Regional Investment Bank

AS "Reģionālā investīciju banka"

Consolidated and Bank's annual report for the year ended 31 December 2018

Prepared in accordance with International Financial Reporting Standards as adopted in the European Union

12.03.2019

Contents

AS "Reģionālā investīciju banka"H
J. Alunana Street 2, Riga, LV-1010, Latvia
Phone: (+371) 67508989
Fax: (+371) 67508988
Unified registration number: 4000 356 3375

Management report

In 2018, AS "Reģionālā investīciju banka" (hereinafter – the Bank), registered office: J. Alunana 2, Riga, LV-1010, Latvia, unified registration number: 4000 356 3375, license for the operation of a credit institution No. 170 issued on 3 October 2001, developed in accordance with the previously approved strategy. Net profit of the Bank in the reporting period amounted to EUR 5,7 million exceeding the results of the year 2017 by 130%. Return on equity (ROE) and return on assets (ROA), based on the results of the year, amounted to 15.66% and 1.80% respectively.

Overall economic situation

The previous year was marked by tension increase not only politically but also in financial and economic spheres. From a geopolitical point of view Donald Trump's administration continued with its 'deglobalization' policy, which mainly materializes in taking unilateral and often unpredictable decisions concerning multiple global challenges. Among the key decisions was imposing tariffs not only on Chinese imports but also on many goods imported from USA trading partners, including EU Member States; rigorous negotiations with Canada and Mexico regarding the North American free trade zone; re-imposing sanctions on Iran unilaterally; conflicts with Turkey and imposing sanctions thereon; etc.

Such a harsh policy was also realized with regard to a wide range of internal issues, which reached their apogee with the government shutdown at the very end of the year due to the conflict about building the "wall" on the US southern border with Mexico. Without doubt, such a policy has a certain logic focused on dramatization of events and further negotiations with a view to more advantageous conditions. The dark side of such an approach is increasing political uncertainty and distrust due to sudden unilateral breach of previous agreements.

Considerable political uncertainty gradually creeps across all countries of the world: the still existing uncertainty as to the United Kingdom leaving the European Union; 'populists' coming to power in Italy, the "yellow vests' protests in France; Chancellor Merkel's announcement on ending her political career after the next general elections; the election of Brazil's far-right president; a scandal over the assassinated journalist of Saudi Arabia in Turkey; etc. All these events signal about dissatisfaction of many population strata all over the world with the social and economic situation and mainly with the increasing income inequality which may become a dangerous political perspective.

At the end of 2018, the financial and economic situation had significantly deteriorated as well. The US Federal Reserve continued to raise the interest rate causing serious corrections on the commodities market and stock markets in October-December. As a result, the previous year was the first year since 2008 when a considerable decrease in stock quotes could be observed throughout the year. The International Monetary Fund has estimated that in 2018 - 2019 the world GDP growth rate will remain at the level of 2017, i.e., at 3.7%. The Fund's experts consider that their estimates have become more conservative as the growth rates in different parts of the world become less balanced while the leading developed countries have reached the peak of an economic cycle due to the introduction of protectionist measures in the sphere of foreign trade, stricter financial conditions in the form of interest rates and geopolitical tension.

The same as in 2017, the economy of Latvia continued to exhibit impressive growth rates in 2018. In the 1st quarter of 2018, GDP grew by 4.0% (in 2017: 4.3%) in real terms, in the 2nd quarter – by 5.3% (in 2017: 4.4%) and in the 3rd quarter - by 4.7% (in 2017: 5.5%). In the first half of the year, the construction sector still showed high growth rates due to the utilization of remaining EU funds (an increase of more than 30%) while in the 3rd quarter the growth rate considerably fell (10%).

Instead, the title of the fastest growing sector was taken over by such sectors as information technology and communications (an increase of 13% in 2018) and transport (an increase of 5.3% in 2018). Positive growth dynamics was also observed in the hotel, restaurant and catering services sector along with the increasing number of foreign tourists in Latvia. The financial and insurance services sector experienced a shock in the first half of the year caused by the events concerning *ABLV Bank* and the overall financial services sector. The fast outflow of non-resident deposits from Latvia's

Overall economic situation (cont'd)

banking system continued throughout the first half of the year along with the strengthened anti-money laundering requirements of the regulator.

