot yet be identified. The collective impairment losses take account of observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and receivables with similar credit risk characteristics, although the decrease cannot yet be identified with the individual loans in the portfolio.

Future cash flows in a portfolio of loans and receivables that are collectively evaluated for impairment are estimated on the basis of historical loss experience for loans and receivables with credit risk characteristics similar to those in the portfolio. Historical loss experience is adjusted for current observable market data using the Group's experienced judgement to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

The future credit quality of the loan portfolio for which the collective impairment losses are estimated is subject to uncertainties that could cause actual credit losses to differ materially from reported impairment losses. These uncertainties include factors such as international and local economic conditions, borrower specific factors, industry and market trends, interest rates, unemployment rates and other external factors. Changes in the Bank's LGD ratio by 500 basis points would result in increase/ decrease in collectively assessed impairment by ca. LVL 1.96 million.

*Impairment of securities*

The Group makes various estimates to determine the value of securities assessed for impairment. When the value of securities, for which loss event have occurred, is assessed for impairment, an estimate is made involving factors such as liquidity (quoted prices and volumes from several reliable providers as well as judgemental evaluation), spreads (estimation of securities' spreads and spreads on securities rated Caa1 and below), ratings (subordination) and loss-given-default (LGD) rates.

The future credit quality of the securities for which the impairment losses are estimated is subject to uncertainties that could cause actual credit losses to differ materially from reported impairment losses. These uncertainties include factors such as international, regional and local economic conditions, issuer specific factors, market activity and depth, interest rates and other external factors. As at 31 December 2010, increase or decrease in credit spread delta by 200 basis points would result in no additional impairment for the Bank.

*Deferred tax asset*

The future taxable profits and the amount of tax benefits that are probable in the future are based on a medium term financial forecast prepared by management and extrapolated results thereafter. The aforementioned forecasts indicate that the Bank will have sufficient taxable profits in the future periods to realise the recognised deferred tax asset.

## NOTE 4. INTEREST INCOME AND EXPENSE

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Interest income: | | |
| - interest on financial assets measured at amortised cost: | 21,421 | 18,799 |
| *- interest on loans and receivables to customers* | *20,095* | *17,441* |
| *- interest on balances due from credit institutions and central banks* | *512* | *701* |
| *- interest on held-to-maturity securities* | *814* | *657* |
| - interest on available-for-sale securities | 4,181 | 3,519 |
| - interest on held for trading securities | 66 | 61 |
| - interest income on financial assets designated at fair value through profit or loss | 27 | - |
| **Total interest income** | **25,695** | **22,379** |
| | | |
| Interest expense: | | |
| - interest on financial liabilities measured at amortised cost: | (26,366) | (24,852) |
| *- interest on deposits from customers* | *(20,075)* | *(18,454)* |
| *- interest on subordinated liabilities* | *(3,761)* | *(3,761)* |
| *- interest on issued debt securities* | *(2,507)* | *(2,509)* |
| *- interest on balances due to credit institutions and central banks* | *(14)* | *(128)* |
| *- interest on other financial liabilities* | *(9)* | - |
| **Total interest expense** | **(26,366)** | **(24,852)** |
| | | |
| **Net interest expense** | **(671)** | **(2,473)** |

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Interest income recognised on impaired assets | 5,403 | 5,698 |

## NOTE 5. COMMISSION AND FEE INCOME AND EXPENSE

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Commission and fee income: | | |
| - transactions with settlement cards | 5,357 | 4,862 |
| - payment transfer fee | 1,955 | 1,477 |
| - custody, trust and asset management fees | 1,729 | 125 |
| - securities, financial instrument brokerage fees | 475 | 422 |
| - service fee for account maintenance | 451 | 393 |
| - cash disbursement/ transaction commission | 436 | 283 |
| - cash collection | 348 | 348 |
| - letters of credit and guarantees | 127 | 66 |
| - review of loan applications and collateral evaluation | 69 | 64 |
| - other fees | 254 | 250 |
| **Total commission and fee income** | **11,201** | **8,290** |

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Commission and fee expense: | | |
| - fees related to settlement card operations | (2,767) | (2,312) |
| - fees related to correspondent accounts | (431) | (384) |
| - brokerage and custodian fees: | (183) | (198) |
| *- securities, financial instrument brokerage fees* | *(127)* | *(108)* |
| *- custody, trust and asset management fees* | *(56)* | *(90)* |
| - other fees | (41) | (4) |
| **Total commission and fee expense** | **(3,422)** | **(2,898)** |
| | | |
| **Net commission and fee income** | **7,779** | **5,392** |

Commission and fee income and expense from financial instruments not at fair value through profit and loss, other than amounts included in determining the effective interest rate, can be specified as follows:

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Commission and fee income | 11,201 | 8,290 |
| Commission and fee expense | (3,422) | (2,898) |

## NOTE 6. GAIN ON TRANSACTIONS WITH FINANCIAL INSTRUMENTS, NET

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Gain from trading and revaluation of securities held for trading purposes, net | 17 | 7 |
| Loss from disposal of available for sale securities, net | (493) | (595) |
| Gain on financial assets measured at amortised cost, net | 275 | - |
| Gain from foreign exchange trading and revaluation of open positions, net | 3,888 | 3,346 |
| Loss from trading and revaluation of other derivatives, net | (1,183) | (988) |
| **Gain on trading with financial instruments, net** | **2,504** | **1,770** |

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Net loss on financial instruments not at fair value through profit or loss | (218) | (595) |
| Net gain on financial instruments at fair value through profit or loss | 2,722 | 2,365 |
| **Total gain on financial instruments, net** | **2,504** | **1,770** |

## NOTE 7. OTHER INCOME

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Penalties received | 2,288 | 1,925 |
| Dividends received | 1 | 1 |
| Other income | 1,465 | 816 |
| **Total other operating income** | **3,754** | **2,742** |

## NOTE 8. ADMINISTRATIVE EXPENSE

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Personnel expense | 11,556 | 8,218 |
| Rent, utilities, maintenance | 1,522 | 2,106 |
| IT equipment and software related expense | 1,114 | 663 |
| Non-refundable value added tax | 701 | 495 |
| Consulting and professional fees | 572 | 224 |
| Advertising, marketing and sponsorship | 468 | 366 |
| Office administration expense | 322 | 269 |
| Communications (telephone, telex, etc.) | 284 | 182 |
| Car maintenance | 196 | 184 |
| Business travel expense | 179 | 131 |
| Insurance | 143 | 82 |
| Representation | 104 | 69 |
| Real estate and other taxes | 86 | 1 |
| Security | 73 | 36 |
| Other administrative expense | 696 | 372 |
| **Total administrative expense** | **18,016** | **13,398** |

## NOTE 9. PERSONNEL EXPENSE

Personnel expense has been presented in these financial statements within administrative expense. Personnel expense includes remuneration for work to the personnel and related social security contributions and bonuses and other short-term benefits costs.

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Remuneration (incl. bonuses): | | |
| - management | 740 | 229 |
| - other personnel | 8,570 | 6,387 |
| **Total remuneration for work** | **9,310** | **6,616** |
| Social security contributions: | | |
| - management | 154 | 55 |
| - other personnel | 2,092 | 1,547 |
| **Total social security contributions** | **2,246** | **1,602** |
| **Total personnel expense** | **11,556** | **8,218** |
| Number of full time employees at the end of the period | 1,762 | 1,329 |

## NOTE 10. IMPAIRMENT OF ASSETS AND CHANGES IN IMPAIRMENT ALLOWANCES

An analysis of the change in allowances for impairment of loans and receivables is presented as follows:

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| **Total allowance for impairment as a result of the restructuring, including:** | **52,787** | **53,397** |
| *- loans - specifically assessed impairment* | 37,514 | 44,651 |
| *- loans - collectively assessed impairment* | 15,273 | 8,746 |
| Charge: | **14,188** | **12,415** |
| *- loans - specifically assessed impairment* | 13,201 | 11,632 |
| *- loans - collectively assessed impairment* | 987 | 783 |
| Release: | **(5,284)** | **(4,582)** |
| *- loans - specifically assessed impairment* | (2,755) | (2,373) |
| *- loans - collectively assessed impairment* | (2,529) | (2,209) |
| **Provision charged to the statement of income, net, including:** | **8,904** | **7,833** |
| *- loans - specifically assessed impairment* | 10,446 | 9,259 |
| *- loans - collectively assessed impairment* | (1,542) | (1,426) |
| **Change of allowance due to write-offs, net** | **(1,055)** | **(756)** |
| **Effect of changes in currency exchange rates:** | **(3)** | **49** |
| *- loans - specifically assessed impairment* | - | 49 |
| *- loans - collectively assessed impairment* | (3) | - |
| **Total allowance for impairment at the end of the period, including:** | **60,633** | **60,523** |
| *- loans - specifically assessed impairment* | 46,905 | 53,203 |
| *- loans - collectively assessed impairment* | 13,728 | 7,320 |

An analysis of the change in impairment of other assets is presented as follows:

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| **Total allowance for impairment as a result of the restructuring, including:** | **24,247** | **17,497** |
| *- available-for-sale securities* | 3,013 | 3,013 |
| *- due from credit institutions* | 540 | 540 |
| *- other non-financial assets* | 20,694 | 13,944 |
| Charge: | **1,425** | **2,883** |
| *- available-for-sale securities* | 357 | 357 |
| *- other non-financial assets* | 1,068 | 2,526 |
| Release: | **(356)** | **(4)** |
| *- other non-financial assets* | (356) | (4) |
| **Provision charged to the statement of income, net, including:** | **1,069** | **2,879** |
| *- available-for-sale securities* | 357 | 357 |
| *- other financial and non-financial assets* | 712 | 2,522 |
| **Change of allowance due to write-offs, net:** | **(1,115)** | **-** |
| *- other non-financial assets* | (1,115) | - |
| **Effect of changes in currency exchange rates:** | **(15)** | **(5)** |
| *- due from credit institutions* | (5) | (5) |
| *- other non-financial assets* | (10) | - |
| **Total allowance for impairment at the end of the period, including:** | **24,186** | **20,371** |
| *- available-for-sale securities* | 3,370 | 3,370 |
| *- due from credit institutions* | 535 | 535 |
| *- other non-financial assets* | 20,281 | 16,466 |

## NOTE 11. TAXATION

Corporate income tax expense comprises the following items:

| | LVL 000's | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Current corporate income tax | 115 | - |
| Deferred income tax | (858) | (840) |
| Tax withheld abroad | 268 | 268 |
| Prior year adjustments | (6) | - |
| **Total corporate income tax expense** | **(481)** | **(572)** |

The reconciliation of the Bank’s and the Group’s pre-tax loss for the period to the corporate income tax expense for the period may be specified as follows:

| | LVL 000’s | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| Loss before corporate income tax | (19,292) | (19,999) |
| **Corporate income tax (at standard rate)*** | **(2,894)** | **(3,000)** |
| Permanent differences, net | (1,120) | 328 |
| Prior year adjustments | (6) | - |
| Unrecognised deferred tax assets | 3,539 | 2,100 |
| **Total effective corporate income tax** | **(481)** | **(572)** |

* standard rate for the period ended 31 December 2010 was 15%.

The movements in deferred corporate income tax liability can be specified as follows:

| | LVL 000’s | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| As at 30 June | - | - |
| Restructuring | (28,867) | (29,226) |
| Charge to statement of income | (858) | (840) |
| Charge to statement of comprehensive income** | 116 | 86 |
| **Total deferred income tax (asset) at the end of the year** | **(29,609)** | **(29,980)** |

Deferred corporate income tax assets and liabilities can be specified as follows:

| | LVL 000’s | |
|---|---|---|
| | 2010 Group | 2010 Bank |
| *Deferred tax liabilities:* | | |
| Accumulated excess of tax depreciation over accounting depreciation | 737 | 278 |
| *Deferred tax assets:* | | |
| Vacation pay accrual | (248) | (237) |
| Revaluation of securities and derivatives** | (35) | (35) |
| Non-taxable impairment allowance | (5,679) | (5,703) |
| Unutilised tax losses | (32,216) | (26,383) |
| **Net deferred corporate income tax (asset)** | **(37,441)** | **(32,080)** |
| Unrecognised deferred tax asset | 7,832 | 2,100 |
| **Recognised deferred corporate income tax (asset)** | **(29,609)** | **(29,980)** |

** all changes in deferred tax liability that are charged directly to statement of comprehensive income are related to revaluation of securities.