The above events made the non-resident sector to reconsider its role in the economy and develop new business strategies which were submitted to the regulator for review as well as introduce appropriate internal organizational and structural changes. The Bank of Latvia expects that in 2018 the overall economic growth at constant prices will be 4.7%. In the near future, the economic growth is expected to decline to 3.6% in 2019 and to 3.5% - in 2020.

In general, the Central Bank predicts a gradual slowdown in almost all sectors as it believes that the present growth rate will be difficult to maintain at the same high level. One of constrains will be the gradual rise in inflation caused by the economic growth exceeding potential rapidly rising labor costs and salaries as well as the expected rise in energy prices. In 2018, inflation may increase to 2.6% and in 2019 – to 2.9%.

The year 2018 turned out to be notable for Latvian commercial banks. For the reasons set out below, at the end of November 2018 the total assets of Latvian banking sector fell to EUR 22.0 billion decreasing by EUR 6.3 billion or 22.3% compared with the data at the end of the year 2017. The decrease in the asset volume was mainly due to the similarly dramatic fall in deposits, mostly non-resident, in the banking system, by EUR 4.6 billion or 22.3%.

The outflow of deposits resulted in a reduction of the size both of securities and loan portfolios on the balance sheets of banks. As a result, over the 11 months of the year 2018, the securities portfolio fell by EUR 2.5 billion or by 59.8% to EUR 1.7 billion, whereas the consolidated loan portfolio of Latvian banking system declined by 6.0% to EUR 13.5 billion (at the end of 2017: EUR 14.3 billion).

The quality of issued loans deteriorated: the volume of non-performing loans (over 90 days) for the first 10 months of the year 2018 grew by 4.8%, and at the end of October 2018 amounted to EUR 614 million, i.e., to 4.5% of the total amount of the loan portfolio, compared with the 4.1% at the end of the year 2017. At the end of the 3rd quarter of 2018, the liquidity coverage ratio (LCR) of the banking system remained at the level of 269.0%, compared with the 313.3% at the end of 2017 and considering the 100% minimum set in the laws.

Due to the decreasing asset volume, capital adequacy indicators in Latvian banking sector still remained at the comfort level, significantly exceeding the minimum capital requirements: at the end of the 3rd quarter of 2018 the overall capital adequacy ratio (CAR) reached 22.0 % compared with 21.4% at the end of 2017, whereas Common equity Tier 1 Capital ratio (CET1) was at the level of 19.9% compared with 19.0% previously. The banking sector even managed to remain profitable by considerably reducing administrative expenses and improving asset quality.

During the period from January to November 2018, the overall gross profit totaled EUR 278 million compared with EUR 236 million generated over the same period in 2017, i.e., increasing by 18%. From January to September 2018, ROAE grew to 10.9% compared with 8.7% a year before, mainly due to the decrease in the asset volume. In a short-term, Latvia's financial sector has managed to withstand the biggest shock since the global crisis. Will it be able to adjust to new challenges and business conditions in a long-term remains to be seen. It also depends on the capacities and capabilities of the market players themselves.

Operations during the reporting period

The year 2018 was quite successful for the Bank. According to the Finance Latvia Association, as at 30 September 2018 the Bank ranked 10th among Latvian banks by assets and profits.

In 2018, the Supervisory Council of the Bank approved the new 2018-2021 Development Strategy of the Bank. The Strategy envisages the continuation of banking business in Latvian and EU markets as well as

Operations during the reporting period (cont'd)

transforming the Bank in accordance with the plan and in line with the new operational format which complies with the regulator's and market requirements as well as with the shareholders' interests. The activities in the second quarter of 2018 were directed at achieving the targets set in the new strategy, i.e., ensuring customer risk acceptable to the Bank, optimization of administrative expenses while maintaining high compliance with laws and regulations as well as preparation for active participation in the domestic market.

As a result of more prudent lending policy, in 2018 the Bank issued new loans worth EUR 17.25 million whereas the loans repaid amounted to EUR 36.45 million; consequently, the overall loan portfolio decreased by12.28%. Nevertheless, the increase in the effective annual interest rate resulted in a decrease in the loan interest income in the reporting year only by 6.35% and amounted to EUR 6,5 million. As at 31 December 2018, the total loan portfolio amounted to EUR 110,49 million. In the reporting year, allowances decreased by 18%.

In the reporting period, the Bank successfully implemented two Investment deposit programs ending in January and June with a yield of 3.5% and 1.6% per annum respectively.

At the end of the year, the Bank began cooperation with the German deposit broker *Deposit Solutions*. The aim of cooperation is to diversify the Bank's sources of financing, ensure more stable depositor base and focus on EU resident sector. The Bank plans to use the raised funds for lending in Latvia.

In September 2018, the Bank started to issue the payment cards *MasterCard Standard* and *MasterCard Business* with a new modern design and contactless payment function.

In 2018, following the requirements laid down in the revised AML/CTF Law and new ML/TF risk management strategy, the Bank considerably reduced its non-resident customer base – overall 2,520 customer accounts were closed in 2018. The reduction of the customer base led to a decrease in deposits and assets by 24% and 23% respectively. The Bank is strongly committed towards completing the de-risking measures with respect to the Bank's customer base assets by the end of the 1st quarter of 2019 – reaching the minimum number of customers, i.e., approximately 2,400 customers. Starting from the 2nd quarter, the Bank expects a gradual increase in the number of customers mainly through winning customers in the domestic market.

On 1 December 2017, the Financial and Capital Market Commission (FCMC) set the capital adequacy requirement for the Group amounting to 13.2%. The Bank continues to outperform this requirement, and the Bank's ratio as at 31 December 2018 was 27.21%, which included the preservation of capital reserve amounting to 2.5%. The Bank continuously maintains its liquidity ratio in compliance with the minimum requirement set by the FCMC at the rate of 60%, and as at 31 December 2018, the Bank's liquidity ratio amounted to 69.29%.

In September 2018, Daiga Junga resigned from the position of a Board Member. As a result of changes in the management composition, the Bank's internal structure was revised and optimized. Under the ongoing transformation and optimization process, at the end of 2018, a decision on the merger of the three representation offices of the Bank in Ukraine was taken resulting in winding up the representation offices in Kiev and Dnepr. Customers can address all their questions to the representation office in Odessa.

Management report *(cont'd)*

Operations during the reporting period (cont'd)

For the first time in its history, the Bank's shareholders decided to pay dividends. In December, the approval of the Financial and Capital Market Commission was received and dividends of EUR 6.9 million were paid out of retained earnings.

Profit distribution as suggested by the Management Board

The Management Board suggests that the profit for the reporting year should be transferred to retained earnings.

Future plans and prospects

In 2019, the Bank plans to finalize several projects of strategic importance for the transformation of the Bank's business model, namely: implementation of an advanced Mobile Banking application and a new website, finishing the change of the Bank's logo and creation of a new visual identity as well as ongoing development of the Bank's image on the domestic market. The Bank's management strongly believes that the implementation of the above projects will enhance the Bank's visibility both in Latvia and EU. In the first six months, the Bank expects to draw up a strategy for the development of technologies and the digital transformation of the Bank's products.

As a result of the optimization of administrative expenses carried out at the end of 2018, the Bank achieved the optimum both as to the number of employees and in the expenditure part of its budget. One of the objectives for 2019 under this process is raising the qualifications of personnel and developing professional skills. In 2019, the Bank plans to focus on the staff in charge of domestic sales and Latvian and EU resident service.

The Bank's profit forecast for 2019 is quite conservative. The budget for 2019 foresees that the Bank will close the year 2019 with a net profit of EUR 2.15 million. Moreover, stimulating the Bank's development in the new market segment, the expenditure part of the budget includes considerable investments in marketing, IT system development, mainly, in renovation of the Bank's premises, as well as audit of the internal control system in the AML/CTF area according to the set plan.