Group’s and Banks unutilised tax losses by expiry date can be specified as follows:

| | LVL 000’s | |
|---|---|---|
| | Group | Bank |
| Expiry year: | | |
| 2011 | 253 | - |
| 2012 | 2,295 | - |
| 2013 | 1,198 | - |
| 2014 | 634 | - |
| 2015 | - | - |
| 2016 | 61,494 | 61,494 |
| 2017 | 55,976 | 55,976 |
| 2018 | 55,428 | 55,428 |
| Undated | 27,772 | 2,989 |
| **Total unutilised tax losses** | **205,050** | **175,887** |

The movements in tax accounts of the Bank during 2010 can be specified as follows:

| | LVL 000's | | | |
|---|---|---|---|---|
| | Balance as at 30/06/2010 | Calculated in 2010 | Paid in 2010 | Balance as at 31/12/2010 |
| Corporate income tax | - | (268) | 268 | - |
| *including corporate income tax withheld abroad* | - | *(268)* | *268* | - |
| Social security contributions | - | (2,061) | 1,643 | (418) |
| Personal income tax | - | (1,719) | 1,718 | (1) |
| Value added tax | - | (128) | 104 | (24) |
| Real estate tax | - | - | - | - |
| **Total tax (payable)/ receivable** | **-** | **(4,176)** | **3,733** | **(443)** |

## NOTE 12. CASH AND DEPOSITS WITH CENTRAL BANKS

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Cash | 40,647 | 38,268 |
| Deposits with the Bank of Latvia | 106,472 | 106,472 |
| Demand deposits with other central banks | 40,101 | 32,608 |
| **Total cash and deposits with central banks** | **187,220** | **177,348** |

According to the resolution of the Council of the Bank of Latvia, credit institutions should comply with the compulsory reserve requirement calculated on the basis of attracted funding. The Bank's compulsory reserve must be exceeded by a credit institution's average monthly LVL balance on its correspondent account with the Bank of Latvia. Similar requirements also apply to the funding attracted by the Bank's branch in Estonia. During the reporting year, the Bank was in compliance with these requirements.

Demand deposits with other central banks include balances with central banks of Lithuania, Estonia, Germany and Switzerland. As at 31 December 2010, none of the amounts due from central banks were past due.

## NOTE 13. BALANCES DUE FROM CREDIT INSTITUTIONS

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Due from credit institutions registered in OECD countries | 155,673 | 127,670 |
| Due from credit institutions registered in Latvia | 57,932 | 54,576 |
| Due from credit institutions registered in other non-OECD countries | 6,554 | 29,897 |
| **Total gross balances due from credit institutions** | **220,159** | **212,143** |
| *Incl. impaired balances* | *535* | *535* |
| Impairment allowance | (535) | (535) |
| **Total net balances due from credit institutions** | **219,624** | **211,608** |

As at 31 December 2010, the Bank had inter-bank term deposits with 4 Latvian credit institutions and 6 OECD region credit institutions. Term deposit balances comprised 100% and 54% of total balances due from credit institutions registered in Latvia and OECD, respectively. As at 31 December 2010, none of the amounts due from credit institutions were past due.

The Bank's balances with its subsidiary AB Citadele Bankas (Lithuania) accounted for 82% of the total balances due from credit institutions registered in other non-OECD countries.

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Correspondent accounts (nostro) | 65,809 | 62,383 |
| Overnight deposits | 26,773 | 34,704 |
| **Total demand deposits** | **92,582** | **97,087** |
| *Term deposits with credit institutions:* | | |
| due within 1 month | 106,496 | 89,345 |
| due within 1-3 months | 6,800 | 12,720 |
| due within 3-6 months | 246 | - |
| due within 6-12 months | 201 | - |
| due within 1-5 years | 13,034 | 12,456 |
| Over 5 years and undated | 800 | 535 |
| **Total term deposits** | **127,577** | **115,056** |
| **Total gross balances due from credit institutions** | **220,159** | **212,143** |
| Impairment allowance | (535) | (535) |
| **Total net balances due from credit institutions** | **219,624** | **211,608** |

The above balances represent a maximum credit risk exposure to the Group and the Bank respectively.

## NOTE 14. LOANS AND RECEIVABLES TO CUSTOMERS

The following table represents the current classes of loans:

| | Group, LVL 000's | | | Bank, LVL 000's | | |
|---|---|---|---|---|---|---|
| | 31/12/2010 | | | 31/12/2010 | | |
| | Balance sheet amount | Off-balance sheet credit exposure | Total gross credit exposure | Balance sheet amount | Off-balance sheet credit exposure | Total gross credit exposure |
| Regular loans | 649,225 | 6,162 | 655,387 | 560,114 | 5,965 | 566,079 |
| Utilised credit lines | 62,086 | 12,720 | 74,806 | 107,751 | 44,571 | 152,322 |
| Finance leases | 50,471 | - | 50,471 | 15 | - | 15 |
| Debit balances on payment cards | 75,187 | 64,816 | 140,003 | 66,583 | 54,573 | 121,156 |
| Overdraft facilities | 12,988 | 7,935 | 20,923 | 13,100 | 7,940 | 21,040 |
| Loans under reverse repurchase agreements | 596 | - | 596 | - | - | - |
| Factoring | 304 | - | 304 | - | - | - |
| Due from investment and brokerage firms | 4,105 | - | 4,105 | 4,058 | - | 4,058 |
| **Total loans and receivables to customers** | **854,962** | **91,633** | **946,595** | **751,621** | **113,049** | **864,670** |
| Impairment allowance | (60,633) | - | (60,633) | (60,523) | - | (60,523) |
| **Total net loans and receivables to customers** | **794,329** | **91,633** | **885,962** | **691,098** | **113,049** | **804,147** |

Off-balance sheet credit exposure comprises various committed financing facilities to the borrowers.

The table below provides information about loans with renegotiated terms:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Carrying amount of restructured loans | 96,722 | 90,200 |

Loans and advances by customer profile may be specified as follows:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Private individuals | 417,441 | 293,813 |
| Privately held companies | 386,000 | 415,493 |
| State owned enterprises | 22,745 | 18,814 |
| Municipality owned enterprises | 13,450 | 12,741 |
| Public and religious institutions | 11,739 | 7,767 |
| Local municipalities | 3,585 | 2,991 |
| Government | 2 | 2 |
| **Total gross loans and receivables to customers** | **854,962** | **751,621** |
| Impairment allowance | (60,633) | (60,523) |
| **Total net loans and receivables to customers** | **794,329** | **691,098** |

The borrowers' industry analysis of the gross portfolio of loans and receivables to corporate customers before impairment allowance may be specified as follows:

| | LVL 000's | |
|---|---|---|
| | 31/12/20109 Group | 31/12/2010 Bank |
| Transport and communications | 124,208 | 109,348 |
| Real estate purchase and management | 108,337 | 146,984 |
| Trade | 65,409 | 49,529 |
| Hotels, restaurants | 40,214 | 38,025 |
| Manufacturing | 24,622 | 20,982 |
| Construction | 13,837 | 9,620 |
| Financial intermediation | 11,401 | 58,285 |
| Agriculture and forestry | 10,805 | 2,148 |
| Electricity, gas and water supply | 3,650 | 3,008 |
| Other industries | 35,038 | 19,879 |
| **Total gross loans and receivables to corporate customers** | **437,521** | **457,808** |

The following table represents geographical profile of the portfolio of loans and receivables to customers analysed by the place of customers' reported residence:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Latvian residents | 479,977 | 533,202 |
| OECD region residents | 53,861 | 49,987 |
| Non-OECD region residents | 321,124 | 168,432 |
| **Total gross loans and receivables to customers** | **854,962** | **751,621** |
| Impairment allowance | (60,633) | (60,523) |
| **Total net loans and receivables to customers** | **794,329** | **691,098** |

## NOTE 15. LEASES

The following table represents finance leases analysed by type of assets:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Transport vehicles | 41,236 | 15 |
| Manufacturing equipment | 4,426 | - |
| Real estate | 1,067 | - |
| Other | 3,742 | - |
| **Total present value of finance lease payments, excluding impairment** | **50,471** | **15** |
| Impairment allowance | (6,432) | - |
| **Net present value of finance lease payments** | **44,039** | **15** |

The following table represents reconciliation between the gross investment in the finance leases and the present value of minimum lease payments receivable:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Gross investment in finance leases receivable: | | |
| within 1 year | 10,869 | 12 |
| later than 1 year and no later than in 5 years | 41,617 | 3 |
| later than in 5 years | 1,970 | - |
| **Total gross investment in finance leases** | **54,456** | **15** |
| Unearned finance income receivable: | | |
| within 1 year | 668 | - |
| later than 1 year and no later than in 5 years | 3,220 | - |
| later than in 5 years | 97 | - |
| **Total** | **3,985** | **-** |
| Present value of minimum lease payments receivable: | | |
| within 1 year | 10,201 | 12 |
| later than 1 year and no later than in 5 years | 38,397 | 3 |
| later than in 5 years | 1,873 | - |
| **Total** | **50,471** | **15** |

## NOTE 16. FIXED INCOME SECURITIES

The Group's fixed income securities are further split as follows:

| | LVL 000's 31/12/2010 | | | |
|---|---|---|---|---|
| | Held to maturity | Available for sale | Held for trading | Total |
| Government bonds | 117,688 | 119,622 | 63 | 237,373 |
| Municipality bonds | 1,726 | 721 | - | 2,447 |
| Credit institution bonds | 854 | 33,937 | 73 | 34,864 |
| Corporate bonds | 1,345 | 19,055 | 4 | 20,404 |
| Other financial institution bonds | 5,959 | 14,189 | - | 20,148 |
| **Total net fixed income securities** | **127,572** | **187,524** | **140** | **315,236** |

The above table represents a maximum credit risk exposure to the Group and the Bank respectively.

The Bank’s fixed income securities are further split as follows:

| | LVL 000’s 31/12/2010 | | | |
|---|---|---|---|---|
| | Held to maturity | Available for sale | Held for trading | Total |
| Government bonds | 117,280 | 98,539 | - | 215,819 |
| Municipality bonds | - | 721 | - | 721 |
| Credit institution bonds | - | 22,160 | - | 22,160 |
| Corporate bonds | - | 18,705 | 4 | 18,709 |
| Other financial institution bonds | - | 3,373 | - | 3,373 |
| **Total net fixed income securities** | **117,280** | **143,498** | **4** | **260,782** |

As at 31 December 2010, there are no Group’s and Bank’s securities on which payments are past due or which were restructured during the reporting period.

As at 31 December 2010, the carrying amount of the Group’s and Bank’s securities, which were impaired but not past due amounted to LVL 4,175 thousand.

| | Group, LVL 000’s 31/12/2010 |
|---|---|
| Government bonds: | |
| Latvia | 171,705 |
| OECD | 48,043 |
| Non-OECD | 17,625 |
| Total government bonds | **237,373** |
| Municipality bonds: | |
| OECD | - |
| Non-OECD | 2,447 |
| Total municipality bonds | **2,447** |
| Credit institution bonds: | |
| Latvia | 4,145 |
| OECD | 28,011 |
| Non-OECD | 2,708 |
| Total credit institution bonds | **34,864** |
| Corporate bonds (OECD and non-OECD) | 20,404 |
| Other financial institution bonds (OECD and non-OECD) | 20,148 |
| **Total net fixed income securities** | **315,236** |

| | Bank, LVL 000's 31/12/2010 |
|---|---|
| Government bonds: | |
| Latvia | 171,705 |
| OECD | 44,114 |
| Non-OECD | - |
| Total government bonds | **215,819** |
| Municipality bonds: | |
| OECD | - |
| Non-OECD | 721 |
| Total municipality bonds | **721** |
| Credit institution bonds: | |
| Latvia | 2,824 |
| OECD | 18,631 |
| Non-OECD | 705 |
| Total credit institution bonds | **22,160** |
| Corporate bonds (OECD and non-OECD) | 18,709 |
| Other financial institution bonds (OECD and non-OECD) | 3,373 |
| **Total net fixed income securities** | **260,782** |

All fixed income securities as at 31 December 2010 are listed.