Aleksandrs Jakovlevs Acting Chairman of the Board	Mark Bekker Deputy Chairman of the Council

Riga, 12 March 2019

Management report *(cont'd)*

The supervisory council and the board of directors of the bank

As at 31 December 2018 and as at the date of signing the financial statements:

The Council

		Date of appointment
Yuriy Rodin	Chairman of the Council	Re-elected – 15.05.2017
Mark Bekker	Deputy Chairman of the Council	Re-elected – 15.05.2017
Dmitrij Bekker	Member of the Council	Re-elected – 15.05.2017
Alla Vanetsyants	Member of the Council	Re-elected – 15.05.2017
Irina Buts	Member of the Council	Re-elected – 15.05.2017

Bankas valde

		Date of appointment
Aleksandrs Jakovlevs	Acting Chairman of the Board	06.08.2014.
Gints Gritans	Member of the Board	05.06.2015.
Andrii Homza	Member of the Board	30.11.2016.

During 2018, the following changes took place in the composition of the Board of JSC Regionala investiciju banka:

On September 28, 2018 member of the Board Daiga Muravska was removed.

Aleksandrs Jakovlevs
Acting Chairman of the Board

Mark Bekker
Deputy Chairman of the Council

Riga, 12 March 2019

Statement of Management Responsibility

The Supervisory Council and the Board of Directors (hereinafter - the Management) of the Bank are responsible for the preparation of the Consolidated financial statements of the Bank and its subsidiary (hereinafter – the Group) and the Bank's financial statements.

The Consolidated and Bank's financial statements on pages 17 through 107 are prepared in accordance with the source documents and present fairly the financial position of the Group and the Bank as at 31 December 2018 and the results of their operations and cash flows for the reporting year 2018.

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted in 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 the Bank is responsible for the maintenance of proper accounting records, the safeguarding of the Bank's assets and the prevention and detection of fraud and other irregularities in the Bank. 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 Bank of Latvia and other legislation of the Republic of Latvia applicable for credit institutions

Aleksandrs Jakovlevs
Acting Chairman of the Board

Mark Bekker
Deputy Chairman of the Council

Riga, 12 March 2019

Building a better
working world

SIA „Ernst & Young Baltic"
Muitas iela 1a
Rīga, LV-1010
Latvija
Tel.: +371 6704 3801
Faks.: +371 6704 3802
riga@lv.ey.com
www.ey.com/lv

Reģistrācijas Nr. 40003593454
PVN maksātāja Nr. LV40003593454

SIA Ernst & Young Baltic
Muitas iela 1a
Rīga, LV-1010
Latvia
Tel.: +371 6704 3801
Fax: +371 6704 3802
riga@lv.ey.com
www.ey.com/lv

Reg. No: 40003593454
VAT payer code: LV40003593454

Translation from Latvian

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Reģionālā Investīciju Banka AS

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Reģionālā Investīciju Banka AS and its subsidiaries (the Group) and the accompanying financial statements of Reģionālā Investīciju Banka AS (the Bank) set out on pages 17 to 107 of the accompanying Annual Report, which comprise the statements of financial position as at 31 December 2018, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements of the Group and the Bank give a true and fair view of the financial position of the Group and the Bank as at 31 December 2018, and of financial performance of the Group and the Bank and cash flows of the Group and the Bank for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group and the Bank in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the independence requirements included in the Law on Audit Services of Republic of Latvia that are relevant to our audit of the financial statements in the Republic of Latvia. We have fulfilled our other ethical responsibilities in accordance with the Law on Audit Services of Republic of Latvia and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 37 of the consolidated and the Bank's financial statements, which indicates that in May 2018 amendments to the Law on the Prevention of Money Laundering and Terrorism Financing came into force prohibiting the service provision to a part of shell-companies. The Group and the Bank had to revise the business model and implement a new development strategy. Given that the Group and the Bank are in the early stage of new business model implementation as defined in the development strategy, there is uncertainty on whether and how the Group and the Bank will succeed in implementing the new strategy. These events or conditions indicate that a material uncertainty exists that may cast significant doubt on the Group's and the Bank's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the Group and the Bank of the current period. These matters were addressed in the context of our audit of the financial statements of the Group and the Bank as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements of the Group and the Bank. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements of the Group and the Bank.