## NOTE 17. SHARES AND OTHER NON-FIXED INCOME SECURITIES

The following table provides the split of the Group's and Bank’s shares and other non-fixed income securities:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Latvian entities’ equity shares: | | |
| listed | 24 | - |
| unlisted | - | - |
| Total Latvian entities’ equity shares | 24 | - |
| Foreign entities’ equity shares: | | |
| listed | - | - |
| unlisted | 68 | 54 |
| Total foreign entities’ equity shares | 68 | 54 |
| Mutual investment funds | 9,409 | 9,375 |
| **Total shares and other non-fixed income securities** | **9,501** | **9,429** |

The Group possess limited information on the structure of investments in managed funds, which are managed on the behalf of investors by other financial institutions. As such, these investments are not analysed by their ultimate issuer. Investments in funds, where the Group does not possess sufficient information on portfolios’ composition between fixed income securities and shares are classified as investments in shares and other non-fixed income securities.

There are no off-balance sheet commitments bearing credit risk that are related to the issuers of the above securities. Further, no payments on the above instruments are past due.

## NOTE 18. INVESTMENTS IN SUBSIDIARIES AND BUSINESS COMBINATIONS

Changes in the Bank’s investments in subsidiaries may be specified as follows:

| | LVL 000’s |
|---|---|
| | 2010 |
| **Balance as at 30 June 2010** | **-** |
| Restructuring | 15,233 |
| Acquisitions of new a subsidiary - Citadele Bankas AB | 30,809 |
| Impairment | (2,203) |
| **Balance as at 31 December 2010** | **43,839** |

AP Anlage & Privatbank (Switzerland) is included in the consolidation group as of restructuring date based on the provisions of the agreement on the transfer of undertaking concluded between AS Parex Banka and AS Citadele Banka on 28 July 2010. The Swiss Financial Market Surpervisory authority FINMA granted the supplementary permit on 24 September 2010 and the Board of Directors of AP Anlage & Privatbank approved the transfer of shares from AS Parex Banka to AS Citadele Banka on 29 October 2010.

In 2010, the management of the Bank concluded that there is an evidence of impairment of investment in the Bank’s subsidiary SIA Citadele Express Kredīts. As a result an impairment amounting to LVL 400 thousand was recognized.

On 1 August 2010 AS Citadele Bank purchased AB Citadele Bankas (Lithuania) from AS Parex Bank. Both AS Citadele Bank and AS Parex Bank are under common control by Privatisation Agency. Impairment allowance in the amount of LVL 1,803 thousand was established in Bank’s statements, attributable to the investment in subsidiary. Subsequent to the purchase date, the initial price was adjusted by LVL 11,192 thousand to reflect the additional information learned after the transaction took place. See Note 36.

As at 31 December 2010 the Bank held the following investments in subsidiaries:

| Company | Country of registration | Business profile | Share capital LVL 000’s | The Bank’s share (%) | % of total voting rights | Carrying value LVL 000’s |
|---|---|---|---|---|---|---|
| AB Citadele bankas | Lithuania | Banking | 58,100 | 100.0 | 100.0 | 29,006 |
| AP Anlage & Privatbank AG | Switzerland | Banking | 5,630 | 100.0 | 100.0 | 9,702 |
| AS Citadele Atklātais Pensiju Fonds | Latvia | Pension fund | 450 | 100.0 | 100.0 | 454 |
| IPAS Citadele Asset Management | Latvia | Finance | 4,150 | 100.0 | 100.0 | 4,151 |
| ZAO Parex Asset Management | Russia | Finance | 458 | 100.0 | 100.0 | - |
| OOO Citadele Asset Management Ukraina | Ukraine | Finance | 621 | 100.0 | 100.0 | - |
| UAB Citadele Investiciju Valdymas | Lithuania | Finance | 727 | 100.0 | 100.0 | - |
| OU Citadele Leasing & Factoring | Estonia | Finance | 351 | 100.0 | 100.0 | 313 |
| UAB Citadele faktoringas ir lizingas | Lithuania | Finance | 305 | 100.0 | 100.0 | - |
| SIA Rīgas Pirmā Garāža | Latvia | Misc.* | 352 | 100.0 | 100.0 | - |
| SIA Citadele Express Kredīts | Latvia | Leasing | 31 | 100.0 | 100.0 | 213 |
| SIA E&P Baltic Properties | Latvia | Finance | 20 | 50.0 | 50.0 | - |
| SIA Citadele Līzings un Faktorings | Latvia | Leasing | 9,400 | 100.0 | 100.0 | - |
| AAS Citadele Life | Latvia | Life insurance | 3,000 | 100.0 | 100.0 | - |
| Calenia Investments Limited | Cyprus | Misc.* | - | 100.0 | 100.0 | - |
| OOO Citadele Investments Ukraine | Ukraine | Finance | 44 | 100.0 | 100.0 | - |
| SIA RPG Interjers | Latvia | Misc.* | 2 | 100.0 | 100.0 | - |
| OAO Parex Ukrainian Equity Fund | Ukraine | Finance | - | 100.0 | 100.0 | - |
| SIA PR Speciālie Projekti | Latvia | Misc.* | 2 | 100.0 | 100.0 | - |
| **Total investments in subsidiaries** | | | | | | **43,839** |

* Misc. – the companies are providing various support services

## NOTE 19. INTANGIBLE ASSETS

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Software | 604 | 405 |
| Other intangible assets | 615 | 23 |
| Total intangible assets excluding advances | 1,219 | 428 |
| Advances for intangible assets | 841 | 828 |
| **Total net book value of intangible assets** | **2,060** | **1,256** |

Movements in the Group's intangible assets excluding advances for the six month period ended 31 December 2010 can be specified as follows:

| | LVL 000's | | | |
|---|---|---|---|---|
| | Goodwill from acquisition of subsidiaries | Software | Other intangible assets | Total intangible assets excluding advances |
| *Historical cost* | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** |
| Restructuring | 131 | 8,818 | 2,448 | 11,397 |
| Additions | - | 131 | - | 131 |
| Disposals | - | (45) | (26) | (71) |
| Impairment allowance | (131) | - | - | (131) |
| **As at 31 December 2010** | **-** | **8,904** | **2,422** | **11,326** |
| *Accumulated amortisation* | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** |
| Restructuring | - | 8,126 | 1,700 | 9,826 |
| Charge for the year | - | 219 | 132 | 351 |
| Reversal due to disposals | - | (45) | (25) | (70) |
| **As at 31 December 2010** | **-** | **8,300** | **1,807** | **10,107** |
| *Net book value* | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** |
| **As at 31 December 2010** | **-** | **604** | **615** | **1,219** |

## NOTE 20. FIXED ASSETS

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Leasehold improvements | 1,296 | 1,296 |
| Land and buildings | 30,204 | 679 |
| Transport vehicles | 912 | 281 |
| Other fixed assets | 5,606 | 1,601 |
| Total fixed assets excluding advances | 38,018 | 3,857 |
| Advances for fixed assets | 54 | 53 |
| **Total net book value of fixed assets** | **38,072** | **3,910** |

The following changes in the Group's fixed assets excluding advances for fixed assets took place during the 6 month period ended 31 December 2010:

| | LVL 000's | | | | |
|---|---|---|---|---|---|
| | Leasehold improve-ments | Land and buildings | Transport vehicles | Other fixed assets | Total fixed assets excluding advances |
| *Historical cost* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 3,654 | 35,253 | 2,706 | 25,827 | 67,440 |
| Additions | 17 | 8 | 359 | 339 | 723 |
| Disposals | (4) | - | (525) | (1,082) | (1,611) |
| **As at 31 December 2010** | **3,667** | **35,261** | **2,540** | **25,084** | **66,552** |
| *Accumulated depreciation* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 2,011 | 3,751 | 1,887 | 19,389 | 27,038 |
| Charge for the year | 364 | 1,306 | 179 | 1,091 | 2,940 |
| Reversal due to disposals | (4) | - | (438) | (1,002) | (1,444) |
| **As at 31 December 2010** | **2,371** | **5,057** | **1,628** | **19,478** | **28,534** |
| *Net book value (incl .impairment allowance)* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| **As at 31 December 2010** | **1,296** | **30,204** | **912** | **5,606** | **38,018** |
| *Impairment allowance* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | - | (17,915) | - | - | (17,915) |
| **As at 31 December 2010** | **-** | **(17,915)** | **-** | **-** | **(17,915)** |

The following changes in the Bank’s fixed assets excluding advances for fixed assets took place during the 6 month period ended 31 December 2010:

| | LVL 000’s | | | | |
|---|---|---|---|---|---|
| | Leasehold Improvements | Land and buildings | Transport vehicles | Other fixed assets | Total fixed assets excluding prepayments |
| *Historical cost* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 3,654 | 814 | 1,581 | 18,443 | 24,492 |
| Additions | 17 | - | - | 241 | 258 |
| Disposals | (4) | - | (142) | (498) | (644) |
| **As at 31 December 2010** | **3,667** | **814** | **1,439** | **18,186** | **24,106** |
| *Accumulated depreciation* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 2,011 | 129 | 1,227 | 16,517 | 19,884 |
| Charge for the year | 364 | 6 | 73 | 566 | 1,009 |
| Reversal due to disposals | (4) | - | (142) | (498) | (644) |
| **As at 31 December 2010** | **2,371** | **135** | **1,158** | **16,585** | **20,249** |
| *Net book value* | | | | | |
| **As at 30 June 2010** | **-** | **-** | **-** | **-** | **-** |
| **As at 31 December 2010** | **1,296** | **679** | **281** | **1,601** | **3,857** |

## NOTE 21. NON-CURRENT ASSETS HELD FOR SALE

| | LVL 000’s 31/12/2010 Group |
|---|---|
| Transport vehicles | 4,827 |
| **Total gross non-current assets held for sale** | **4,827** |
| Impairment allowance | (1,538) |
| **Total net non-current assets held for sale** | **3,289** |

| | LVL 000’s 31/12/2010 Group |
|---|---|
| **Net carrying amount at the beginning of the period** | **-** |
| Restructuring - initial carrying amount | 6,425 |
| Restructuring - impairment allowance | (2,256) |
| **Restructuring - net carrying amount** | **4,169** |
| Impairment charges | (338) |
| Impairment reversals | 352 |
| Decrease of impairment allowance due to disposals | 703 |
| **Net impairment charge to income statements** | **717** |
| Increase of initial carrying amount due to additions | 1,212 |
| Decrease of initial carrying amount due to disposals | (2,809) |
| **Net change in initial carrying amount** | **(1,597)** |
| **Initial carrying amount as at the end of the year** | **4,828** |
| **Impairment allowance at the end of the year** | **(1,539)** |
| **Net carrying amount at the end of the year** | **3,289** |

## NOTE 22. OTHER ASSETS

| | LVL 000’s | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Money in transit | 1,970 | 1,957 |
| Prepayments | 779 | 610 |
| Accrued income * | 773 | 142 |
| VAT receivables | 293 | 244 |
| Other assets * | 2,787 | 1,309 |
| **Total gross other assets** | **6,602** | **4,262** |
| Impairment allowance | (611) | (326) |
| **Total net other assets** | **5,991** | **3,936** |

* As at 31 December 2010, included in the Group’s and Bank’s other assets and accrued income are assets amounting to LVL 902 thousand and LVL nil, respectively, which are delayed. Additionally, as at 31 December 2010, the Group’s and the Bank’s other assets amounts that are not delayed but impaired amount to LVL 344 thousand and LVL 326 thousand, respectively.

## NOTE 23. ISSUED DEBT SECURITIES

As at 31 December 2010, the Bank had the following outstanding debt issues:

| Issue date | Issue amount | Coupon | Payment, frequency | Maturity | Debt outstanding (LVL 000’s) 31/12/2010 |
|---|---|---|---|---|---|
| May, 2007 | EUR 200 million | 5.625% | Annual | May, 2011 | 70,573 |
| February and June, 2010 | EUR 29.3 million | 5% | Semi annual | February, 2012 | 20,984 |
| **Total** | | | | | **91,557** |

## NOTE 24. BALANCES DUE TO CREDIT INSTITUTIONS AND CENTRAL BANKS

| | LVL 000’s | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Due to credit institutions registered in OECD countries | 8,318 | 16,830 |
| Due to credit institutions registered in Latvia | 57,664 | 56,557 |
| Due to credit institutions registered in other non-OECD countries | 4,577 | 8,788 |
| **Total balances due to credit institutions and central banks** | **70,559** | **82,175** |

The following table presents the Group's and Bank's balances due to credit institutions and central banks according to maturity profile:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Balances on demand | 58,668 | 58,216 |
| Overnight deposits | - | 8,434 |
| **Total balances repayable on demand** | **58,668** | **66,650** |
| Loans from credit institutions: | | |
| due within 1 month | 4,862 | 4,711 |
| due within 1-3 months | 7,029 | 10,199 |
| due within 3-6 months | - | 615 |
| **Total loans from credit institutions** | **11,891** | **15,525** |
| **Total due to credit institutions** | **70,559** | **82,175** |

The Bank has concluded a repo transaction, whereby it pledged part of the securities portfolio against the financing received. Please refer to Note 31 for more details.