Key audit matter	How we addressed the key audit matter
Loan loss impairment (the Consolidated and the Bank's financial statements)	
The carrying amount of loans to corporate and individual customers as at 31 December 2018 amounted to EUR 88 260 thousand in the Bank's financial statements and to EUR 85 499 thousand in the Consolidated financial statements; the impairment reversal recognised in the Consolidated and the Bank's financial statements amounted to EUR 890 thousand in 2018. The total impairment loss allowance as at 31 December 2018 amounted to EUR 22 227 thousand (in the Bank's and the Consolidated financial statements). Effective 1 January 2018, the Group and the Bank adopted IFRS 9 "Financial Instruments" and the requirements of the IFRS 9 have been applied retrospectively without restating comparatives. The additional impairment as a result of IFRS 9 adoption recognized in the opening retained earnings of the Group and the Bank on 1 January 2018 amounts to EUR 5 833 thousand. Under IFRS 9, the Group and the Bank has introduced the expected credit loss model. The basis of the Bank's and the Group's impairment provision policy is presented in the accounting policies section in Notes 3(m) and 4(a) to the financial statements. Critical accounting estimates and judgments, disclosures of loans and guarantees and the credit risk management are set out in Notes 3(m), 4 (a) and 13 to the financial statements. Loan receivables are significant to the total assets of the Consolidated and the Bank's financial statements. The Group and the Bank have significant exposures to the borrowers in foreign jurisdictions including those in the Ukraine. We identified this area to be significant for the audit because recognition of allowances for loan loss impairment reflected in the Group's and the Bank's expected credit loss model is associated with significant estimation as it requires the management to exercise judgement and apply complex and subjective assumptions both about the timing and amounts of such impairment. Key areas of judgement include the identification of exposures with a significant deterioration in credit quality, assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward looking macroeconomic factors. Individual impairment allowances recognised by the Group and the Bank mostly relate to large, individually monitored exposures to corporates and individuals. Therefore, the assessment of the aforementioned exposures is based on the knowledge about	Our audit procedures included, among others, the following: We gained understanding and tested the key controls over the loan issuance, booking and monitoring and loan impairment provisioning processes. We obtained and read the Group's and the Bank's Impairment provisioning policy that is based on IFRS 9 and involved our internal IFRS 9 specialists to assess its compliance with the requirements of IFRS 9. In addition to testing the key controls, we selected a sample of loans with higher risk characteristics such as significant exposures arising from the related borrower groups, restructured loans or borrowers in foreign jurisdictions, exposures arising from delayed payments outstanding on the reporting date. The sample of loans was assessed as to the existence of significant increase in credit risk and default triggers by reviewing the underlying loan documentation and discussing the respective loans with the representatives of the Loan Department and the Debt Collection Department. As concerns non-performing loans, we reviewed the forecasts of future cash flows used in the assessment of loan impairment, evaluated the key assumptions made by the management such as the applied discount rates, collateral values (by involving our valuation specialists), forecasted business performance and, as applicable, cost to repossess the collateral, collateral sales costs and sales periods. The sample of loans was examined considering whether all impairment events identified by us had also been identified by the Group's and Bank's management. As to the performing loans and receivables, we assessed whether the borrowers exhibited the significant increase in credit risk or the possible default risk that may affect meeting their scheduled repayment obligations. We reviewed the Group's and the Bank's accounting policies and the management's assumptions relating to the estimation of expected credit loss. For a sample of the loans we checked the appropriateness of the Group's and the Bank's staging. We checked the calculation of the Loss Given Default (LGD), Probability of Default (PD) and, for a sample of loans, we checked the appropriateness of determining Exposure at Default and assessed whether the Group and the Bank has calculated estimated expected credit loss in line with the provisioning policy. We performed analytical procedures, such as a comparison of loan loss impairment allowance balances to industry, and other substantive procedures. We also assessed the adequacy of the financial statement disclosures in Notes 3 (m), 4 (a) and 13.