## NOTE 25. DEPOSITS FROM CUSTOMERS

The following table presents deposits from customers according to customer profile:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Privately held companies | 526,916 | 436,166 |
| Private individuals | 436,484 | 353,354 |
| Government | 173,684 | 171,707 |
| State owned enterprises | 88,835 | 88,648 |
| Financial institutions | 37,314 | 37,311 |
| Municipalities | 26,240 | 26,229 |
| Public and religious institutions | 4,862 | 3,859 |
| **Total deposits from customers** | **1,294,335** | **1,117,274** |

*Financing support from the Ministry of Finance*

According to EU restructuring plan a certain amount of State support was transferred to the Bank. Ministry of Finance of Latvia has made a number of deposits on a secured basis, receiving part of Bank's loan portfolio as collateral (please refer to Note 31 for details on assets pledged). As at 31 December 2010, the following financing support received from the Ministry of Finance was outstanding:

| Agreement currency | Interest rate (%) | Agreement date | Maturity date | Amortised cost LVL 000's 31/12/2010 |
|---|---|---|---|---|
| EUR | 10.003 | 01/08/2010 | 30/06/2011 | 32,751 |
| EUR | 10.003 | 01/08/2010 | 30/09/2011 | 32,751 |
| EUR | 10.003 | 01/08/2010 | 30/12/2011 | 32,750 |
| EUR | 10.003 | 01/08/2010 | 30/03/2012 | 32,748 |
| **Total Treasury deposits** | | | | **131,000** |

Subsequent to the balance sheet date the Bank has repaid EUR 46.6 million ahead of the schedule from the State support deposits outstanding. Please refer to Note 36 for more information.

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Demand deposits | 516,872 | 416,633 |
| Term deposits: | | |
| due within 1 month | 169,440 | 149,798 |
| due within 1-3 months | 163,546 | 144,016 |
| due within 3-6 months | 141,754 | 120,632 |
| due within 6-12 months | 152,419 | 138,317 |
| due within 1-5 years | 149,826 | 147,448 |
| due in more than 5 years | 478 | 430 |
| Total term deposits | 777,463 | 700,641 |
| **Total deposits from customers** | **1,294,335** | **1,117,274** |

## NOTE 26. OTHER LIABILITIES

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Accrued expense | 4,817 | 3,984 |
| Suspense liabilities | 1,663 | 1,663 |
| Amounts due to suppliers | 1,176 | 801 |
| Provisions for other liabilities | 319 | - |
| VAT payables | 203 | 26 |
| Deferred income | 31 | - |
| Other liabilities | 4,519 | 2,445 |
| **Total other liabilities** | **12,728** | **8,919** |

Suspense liabilities comprise funds received by the Group and the Bank as at year end, but not yet transferred to ultimate beneficiaries due to unclear or incomplete details of the supporting documentation.

## NOTE 27. SUBORDINATED DEBT

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

| Counterparty | Residence country | Currency | Issue size, 000's | Interest rate | Original agreement date | Original maturity date | Amortised cost (LVL 000's) 31/12/2010 |
|---|---|---|---|---|---|---|---|
| Privatisation Agency | Latvia | EUR | 53,128 | 20.861% | 22/05/2009 | 21/05/2016 | 38,008 |
| Privatisation Agency | Latvia | EUR | 11,205 | 8.152% | 02/08/2010 | 08/08/2016 | 8,128 |
| EBRD | UK | EUR | 7,195 | 8.152% | 11/09/2009 | 08/08/2016 | 5,099 |
| **Total** | | | | | | | **51,235** |

## NOTE 28. ISSUED SHARE CAPITAL

As at 31 December 2010, the Bank's registered and paid-in share capital was LVL 103,000 thousand. In accordance with the Bank's statutes, the share capital consists of 103,000 thousand ordinary shares with voting rights. All shares have a par value of LVL 1 each and, as at 31 December 2010, they all were issued and fully paid. As at 31 December 2010, the Bank did not possess any of its own shares. No dividends were proposed and paid during 2010.

As at 31 December 2010, the Bank had 2 shareholders. The respective shareholdings as at 31 December 2010 may be specified as follows:

| | 31/12/2010 | | |
|---|---|---|---|
| | Paid-in share capital (LVL) | % of total paid-in capital | % of total voting rights |
| Privatisation Agency | 77,249,999 | 75% minus 1 share | 75% minus 1 share |
| European Bank for Reconstruction and Development | 25,750,001 | 25% plus 1 share | 25% plus 1 share |
| **Total** | **103,000,000** | **100.00** | **100.00** |

AS Citadele Banka was established by *Privatisation Agency* on 30 June 2010 with initial paid-in share capital of LVL 4 million.

*Capital increases*

On 29 July 2010 the Bank's capital was further increased by LVL 99 million to LVL 103 million. The increase was carried out by the sole shareholder of the Bank *Privatisation Agency* by purchase of a corresponding amount of voting shares.

*Changes in the shareholding structure*

On 30 July 2010, *European Bank for Reconstruction and Development* (EBRD) concluded a share purchase agreement with *Privatisation Agency*, whereby the EBRD became part owner of Citadele's shareholding structure with 25 % of share capital plus 1 voting share.

## NOTE 29. OFF-BALANCE SHEET ITEMS

Memorandum items comprise contingent liabilities, financial commitments, foreign exchange contracts and derivative financial instruments. The following table provides a specification of contingent liabilities (showing maximum amount payable) and financial commitments outstanding as at 31 December 2010.

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Contingent liabilities: | | |
| Outstanding guarantees | 9,893 | 6,706 |
| Outstanding letters of credit | 235 | 18 |
| **Total contingent liabilities** | **10,128** | **6,724** |
| Financial commitments: | | |
| Loans granted, not fully drawn down | 6,162 | 5,965 |
| Unutilised credit lines and overdraft facilities | 20,655 | 52,511 |
| Credit card commitments | 64,816 | 54,573 |
| **Total financial commitments** | **91,633** | **113,049** |

The following table presents the notional amounts and fair values of foreign exchange contracts and derivative financial instruments. The notional amounts of foreign exchange contracts represent the amounts receivable under these contracts. The notional amounts of other financial instruments represent the value of the underlying assets.

The Group:

| | Notional amount LVL 000's | Fair value LVL 000's | |
|---|---|---|---|
| | 31/12/2010 | 31/12/2010 | |
| | | Assets | Liabilities |
| Foreign exchange contracts: | | | |
| Spot exchange | 20,122 | 144 | (359) |
| Forwards | 54,492 | 88 | (66) |
| Swaps | 457,053 | 2,378 | (193) |
| **Total foreign exchange contracts** | **531,667** | **2,610** | **(618)** |
| Other financial instruments: | | | |
| Other derivatives | 7,028 | 60 | (26) |
| **Total other financial instruments** | **7,028** | **60** | **(26)** |
| **Derivative financial instruments** | **538,695** | **2,670** | **(644)** |

The Bank:

| | Notional amount LVL 000's | Fair value LVL 000's | |
|---|---|---|---|
| | 31/12/2010 | 31/12/2010 | |
| | | Assets | Liabilities |
| Foreign exchange contracts: | | | |
| Spot exchange | 9,430 | 144 | (363) |
| Forwards | 77,337 | 147 | (58) |
| Swaps | 465,898 | 2,365 | (255) |
| **Total foreign exchange contracts** | **552,665** | **2,656** | **(676)** |
| Other financial instruments: | | | |
| Other derivatives | 7,028 | 60 | (26) |
| **Total other financial instruments** | **7,028** | **60** | **(26)** |
| **Derivative financial instruments** | **559,693** | **2,716** | **(702)** |

The Group's banks use derivative foreign exchange instruments to manage their currency positions, which arise also due to derivative foreign exchange contracts concluded with the banks' clients. Before entering into derivative foreign currency agreement with private individual or company, the Group's entities assess the counterparty's ability to meet the contractual provisions. As at 31 December 2010, more than 92% of the fair value assets on foreign exchange contracts is attributable to credit and finance institutions. As at 31 December 2010, none of the payments receivable arising out of derivative transactions was past due.

## NOTE 30. FUNDS UNDER TRUST MANAGEMENT

The table below provides analysis of the fair value of funds managed on behalf of customers by investment type:

| | LVL 000’s | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Fixed income securities: | | |
| Government bonds | 41,909 | - |
| Credit institution bonds | 41,626 | - |
| Corporate bonds | 38,062 | - |
| Foreign municipality bonds | 1,711 | - |
| Other financial institution bonds | 4,307 | - |
| **Total investments in fixed income securities** | **127,615** | **-** |
| Other investments: | | |
| Mutual investment funds | 78,087 | - |
| Deposits with credit institutions | 59,714 | - |
| Shares | 38,937 | 1 |
| Real estate | 19,273 | - |
| Loans to corporate entities | 2,955 | 774 |
| Other | 32,194 | - |
| **Total other investments** | **231,160** | **775** |
| **Total assets under trust management agreements** | **358,775** | **775** |

The table below provides an analysis of the customer profile on whose behalf the funds are managed:

| | LVL 000’s | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Investors of investment funds | 231,442 | - |
| Privately held companies | 69,494 | 774 |
| Private individuals | 57,067 | 1 |
| Financial institutions | 772 | - |
| **Total liabilities under trust management agreements** | **358,775** | **775** |

## NOTE 31. FINANCIAL ASSETS PLEDGED

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Due from credit institutions* | 25,839 | 25,839 |
| *Held for trading securities* | *3,174* | *3,174* |
| *Available-for-sale securities* | *4,764* | *4,764* |
| Total securities pledged | 7,938 | 7,938 |
| Loans to customers | 178,804 | 178,804 |
| **Total financial assets pledged** | **212,581** | **212,581** |
| Due to credit institutions and central banks | 7,028 | 7,028 |
| Deposits from Ministry of Finance | 131,000 | 131,000 |
| **Total liabilities secured by pledged financial assets** | **138,028** | **138,028** |

* The amount consists of several placements to secure various Bank's transactions in the ordinary course of business.

As at 31 December 2010, the Bank has entered into repo agreement with European Central Bank, whereby it pledged part of its securities portfolio against the financing facilities received.

Further, the Bank has concluded several agreements with Ministry of Finance of Latvia, whereby it pledged part of the loan portfolio as a security to the financing received. The respective pledges are registered with Commercial Register. Please refer to Note 25 for more detailed information on deposits received from the Ministry of Finance.

## NOTE 32. CASH AND CASH EQUIVALENTS

The table below provides a breakdown of cash and cash equivalents as at 31 December 2010:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| Cash and demand deposits with central banks | 187,220 | 177,348 |
| Deposits with other credit institutions* | 205,465 | 199,152 |
| Demand deposits due to other credit institutions | (58,668) | (66,650) |
| **Total cash and cash equivalents** | **334,017** | **309,850** |

* Deposits include term facilities with initial agreement term of 3 months or less.

## NOTE 33. LITIGATION AND CLAIMS

In the ordinary course of business, the Bank has been involved in a number of legal proceedings to recover collateral or outstanding credit balances, as well as related interest and expenses from defaulted credit customers and interbank counterparties. The Group is also involved in a number of legal proceedings related to its customers in Latvia and abroad.

The management of the Bank believes that any legal proceedings pending as at 31 December 2010 will not result in material losses for the Group.

## NOTE 34. RELATED PARTIES

Related parties are defined as shareholders who have significant influence over the Group, state and municipal institutions, members of the Council and Management Board, key Management personnel, their close relatives and companies in which they have a controlling interest as well as associated companies of the Group. For the purpose of this disclosure, the key management of the Group's companies/ Bank and their related companies are stated in one line, accordingly.

The Bank of Latvia is not considered as related party as it is operating as an independent institution according to special law.

The following table present the outstanding balances and terms of the Group's transactions with counterparties, which were related parties as at 31 December 2010.

| | Amount in LVL 000's 31/12/2010 | Interest income/ expense 30/06/2010- 31/12/2010 |
|---|---|---|
| Credit exposure to related parties | | |
| Securities: | 171,705 | 3,488 |
| *Latvian treasury bills and government bonds* | *171,705* | *3,488* |
| Loans and receivables: | 3,637 | 35 |
| *Management* | *646* | *7* |
| *Municipality institutions* | *2,991* | *28* |
| Financial commitments and outstanding guarantees: | 4,226 | - |
| *Management* | *46* | - |
| *State institutions* | *3,170* | - |
| *Municipality institutions* | *1,010* | - |
| **Total credit exposure to related parties** | **179,568** | |
| Due to related parties: | 247,953 | 10,188 |
| *Deposits from Ministry of Finance* | *131,000* | *5,581* |
| *Subordinated loans from shareholder* | *51,235* | *3,766* |
| *Management* | *530* | *10* |
| *State institutions* | *39,230* | *767* |
| *Municipality institutions* | *25,958* | *64* |
| **Total amounts due to related parties** | **247,953** | |

No Group's exposures with related parties as at 31 December 2010 or for the 6 month period then ended were impaired.

The following table presents the outstanding balances and terms of the Bank's transactions with counterparties, which were related parties as at 31 December 2010.

| | Gross amount in LVL 000's 31/12/2010 | Interest income/ expense 30/06/2010-31/12/2010 |
|---|---|---|
| Credit exposure to related parties | | |
| Securities: | 171,705 | 3,488 |
| *Latvian treasury bills and government bonds* | *171,705* | *3,488* |
| Loans and receivables: | 133,856 | 1,533 |
| *Management* | *160* | *2* |
| *Municipality institutions* | *2,991* | *28* |
| *Subsidiaries* | *130,705* | *1,503* |
| Derivatives – assets: | 71 | - |
| *Subsidiaries* | *71* | - |
| Financial commitments and outstanding guarantees: | 37,221 | |
| *Management* | *46* | |
| *State institutions* | *3,170* | |
| *Municipality institutions* | *1,010* | |
| *Subsidiaries* | *32,995* | |
| **Total credit exposure to related parties** | **342,853** | |
| Due to related parties: | 269,353 | 10,321 |
| *Deposits from Ministry of Finance* | *131,000* | *5,581* |
| *Subordinated loans from shareholders* | *51,235* | *3,766* |
| *Management* | *216* | *12* |
| *State institutions* | *39,230* | *767* |
| *Municipality institutions* | *25,958* | *64* |
| *Subsidiaries* | *21,714* | *131* |
| Derivatives – liabilities: | 71 | - |
| *Subsidiaries* | *71* | - |
| **Total amounts due to related parties** | **269,424** | |

In the 6 month period ended 31 December 2010 the Bank has recognized a net impairment allowance of LVL 2,352 thousand on loans and receivables from subsidiaries. As at 31 December 2010 the total impairment allowance recognized on loans and receivables from subsidiaries was LVL 16,410 thousand. No other Bank's exposures with related parties as at 31 December 2010 or for the 6 month period then ended were impaired.

# NOTE 35 RISK MANAGEMENT

**Risk management polices**

Risk management principles are set out in Group’s Risk and Capital Management Policy (as approved by the Supervisory Board and Management Board). The Group adheres to the following key risk management principles:

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

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

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

## *a) Credit risk*

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

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

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

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

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

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

The tables below provide details of the Group’s loan portfolio delinquencies:

| Group, LVL 000’s 31/12/2010 | Regular loans | Utilised credit lines | Finance leases | Debit balances on settlement cards | Loans under reverse repurchase agreement | Overdraft facilities | Factoring | Due from investment and brokerage firms | Total |
|---|---|---|---|---|---|---|---|---|---|
| Not delayed - not impaired | 529,233 | 58,635 | 32,257 | 50,601 | 596 | 12,140 | 11 | 3,552 | 687,025 |
| *Incl. restructured loans* | *75,918* | *6,496* | *472* | - | - | - | - | - | *82,886* |
| Not delayed - impaired | 18,953 | - | 460 | - | - | - | 4 | - | 19,417 |
| **Total not delayed loans** | **548,186** | **58,635** | **32,717** | **50,601** | **596** | **12,140** | **15** | **3,552** | **706,442** |
| **Past due loans - not impaired** | | | | | | | | | |
| Delayed days: | | | | | | | | | |
| =< 29 | 35,377 | 606 | 7,336 | 1,033 | - | - | - | - | 44,352 |
| 30-59 | 14,980 | - | 2,480 | 576 | - | - | - | - | 18,036 |
| 60-89 | 4,339 | - | 194 | 484 | - | - | - | - | 5,017 |
| 90 and more | 19,825 | 2,408 | 313 | 3,807 | - | 25 | - | - | 26,378 |
| **Total past due loans - not impaired** | **74,521** | **3,014** | **10,323** | **5,900** | **-** | **25** | **-** | **-** | **93,783** |
| **Total past due loans - impaired** | **26,518** | **437** | **7,431** | **18,686** | **-** | **823** | **289** | **553** | **54,737** |
| **Total gross loans and receivables to customers** | **649,225** | **62,086** | **50,471** | **75,187** | **596** | **12,988** | **304** | **4,105** | **854,962** |
| Impairment allowance | (29,319) | (1,297) | (6,432) | (21,749) | - | (951) | (292) | (593) | (60,633) |
| **Total net loans and receivables to customers** | **619,906** | **60,789** | **44,039** | **53,438** | **596** | **12,037** | **12** | **3,512** | **794,329** |

Mostly, not-delayed loans falling into categories “regular loans” and “utilised credit lines” are secured by collateral. More than 77% are secured by real estate collateral. In general, settlement card loans are granted to clients on a basis of their cash flows’ assessment and no collateral is required in most cases. Finance leases are secured by the respective property leased out (for more details on leasing portfolio please refer to Note 15). Loans under reverse repurchase agreements are secured with securities that can be sold in case of client’s default.

As at 31 December 2010, included in the loan portfolio are not delayed impaired loans, not impaired past due loans and impaired past due loans with the estimated value of collateral amounting to approximately LVL 16 million, LVL 125 million and LVL 15 million respectively.

The tables below provide details of the Bank's loan portfolio delinquencies:

| | Bank, LVL 000's | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 31/12/2010 | | | | | | | | |
| | Regular loans | Utilised credit lines | Finance leases | Debit balances on settlement cards | Loans under reverse repurchase agreement | Overdraft facilities | Factoring | Due from investment and brokerage firms | Total |
| Not delayed - not impaired | 414,088 | 61,563 | 10 | 45,060 | - | 12,252 | - | 3,505 | 536,478 |
| *Incl. restructured loans* | *73,248* | *5,899* | - | - | - | - | - | - | *79,147* |
| Not delayed - impaired | 63,963 | 43,720 | - | - | - | - | - | - | 107,683 |
| **Total not delayed loans** | **478,051** | **105,283** | **10** | **45,060** | **-** | **12,252** | **-** | **3,505** | **644,161** |
| **Past due loans - not impaired** | | | | | | | | | |
| Delayed days: | | | | | | | | | |
| =< 29 | 26,880 | 60 | 5 | 610 | - | - | - | - | 27,555 |
| 30-59 | 13,772 | - | - | 463 | - | - | - | - | 14,235 |
| 60-89 | 3,993 | - | - | 399 | - | - | - | - | 4,392 |
| 90 and more | 15,893 | 2,408 | - | 1,365 | - | 25 | - | - | 19,691 |
| **Total past due loans - not impaired** | **60,538** | **2,468** | **5** | **2,837** | - | **25** | **-** | - | **65,873** |
| **Total past due loans - impaired** | **21,525** | **-** | **-** | **18,686** | - | **823** | **-** | **553** | **41,587** |
| **Total gross loans and receivables to customers** | **560,114** | **107,751** | **15** | **66,583** | **-** | **13,100** | **-** | **4,058** | **751,621** |
| Impairment allowance | (35,449) | (4,193) | - | (19,337) | - | (951) | - | (593) | (60,523) |
| **Total net loans and receivables to customers** | **524,665** | **103,558** | **15** | **47,246** | **-** | **12,149** | **-** | **3,465** | **691,098** |

The following table provides details on changes in the Group's specific loan portfolio impairment by classes:

| | Regular loans | Utilised credit lines | Finance leases | Debit balances on settlement cards | Overdraft facilities | Factoring | Due from investment and brokerage firms | Total |
|---|---|---|---|---|---|---|---|---|
| **Outstanding specific impairment as at 30/06/2010** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 14,097 | 847 | 4,779 | 16,595 | 452 | 239 | 505 | 37,514 |
| Impairment charge for the reported period - specific | 8,730 | 190 | 1,819 | 2,091 | 370 | 1 | - | 13,201 |
| Release of previously established impairment allowance - specific | (2,391) | (45) | (319) | - | - | - | - | (2,755) |
| **Impairment charged to the statement of income, net** | **6,339** | **145** | **1,500** | **2,091** | **370** | **1** | **-** | **10,446** |
| Change of impairment allowance due to write-offs, net | (25) | (787) | (243) | - | - | - | - | (1,055) |
| Increase/ (decrease) in impairment allowance due to currency fluctuations | (8) | 39 | (80) | - | 1 | - | 48 | - |
| **Outstanding specific impairment as at 31/12/2010** | **20,403** | **244** | **5,956** | **18,686** | **823** | **240** | **553** | **46,905** |

The following table provides details on changes in the Bank's specific loan portfolio impairment by classes:

| | Regular loans | Utilised credit lines | Finance leases | Debit balances on settlement cards | Overdraft facilities | Factoring | Due from investment and brokerage firms | Total |
|---|---|---|---|---|---|---|---|---|
| **Outstanding specific impairment as at 30/06/2010** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Restructuring | 26,306 | 793 | | 16,595 | 452 | | 505 | 44,651 |
| Impairment charge for the reported period - specific | 6,819 | 2,352 | - | 2,091 | 370 | - | - | 11,632 |
| Release of previously established impairment allowance - specific | (2,373) | - | - | - | - | - | - | (2,373) |
| **Impairment charged to the statement of income, net** | **4,446** | **2,352** | **-** | **2,091** | **370** | **-** | **-** | **9,259** |
| Change of impairment allowance due to write-offs, net | (756) | - | - | - | - | - | - | (756) |
| Increase/ (decrease) in impairment allowance due to currency fluctuations | - | - | - | - | 1 | - | 48 | 49 |
| **Outstanding specific impairment as at 31/12/2010** | **29,996** | **3,145** | **-** | **18,686** | **823** | **-** | **553** | **53,203** |

The tables below provide details of the Group's and Bank's securities portfolio quality:

| | Group, LVL 000's 31/12/2010 | | | |
|---|---|---|---|---|
| | Held to maturity | Available for sale | Held for trading | Total |
| Investment grade: | | | | |
| AAA | - | 66,091 | - | 66,091 |
| AA | - | 11,009 | - | 11,009 |
| A | 5,241 | 11,927 | - | 17,168 |
| BBB/Baa | 112,075 | 48,881 | 63 | 161,019 |
| Other lower ratings | 10,256 | 49,616 | 9 | 59,881 |
| Not rated | - | - | 68 | 68 |
| **Total net fixed income securities** | **127,572** | **187,524** | **140** | **315,236** |

| | Bank, LVL 000's 31/12/2010 | | | |
|---|---|---|---|---|
| | Held to maturity | Available for sale | Held for trading | Total |
| Investment grade: | | | | |
| AAA | - | 59,167 | - | 59,167 |
| AA | - | 2,104 | - | 2,104 |
| A | - | 4,847 | - | 4,847 |
| BBB/Baa | 108,104 | 29,329 | - | 137,433 |
| Other lower ratings | 9,176 | 48,051 | 4 | 57,231 |
| **Total net fixed income securities** | **117,280** | **143,498** | **4** | **260,782** |

*GEOGRAPHICAL PROFILE*

The following tables provide an analysis of the Group's and Bank's assets and liabilities, as well as memorandum items outstanding as at 31 December 2010 by geographical profile. The grouping by is done based on information about the residence of the respective counterparties.

| | Group as at 31/12/2010, LVL 000's | | | | | |
|---|---|---|---|---|---|---|
| | Latvia | Lithuania | Other EU countries | CIS countries | Other countries | Total |
| Assets | | | | | | |
| Cash and deposits with central banks | 141,835 | 7,987 | 35,513 | - | 1,885 | 187,220 |
| Balances due from credit institutions | 55,483 | 356 | 106,821 | 5,676 | 51,288 | 219,624 |
| Securities held for trading | 170 | - | 4 | - | - | 174 |
| Financial assets designated at fair value through profit or loss | 1,796 | 408 | 1,113 | - | 1 | 3,318 |
| Available-for-sale securities | 60,868 | 16,170 | 73,910 | 17,095 | 28,948 | 196,991 |
| Loans and receivables to customers | 432,738 | 163,385 | 63,569 | 87,647 | 46,990 | 794,329 |
| Held-to-maturity securities | 117,280 | - | 179 | 3,786 | 6,327 | 127,572 |
| Derivatives financial instruments | 2,249 | 26 | 57 | 25 | 313 | 2,670 |
| Other assets | 73,752 | 5,497 | 757 | 430 | 175 | 80,611 |
| **Total assets** | **886,171** | **193,829** | **281,923** | **114,659** | **135,927** | **1,612,509** |
| Liabilities | | | | | | |
| Financial liabilities designated at fair value through profit or loss | 1,484 | - | - | - | - | 1,484 |
| Financial liabilities measured at amortised cost | 813,297 | 106,618 | 221,498 | 12,418 | 361,116 | 1,514 ,947 |
| Derivative financial instruments | 222 | 12 | 285 | 13 | 112 | 644 |
| Other liabilities | 10,652 | 1,337 | 386 | 17 | 1,015 | 13,407 |
| **Total liabilities** | **825,655** | **107,967** | **222,169** | **12,448** | **362,243** | **1,530,482** |
| Equity | 82,027 | - | - | - | - | 82,027 |
| **Total liabilities and equity** | **907,682** | **107,967** | **222,169** | **12,448** | **362,243** | **1,612,509** |
| Memorandum items | | | | | | |
| Contingent liabilities | 3,254 | 2,561 | 114 | 2,882 | 1,317 | 10,128 |
| Financial commitments | 71,886 | 11,352 | 283 | 7,705 | 407 | 91,633 |

| | Bank as at 31/12/2010, LVL 000's | | | | | |
|---|---|---|---|---|---|---|
| | Latvia | Lithuania | Other EU countries | CIS countries | Other countries | Total |
| Assets | | | | | | |
| Cash and deposits with central banks | 141,835 | - | 35,513 | - | - | 177,348 |
| Balances due from credit institutions | 54,577 | 24,612 | 92,455 | 4,614 | 35,350 | 211,608 |
| Securities held for trading | - | - | 4 | - | - | 4 |
| Available-for-sale securities | 59,513 | - | 60,583 | 13,570 | 19,261 | 152,927 |
| Loans and receivables to customers | 476,343 | 24,061 | 60,653 | 87,539 | 42,502 | 691,098 |
| Held-to-maturity securities | 117,280 | - | - | - | - | 117,280 |
| Derivatives financial instruments | 2,249 | 71 | 57 | 25 | 314 | 2,716 |
| Other assets | 82,646 | - | 180 | 10 | 85 | 82,921 |
| **Total assets** | **934,443** | **48,744** | **249,445** | **105,758** | **97,512** | **1,435,902** |
| Liabilities | | | | | | |
| Financial liabilities measured at amortised cost | 814,555 | 9,223 | 202,676 | 1,003 | 314,784 | 1,342,241 |
| Derivative financial instruments | 221 | 71 | 285 | 13 | 112 | 702 |
| Other liabilities | 8,594 | 1 | 317 | 6 | 1 | 8,919 |
| **Total liabilities** | **823,370** | **9,295** | **203,278** | **1,022** | **314,897** | **1,351,862** |
| Equity | 84,040 | - | - | - | - | 84,040 |
| **Total liabilities and equity** | **907,410** | **9,295** | **203,278** | **1,022** | **314,897** | **1,435,902** |
| Memorandum items | | | | | | |
| Contingent liabilities | 3,101 | 365 | 44 | 2,882 | 332 | 6,724 |
| Financial commitments | 97,951 | 6,708 | 283 | 7,704 | 403 | 113,049 |

### *b) Market risk*

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

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

To assess the position risk, scenario analysis is applied. Scenario analysis is based on historic data and price changes of various financial instruments in different low probability high impact scenarios. For example, a flight-to-quality scenario assumes that investors move their capital from riskier investments towards safer investments (for instance, U.S. or other AAA-rated sovereign bonds). To manage market risk, the Group sets individual limits to issuers and financial instruments, as well as products exposed to market risk.

### *c) Equity price risk*

Equity price risk is the risk that the Group will incur a loss due to changes in equity prices. Equity price risk is assessed and decisions on limits set are made by the Financial Market and Counterparty Committee. Further the decisions so made are approved by the Bank’s Management Board.

To assess equity price risk, the Group applies the scenario analysis "flight-to-quality" which refers to a fear of investors of global systemic failure when investors start selling assets they consider to be overly risky and substituting them with more dependable ones. According to the Bank’s equity price risk assessment as at 31 December 2010, in the event that all equity (also including investments in investment funds) prices drop by 10% for equities in OECD countries, 20% – Baltic countries and CIS countries and 15% – other equities, revaluation loss charged directly to the equity would increase by approximately LVL 1.1 million and an impairment loss of LVL 0.4 million would be recognized in the income statement.

### *d) Interest rate risk*

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

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

The Group manages interest rate risk by using the gap analysis of the risk sensitive assets and liabilities, duration analysis and sensitivity analysis of assets and liabilities as well as stress testing of interest rate risk. Based on the market analysis and the Group’s financing structure, ALCO sets customer deposit interest rates. Partially, the Group mitigates interest rate risk using derivatives.

The following table represents the impact of a parallel change in all interest rates by 1.0% on Group’s and Bank’s pre-tax profit (in 12-months time) and available-for-sale securities’ fair value revaluation reserve in equity:

| ***Scenario: +1%*** | LVL 000’s | |
|---|---|---|
| | 2010<br>Group | 2010<br>Bank |
| Pre-tax profit/ (loss) | (1,829) | (1,699) |
| Securities fair value revaluation reserve | (1,620) | (1,620) |
| **Total pre-tax effect on equity** | **(3,449)** | **(3,319)** |
| **Estimated net effect on equity** | **(2,932)** | **(2,821)** |
| ***Scenario: -1%*** | | |
| Pre-tax profit | 2,001 | 1,864 |
| Securities fair value revaluation reserve | 1,710 | 1,710 |
| **Total pre-tax effect on equity** | **3,711** | **3,574** |
| **Estimated net effect on equity** | **3,154** | **3,038** |

## FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The concept of fair value assumes realisation of financial instruments by way of a sale. However, in many cases, particularly in respect of loans and receivables to customers, the Group intends to realise assets through collection over time. Users of these financial statements are therefore advised to use caution when using this data to evaluate the Group's financial position.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable and willing parties in an arm's length transaction. The fair value of liquid financial assets has been determined using bid prices, while offer prices have been used to determine the fair value of financial liabilities.

For illiquid financial assets and liabilities, including loans and advances to customers, there are, by definition, no active markets. Accordingly, fair value has been estimated using appropriate valuation techniques. The methods used to determine the fair value of balance sheet items not carried at fair value are as follows:

*Cash and demand deposits with central banks*
The fair value of cash and balances with central banks is their carrying amount as these balances may be withdrawn without notice.

*Balances due from credit institutions/ Balances due to credit institutions and central banks*
The fair value of on-demand balances with credit institutions is their carrying amount as these balances may be withdrawn without notice. The fair value of overnight placements is their carrying amount. The fair value of other amounts due from banks is calculated by discounting expected cash flows using current market rates. In many cases, the carrying value is a close representation of fair value due to short-term maturity profiles.

*Loans and receivables to customers*
The fair value of loans and advances to customers is calculated by discounting expected future cash flows. The discount rates consist of money market rates as at the end of year and credit margins, which are adjusted for current market conditions. If all the assumed discount rates would change by 10%, the fair value of the loan portfolio would change by LVL 8.6 million.

*Held to maturity securities*
Held to maturity securities are valued using unadjusted quoted prices in active markets, where available. In other instances, either quotes of market participants are used or value of securities is determined using valuation models employing observable or non-observable market inputs.

*Customer deposits*
The fair value of customer deposits repayable on demand is their carrying amount. The fair value of other deposits is calculated by discounting expected cash flows using average market interest rates close to or at year-end. If all the assumed discount rates would change by 10%, the fair value of the deposit portfolio would change by LVL 0.5 million.

*Issued debt*
The value of issued debt is determined using either valuation models employing observable or non-observable market inputs or quotes of market participants.

*Subordinated liabilities*
The value of subordinated liabilities approximates the carrying amount.

## Fair value hierarchy

*Quoted market prices*
Financial instruments are valued using unadjusted quoted prices in active markets.

*Valuation technique - observable market inputs*
Financial instruments are valued using techniques based on observable market data. In some instances, valuations received from independent third party are used.

*Valuation technique - non-market observable inputs*
Financial instruments are valued using techniques for which significant inputs are not based on observable market data.

The following table presents fair values of Group’s financial assets and liabilities as at 31 December 2010.

| | **Carrying value** | **Adjustment to (arrive at) fair value** | **Fair value** | | |
|---|---|---|---|---|---|
| | | | Quoted market prices | Valuation technique - observable market inputs | Valuation technique - non-market observable inputs |
| Cash and demand deposits with central banks | 187,220 | - | - | 187,220 | - |
| Balances due from credit institution | 219,624 | - | - | 219,624 | - |
| Held-for-trading securities | 174 | - | 174 | | - |
| Financial assets designated at fair value through profit or loss | 3,318 | - | 3,318 | - | - |
| Derivatives | 2,670 | - | - | 2,670 | - |
| Available-for-sale securities | 196,991 | - | 196,991 | - | - |
| Loans and receivables to customers | 794,329 | (23,674) | - | - | 770,655 |
| Held to maturity securities | 127,572 | 2,635 | 121,358 | 8,849 | - |
| **Total financial assets** | **1,531,898** | **(21,039)** | **321,841** | **418,363** | **770,655** |
| | | | | | |
| Derivatives | 644 | - | - | 644 | - |
| Financial liabilities designated at fair value through profit or loss | 1,484 | - | 1,484 | - | - |
| *Financial liabilities measured at amortised cost:* | | | | | |
| Balances due to credit institutions and central banks | 70,559 | - | - | 70,559 | - |
| Customer deposits | 1,294,335 | (5,252) | - | 56,204 | 1,232,879 |
| Issued debt | 91,485 | (134) | - | - | 91,351 |
| Subordinated liabilities | 51,235 | - | - | - | 51,235 |
| Other financial liabilities | 7,333 | 1,714 | - | - | 9,047 |
| **Total financial liabilities** | **1,517,075** | **(3,672)** | **1,484** | **127,407** | **1,384,512** |

The following table presents fair values of Bank’s financial assets and liabilities as at 31 December 2010.

| | | | Fair value | | |
|---|---|---|---|---|---|
| | **Carrying value** | **Adjustment to (arrive at) fair value** | Quoted market prices | Valuation technique - observable market inputs | Valuation technique - non-market observable inputs |
| Cash and demand deposits with central banks | 177,348 | - | - | 177,348 | - |
| Balances due from credit institution | 211,608 | - | - | 211,608 | - |
| Held-for-trading securities | 4 | - | 4 | - | - |
| Derivatives | 2,716 | - | - | 2,716 | - |
| Available-for-sale securities | 152,927 | - | 152,927 | - | - |
| Loans and receivables to customers | 691,098 | (23,355) | - | - | 667,743 |
| Held to maturity securities | 117,280 | 1,872 | 119,152 | - | - |
| **Total financial assets** | **1,352,981** | **(21,483)** | **272,083** | **391,672** | **667,743** |
| Derivatives | 702 | - | - | 702 | - |
| *Financial liabilities measured at amortised cost:* | | | | | |
| Balances due to credit institutions and central banks | 82,175 | - | - | 82,175 | - |
| Customer deposits | 1,117,274 | (5,923) | - | - | 1,111,351 |
| Issued debt | 91,557 | (134) | - | - | 91,423 |
| Subordinated liabilities | 51,235 | - | - | - | 51,235 |
| **Total financial liabilities** | **1,342,943** | **(6,057)** | **-** | **82,877** | **1,254,009** |

## *e) Currency risk*

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

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

Day-to-day currency risk management is the responsibility of Treasury Sector, while risk monitoring and reporting is the responsibility of Risk and Compliance Sector. The Group has set a limit for open currency positions in each currency at 10% of its equity, and the limit for the total open currency position at 20% of its equity. The limits are equal to the requirements by Latvian legislation. To manage the currency risk, the Group and Bank derivative financial instruments. To assess currency risk, the Group uses scenario analysis. In the event of exchange rates for the following currencies in which the Group and the Bank has open positions adversely change as per scenario bellow, the potential total decrease in the Group’s and Bank’s 6 month pre-tax profit would amount to approximately:

| | Bank LVL 000’s | | | | Group LVL 000’s | | | |
|---|---|---|---|---|---|---|---|---|
| ***Scenario:*** | USD | CHF | RUR | Total for all currencies | USD | CHF | RUR | Total for all currencies |
| ***2% adverse change*** | 80 | 2 | 2 | 369 | 49 | 232 | 3 | 1,702 |
| ***5% adverse change*** | 199 | 6 | 6 | 923 | 122 | 581 | 7 | 4,254 |

In 2010 the Bank was in compliance with currency position limits.

The following table provides an analysis of the Group's and Bank's assets and liabilities and shareholders' equity as well as memorandum items outstanding as at 31 December 2010 and 2008 by currency profile:

| | Group as at 31/12/2010, LVL 000's | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | LVL | USD | EUR | CHF | EEK | LTL | RUB | Other | Total |
| Assets | | | | | | | | | |
| Cash and deposits with central banks | 126,322 | 4,633 | 12,521 | 2,303 | 31,624 | 6,691 | 470 | 2,656 | 187,220 |
| Balances due from credit institutions | 13,274 | 67,881 | 129,500 | 708 | 101 | 144 | 4,620 | 3,396 | 219,624 |
| Securities held for trading | - | - | 106 | - | - | - | 68 | - | 174 |
| Financial assets designated at fair value through profit or loss | 137 | 373 | 2,808 | - | - | - | - | - | 3,318 |
| Available-for-sale securities | 56,876 | 26,184 | 94,779 | 8,073 | - | 7,861 | - | 3,218 | 196,991 |
| Loans and receivables to customers | 64,711 | 138,058 | 526,751 | 3,933 | 18,381 | 41,428 | 877 | 190 | 794,329 |
| Held-to-maturity securities | 117,280 | 6,545 | 3,747 | - | - | - | - | - | 127,572 |
| Derivatives financial instruments | 2,585 | 18 | 42 | - | - | 25 | - | - | 2,670 |
| Other assets | 72,413 | 179 | 1,076 | 105 | 482 | 5,505 | 95 | 756 | 80,611 |
| **Total assets** | **453,598** | **243,871** | **771,330** | **15,122** | **50,588** | **61,654** | **6,130** | **10,216** | **1,612,509** |
| Liabilities | | | | | | | | | |
| Financial liabilities designated at fair value through profit or loss | 566 | 226 | 692 | - | - | - | - | - | 1,484 |
| Financial liabilities measured at amortised cost | 283,522 | 293,406 | 739,998 | 4,477 | 50,184 | 71,471 | 17,650 | 54,239 | 1,514,947 |
| Derivative financial instruments | 606 | - | 26 | - | - | 12 | - | - | 644 |
| Other liabilities | 8,463 | 1,253 | 1,212 | 1,012 | 119 | 997 | 99 | 252 | 13,407 |
| **Total liabilities** | **293,157** | **294,885** | **741,928** | **5,489** | **50,303** | **72,480** | **17,749** | **54,491** | **1,530,482** |
| Equity | 82,027 | - | - | - | - | - | - | - | 82,027 |
| **Total liabilities and equity** | **375,184** | **294,885** | **741,928** | **5,489** | **50,303** | **72,480** | **17,749** | **54,491** | **1,612,509** |
| ***Net long/ (short) position for balance sheet items*** | 78,414 | (51,014) | 29,402 | 9,633 | 285 | (10,826) | (11,619) | (44,275) | - |
| Off-balance sheet claims arising from foreign exchange | | | | | | | | | |
| Spot exchange contracts | - | 2,573 | (9,517) | 40 | - | 10,864 | (4,216) | 227 | (29) |
| Forward foreign exchange contracts | 4,255 | 4,836 | (9,316) | 274 | - | - | 4 | - | 53 |
| Swap exchange contracts | (89,500) | 41,167 | (46,146) | 1,674 | 4,546 | 25,243 | 15,964 | 49,013 | 1,961 |
| *Net long/ (short) positions on foreign exchange* | *(85,245)* | *48,576* | *(64,979)* | *1,988* | *4,546* | *36,107* | *11,752* | *49,240* | *1,985* |
| ***Net long/ (short) position as at 31 December 2010*** | **(6,831)** | **(2,438)** | **(35,577)** | **11,621** | **4,831** | **25,281** | **133** | **4,965** | **1,985** |
| Exchange rates applied as at 31 December 2010 (LVL for 1 foreign currency unit) | - | 0.535 | 0.702804 | 0.563 | 0.0449 | 0.203 | 0.0176 | - | - |

| | Bank as at 31/12/2010, LVL 000's | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | LVL | USD | EUR | CHF | EEK | LTL | RUB | Other | Total |
| Assets | | | | | | | | | |
| Cash and deposits with central banks | 126,313 | 4,131 | 11,848 | 407 | 31,624 | 144 | 417 | 2,464 | 177,348 |
| Balances due from credit institutions | 12,456 | 52,559 | 136,134 | 200 | 87 | 4,083 | 4,545 | 1,544 | 211,608 |
| Securities held for trading | - | - | 4 | - | - | - | - | - | 4 |
| Available-for-sale securities | 56,876 | 12,065 | 80,792 | - | - | - | - | 3,194 | 152,927 |
| Loans and receivables to customers | 64,594 | 131,283 | 474,611 | 3,933 | 15,555 | - | 877 | 245 | 691,098 |
| Held-to-maturity securities | 117,280 | - | - | - | - | - | - | - | 117,280 |
| Derivatives financial instruments | 2,656 | 18 | 42 | - | - | - | - | - | 2,716 |
| Other assets | 81,637 | 119 | 688 | 13 | 29 | 2 | 19 | 414 | 82,921 |
| **Total assets** | **461,812** | **200,175** | **704,119** | **4,553** | **47,295** | **4,229** | **5,858** | **7,861** | **1,435,902** |
| Liabilities | | | | | | | | | |
| Financial liabilities measured at amortised cost | 285,573 | 242,135 | 687,193 | 6,369 | 51,043 | 116 | 17,391 | 52,421 | 1,342,241 |
| Derivative financial instruments | 676 | - | 26 | - | - | - | - | - | 702 |
| Other liabilities | 6,885 | 1,086 | 527 | 3 | 75 | 3 | 90 | 250 | 8,919 |
| **Total liabilities** | **293,134** | **243,221** | **687,746** | **6,372** | **51,118** | **119** | **17,481** | **52,671** | **1,351,862** |
| Equity | 84,040 | - | - | - | - | - | - | - | 84,040 |
| **Total liabilities and equity** | **377,174** | **243,221** | **687,746** | **6,372** | **51,118** | **119** | **17,481** | **52,671** | **1,435,902** |
| ***Net long/ (short) position for balance sheet items*** | 84,638 | (43,046) | 16,373 | (1,819) | (3,823) | 4,110 | (11,623) | (44,810) | - |
| Off-balance sheet claims arising from foreign exchange | | | | | | | | | |
| Spot exchange contracts | - | 2,104 | 1,802 | 40 | - | - | (4,216) | 236 | (34) |
| Forward foreign exchange contracts | 4,255 | 5,304 | 14,815 | 274 | - | (24,532) | 4 | - | 120 |
| Swap exchange contracts | (89,500) | 31,662 | (36,357) | 1,618 | 4,546 | 25,243 | 15,718 | 48,958 | 1,888 |
| *Net long/ (short) positions on foreign exchange* | *(85,245)* | *39,070* | *(19,740)* | *1,932* | *4,546* | *711* | *11,506* | *49,194* | *1,974* |
| ***Net long/ (short) position as at 31 December 2010*** | **(607)** | **(3,976)** | **(3,367)** | **113** | **723** | **4,821** | **(117)** | **4,384** | **1,974** |
| Exchange rates applied as at 31 December 2010 (LVL for 1 foreign currency unit) | - | 0.535 | 0.702804 | 0.563 | 0.0449 | 0.203 | 0.0176 | - | - |

### *f) Liquidity risk*

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

The Group manages its liquidity risk in accordance with the Group’s Liquidity Risk Management Policy. Liquidity risk is assessed and decisions are made by ALCO. The decisions of ALCO are approved by the Bank’s Executive Board. ALCO sets the acceptable liquidity risk level, the Group’s internal limit system and defines instruments for the management of liquidity risk, as well as monitors the compliance with the set limits. Daily liquidity management, as well as control is ensured by the Treasury department. Liquidity risk management and reporting in the Group is coordinated by the Risk and Compliance Sector.

The Bank evaluates liquidity risk by using scenario analysis. For this purpose several scenarios of Bank’s operations under a variety of conditions are developed: gentle crisis (base case scenario), bank's crisis, general market crisis and a combined scenario. The Bank evaluates its liquidity position for each of the scenarios for variety of periods (ranging from 1 to 3 months). In the Bank a liquidity risk limit and early warning indicator system has been implemented. In addition to scenarios analysis, the Bank also prepares yearly cash flows, which heed assumptions about the most likely flows of funds. For general assessment of asset and liability gaps the Bank regularly prepares and analyses liquidity term structure.

In 2010 the Bank was in compliance with liquidity ratio requirements and mandatory reserve requirements in the Bank of Latvia.

The following table contains Bank’s liquidity ratios calculated in accordance with FCMC requirements:

| Year | *High* | *Low* | *Average* | *Year-end* |
|---|---|---|---|---|
| 2010 | 88% | 76% | 81% | 80% |

Liquidity ratio is calculated as liquid assets divided by all liabilities with remaining contractual maturity of 30 days or less. Liquid assets for the purpose of the calculation are cash, balances due from Bank of Latvia and solvent credit institutions placed on demand and up to 30 days and balances redeemable before maturity with insignificant contractual penalties and investments in securities that can be sold in short time or pledged to obtain a loan.

*Group's assets, liabilities and memorandum items by contractual maturity structure as at 31 December 2010*

| | Group as at 31/12/2010, LVL 000's | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years and undated | Total |
| Assets | | | | | | | |
| Cash and deposits with central banks | 179,233 | - | - | - | - | 7,987 | 187,220 |
| Balances due from credit institutions | 199,078 | 6,800 | 246 | 201 | 13,034 | 265 | 219,624 |
| Securities held for trading | 34 | - | - | - | 136 | 4 | 174 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | 1,483 | 1,835 | 3,318 |
| Available-for-sale securities | 5,228 | 10,830 | 43,891 | 59,901 | 54,267 | 22,874 | 196,991 |
| Loans and receivables to customers | 30,428 | 14,501 | 31,329 | 32,444 | 408,853 | 276,774 | 794,329 |
| Held-to-maturity securities | - | 1,374 | 180 | 4,288 | 111,947 | 9,783 | 127,572 |
| Derivatives financial instruments | 2,618 | 14 | 36 | 2 | - | - | 2,670 |
| Other assets | 5,099 | 391 | 2,283 | 207 | 141 | 72,490 | 80,611 |
| **Total assets** | **421,718** | **33,910** | **77,965** | **97,043** | **589,861** | **392,012** | **1,612,509** |
| Liabilities | | | | | | | |
| Financial liabilities designated at fair value through profit or loss | - | - | - | - | 1,484 | - | 1,484 |
| Financial liabilities measured at amortised cost | 749,926 | 170,607 | 212,482 | 152,730 | 174,219 | 54,983 | 1,514,947 |
| Derivative financial instruments | 627 | 13 | - | 4 | - | - | 644 |
| Other liabilities | 10,859 | 625 | 134 | 19 | 667 | 1,103 | 13,407 |
| **Total liabilities** | **761,412** | **171,245** | **212,616** | **152,753** | **176,370** | **56,086** | **1,530,482** |
| Equity | - | - | - | - | - | 82,027 | 82,027 |
| **Total liabilities and equity** | **761,412** | **171,245** | **212,616** | **152,753** | **176,370** | **138,113** | **1,612,509** |
| Net balance sheet position – long/ (short) | (339,694) | (137,335) | (134,651) | (55,710) | 413,491 | 253,899 | - |
| Memorandum items | | | | | | | |
| Contingent liabilities | 10,128 | - | - | - | - | - | 10,128 |
| Financial commitments | 91,633 | - | - | - | - | - | 91,633 |

*Group's contractual undiscounted cash flows of the financial liabilities as at 31 December 2010*

The following table represents the analysis of the estimated contractual cash flows arising from Group's financial liabilities as at 31 December 2010:

| | LVL 000's | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years | Total contractual cash flows |
| Financial liabilities designated at fair value through profit or loss | - | - | - | - | 1,484 | - | 1,484 |
| Financial liabilities measured at amortised cost | 750,127 | 173,710 | 217,863 | 158,255 | 205,984 | 61,473 | 1,567,412 |
| Memorandum items | | | | | | | |
| Contingent liabilities | 10,128 | - | - | - | - | - | 10,128 |
| Financial commitments | 91,633 | - | - | - | - | - | 91,633 |

*Bank’s assets, liabilities and memorandum items by contractual maturity structure as at 31 December 2010*

| | Bank as at 31/12/2010, LVL 000’s | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years and undated | Total |
| Assets | | | | | | | |
| Cash and deposits with central banks | 177,348 | - | - | - | - | - | 177,348 |
| Balances due from credit institutions | 186,432 | 12,720 | - | - | 12,456 | - | 211,608 |
| Securities held for trading | - | - | - | - | 4 | - | 4 |
| Available-for-sale securities | 3,653 | 8,900 | 39,142 | 50,883 | 28,879 | 21,470 | 152,927 |
| Loans and receivables to customers | 23,950 | 46,157 | 27,825 | 22,593 | 352,909 | 217,664 | 691,098 |
| Held-to-maturity securities | - | - | - | - | 108,103 | 9,177 | 117,280 |
| Derivatives financial instruments | 2,684 | 8 | 22 | 2 | - | - | 2,716 |
| Other assets | 3,826 | 10 | 36 | 50 | 14 | 78,985 | 82,921 |
| **Total assets** | **397,893** | **67,795** | **67,025** | **73,528** | **502,365** | **327,296** | **1,435,902** |
| Liabilities | | | | | | | |
| Financial liabilities measured at amortised cost | 637,792 | 154,215 | 191,820 | 138,317 | 168,432 | 51,665 | 1,342,241 |
| Derivative financial instruments | 693 | 6 | - | 3 | - | - | 702 |
| Other liabilities | 8,919 | - | - | - | - | - | 8,919 |
| **Total liabilities** | **647,404** | **154,221** | **191,820** | **138,320** | **168,432** | **51,665** | **1,351,862** |
| Equity | - | - | - | - | - | 84,040 | 84,040 |
| **Total liabilities and equity** | **647,404** | **154,221** | **191,820** | **138,320** | **168,432** | **135,705** | **1,435,902** |
| Net balance sheet position – long/ (short) | (249,511) | (86,426) | (124,795) | (64,792) | 333,933 | 191,591 | - |
| Memorandum items | | | | | | | |
| Contingent liabilities | 6,724 | - | - | - | - | - | 6,724 |
| Financial commitments | 113,049 | - | - | - | - | - | 113,049 |

*Banks’s contractual undiscounted cash flows of the financial liabilities as at 31 December 2010*

| | LVL 000’s | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years | Total contractual cash flows |
| Financial liabilities measured at amortised cost | 637,792 | 156,781 | 196,744 | 143,246 | 199,521 | 57,832 | 1,391,916 |
| Memorandum items | | | | | | | |
| Contingent liabilities | 6,724 | - | - | - | - | - | 6,724 |
| Financial commitments | 113,049 | - | - | - | - | - | 113,049 |

*Group’s derivative financial liabilities settled on a net basis and contractual undiscounted cash flows arising from Group’s derivatives settled on a gross basis as at 31 December 2010.*

| | LVL 000’s | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years | Total |
| **Derivatives settled on a net basis** | | | | | | | |
| Foreign exchange contracts | (606) | (6) | - | (3) | - | - | (615) |
| Interest rate derivatives | - | (5) | (1) | - | - | - | (6) |
| **Derivatives settled on a gross basis** | | | | | | | |
| Foreign exchange derivatives: | | | | | | | |
| outflow | (4,488) | - | - | (1) | - | - | (4,489) |
| inflow | 4,528 | - | - | 1 | - | - | 4,529 |
| Other derivatives: | | | | | | | |
| outflow | - | - | - | - | (20) | - | (20) |
| inflow | - | - | - | - | 42 | - | 42 |

*Bank’s derivative financial liabilities settled on a net basis and contractual undiscounted cash flows arising from Bank’s derivatives settled on a gross basis as at 31 December 2010.*

| | LVL 000’s | | | | | | |
|---|---|---|---|---|---|---|---|
| | Within 1 month | 1-3 months | 3-6 months | 6-12 months | 1-5 years | Over 5 years | Total |
| **Derivatives settled on a net basis** | | | | | | | |
| Foreign exchange contracts | (664) | (6) | - | (3) | - | - | (673) |
| Interest rate derivatives | - | (5) | (1) | - | - | - | (6) |
| **Derivatives settled on a gross basis** | | | | | | | |
| Foreign exchange derivatives: | | | | | | | |
| outflow | (4,697) | - | - | - | - | - | (4,697) |
| inflow | 4,734 | - | - | - | - | - | 4,734 |
| Other derivatives: | | | | | | | |
| outflow | - | - | - | - | (20) | - | (20) |
| inflow | - | - | - | - | 42 | - | 42 |

## *g) Operational risk*

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

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

The Group applies following approaches for operational risk management:

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

*h) Capital management*

Capital adequacy refers to the sufficiency of the Group’s capital resources to cover the credit risks and market risks arising from the portfolio of assets and the off-balance sheet exposures. The Financial and Capital Markets Commission’s (FCMC), the banking regulator, regulations require Latvian banks to maintain a capital adequacy ratio based on financial statements prepared under IFRS as adopted by EU of 8% of risk weighted assets.

Since the Bank has subsidiaries, which are financial institutions, it should comply with the regulatory requirements based on both the Group’s financial statements and the Bank’s financial statements as a stand-alone entity.

The Capital Requirements Directive (CRD), which implements Basel II capital regulations in the EU, came into full force on 1 January 2008. In Latvia the directive was implemented through FCMC regulations. Among the options provided in the regulations, the Bank and Group has chosen to use standardized approach in credit risk calculations and basic indicators approach in calculating operation risk charge.

The eligible capital for the capital adequacy purposes constitutes the capital that the Bank manages. The eligible capital comprises of Tier 1 and Tier 2 items, reduced by specific capital charges in accordance with the regulatory requirements.

The capital adequacy calculation of Bank and Group in accordance with FCMC regulations (*Basel II* framework) can be disclosed as follows:

| | LVL 000's | |
|---|---|---|
| | 31/12/2010 Group | 31/12/2010 Bank |
| *Tier 1* | | |
| - paid-in share capital | 103,000 | 103,000 |
| - audited retained earnings/ (accumulated loss) (not subject to dividend distribution)* | (18,807) | (19,427) |
| *Less* | | |
| - intangible assets | (2,001) | (1,256) |
| - restructuring reserve | (3,389) | - |
| - Investments in subsidiaries – insurance company (50% from total)* | (1,500) | - |
| **Total Tier 1** | **77,303** | **82,317** |
| *Tier 2* | | |
| - subordinated debt – total | 50,270 | 50,270 |
| - positive securities fair value revaluation reserve | 553 | 467 |
| - Tier 2 excess over 50% from Tier 1 | (11,422) | (9,579) |
| - investments in subsidiaries – insurance company (50% from total)* | (1,500) | - |
| **Total Tier 2** | **37,901** | **41,158** |
| **Equity to be utilised in the capital adequacy ratio** | **115,204** | **123,475** |
| *Credit risk and counterparty risk capital charge by regulatory asset classes:* | | |
| Central governments and banks | 443 | 57 |
| Municipalities | 184 | 125 |
| Government institutions | 19 | 19 |
| Credit institutions | 7,388 | 8,826 |
| Companies | 33,593 | 34,865 |
| Assets qualifying for "retail" definition | 6,651 | 4,431 |
| Qualifying residential mortgage loans | 8,211 | 5,989 |
| Assets qualifying for "past due" definition | 3,017 | 2,655 |
| Covered bonds | 113 | 113 |
| Investment funds | 750 | 750 |
| Other assets | 16,137 | 10,948 |
| *Other risk capital charges:* | | |
| Foreign currency open positions subject to capital charge | 3,756 | 635 |
| Fixed income securities position risk capital charge | 168 | 168 |
| Equity instruments' position risk capital charge | - | - |
| Operational risk capital charge | 11,604 | 9,390 |
| **Total capital charges** | **92,034** | **78,971** |
| **Capital Adequacy Ratio (Equity/Total capital charges) x 8%** | **10.0%** | **12.5%** |

* AAS Citadele Life is not included in consolidation group for capital adequacy purposes. The investment value directly reduces the equity eligible for the capital adequacy ratio calculation purposes.

## NOTE 36. EVENTS AFTER THE BALANCE SHEET DATE

*Early repayment of Ministry of Finance deposit*

On 18 January 2011 the Bank repaid EUR 46.6 million to Ministry of Finance, half a year ahead of the schedule.

*Changes in subordinated debt agreements with State JSC Privatisation Agency*

On 31 January 2011, the Bank and *JSC Privatisation Agency* agreed to amend the subordinated debt agreement concluded on 22 May 2009, whereby the mechanism for subordinated rate determination was changed. Effective from 1 January 2011 until 7 February 2011, the interest rate was changed from 20.861% to 8.84% and as of 8 February 2011 it is 8.8%. From then on, the rate will be revised on semi-annual basis.

*Ministry of Finance deposit interest rate change*

Based on the deposit agreements concluded with Ministry of Finance in relation to the State aid received by the Bank, as of 1 January 2011, the interest rate on the deposits received from the Ministry of Finance was revised from 10.003% p.a. to 5.01%. The rate is revised on a quarterly basis.

*Agreement with AS Parex Banka*

On 19 April 2011, the Bank concluded agreement with AS Parex Banka, whereby both parties agreed to adjust the initial price established, when concluding share purchase agreement on buying AB Citadele Bankas (Lithuania) shares in 2010. For more information please refer to Note 18.

*Competition council's decision*

On 3 March 2011, the Competition council took the decision to fine 22 Latvian commercial banks for allegedly fixing commission fees for ATM and credit card payments. The Competition council's calculated fine for the Bank amounted to LVL 1.2 million. The Bank disagrees with the decision and will appeal.

Translation from Latvian original*

# INDEPENDENT AUDITOR'S REPORT

## To the Shareholders of AS Citadele banka

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of AS Citadele banka and its subsidiaries (the "Group") and financial statements of AS Citadele banka (the "Bank") on pages 8 to 68, which comprise the balance sheets as of 31 December 2010 and the statements of income and the statements of comprehensive income, changes in equity and cash flows for the 6 month period ended 31 December 2010 and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's 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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from 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 the auditor's 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, the auditor considers 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 policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

*Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the Group and the Bank as of 31 December 2010, and of its financial performance and its cash flows for the 6 month period then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

**Report on Other Legal and Regulatory Requirements**

We have read the Management Report set out on pages 3 to 5 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the financial statements for 2010.

PricewaterhouseCoopers SIA
Certified audit company
Licence No. 5

Ahmed Abu Sharkh
Chairman of the Board

Ilandra Lejiņa
Certified auditor in charge
Certificate No. 168

Riga, Latvia
16 May 2011

* This version of our report is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.