each individual borrower and often on the estimated fair value of the relevant collaterals, the assessment of customers which are likely to default, and the future cash flows relating to loans. Due to the above circumstances, we considered loan impairment assessment to be the key audit matter.	
Anti-money Laundering (regulatory requirements regarding anti-money laundering) (the Consolidated and the Bank's financial statements)	
In 2018, the amendments to the Law on the Prevention of Money Laundering and Terrorism Financing (NILLTF) have come into force. The banks in Latvia were prohibited to establish and maintain the business relationship with shell-companies that possessed certain indications as disclosed in Note 4(i). As the Group and the Bank historically have cooperated with the shell-companies, these events required the Group and the Bank to revise their AML policies as well as the client's base. In late 2018 the Financial Capital and Market Commission (hereinafter FCMC) carried out the inspection to assess the fulfilment of the requirements specified in Law on NILLTF concerning the prohibition to cooperate with shell companies and issued findings report. As disclosed in Note 37, based on the findings, the FCMC issued the results of the inspection subsequent to year-end. Additionally, as disclosed in Note 9 to the financial statements, during 2017 the Group and the Bank was involved in an administrative proceeding initiated by Latvian financial services regulator, the FCMC concerning the failure to comply with anti-money laundering requirements embedded in Latvian legislation and on 26th June 2017 the FCMC announced a regulatory fine amounting to EUR 570 thousand imposed on the Bank. The Group and the Bank acknowledged misconduct and paid the imposed fine during 2017. The FCMC and the Bank concluded a mutual administrative agreement wherein the FCMC laid down requirements for the Bank with a view to strengthening its internal anti-money laundering control system so that it complies with the FCMC requirements which are considered a key requisite for the Group's and the Bank's successful operations in the future. Given the importance of the matter to the Group's and the Bank's reputational risk and significant impact on the future operations, we have this as a key audit matter.	Our audit procedures included, among others, the following: We gained understanding of the processes and implemented controls in relation to client acceptance and anti-money laundering. We tested the controls related to new client acceptance and compliance with the anti-money laundering legislative requirements. We tested the application of the Group's and the Bank's anti-money laundering procedures on a selected sample of the Group's and the Bank's deposit clients and their transactions. We discussed with the Group's and the Bank's representatives the strategy of the clients' termination that the Group and the Bank pursued right after the amendments to the Law on NILLTF came into force. We tested a sample of terminated clients to evaluate whether the cooperation had been terminated. We tested the Group's and the Bank's assessment of the indications of shell company on a sample of the clients by reviewing the due diligence questionnaires. We reviewed the Group's and the Bank's NILLTF risk management strategy for 2018-2020 and discussed the implementation status. We reviewed the findings reported by the FCMC as a result of its anti-money laundering inspection. We inspected the correspondence between the Bank and the FCMC, including the Administrative Agreement with the FCMC, the recent inspection findings report and the results of the inspection. We discussed the matter with the Group's and the Bank's representatives responsible for compliance with anti-money laundering, the improvement plan and its implementation. We reviewed and evaluated the Bank's action plan in relation to the FCMC findings and its implementation by inspecting the implementation status reports and correspondence on the implementation with the regulator. We reviewed all other communication with the FCMC and the State Revenue Service in order to identify whether there are any undisclosed or unrecorded violations noted by the main regulatory institutions. We reviewed the findings of the report and met with the representatives of the FCMC to discuss the findings of the recent

	inspection and the implication of these findings on the Group's and Bank's operations. We also assessed the adequacy of the disclosures relating the matter in Note 4(i), 9 and 37 to the financial statements.
Valuation of repossessed assets (the Consolidated and the Bank's financial statements)	
As disclosed in Note 19 to the financial statements the Group and the Bank have repossessed real estate as part of the loan recovery process and have accounted them both in the Consolidated and the Bank's financial statements as at 31 December 2018 amounting to EUR 11 355 thousand and EUR 2 166 thousand respectively. The largest repossessed property recorded in the Consolidated financial statements amounting to EUR 9 100 thousand is located in Germany (Berlin) and there are certain legal restrictions to be resolved. Some of the real estate is located in Ukraine (the Consolidated and the Bank's financial statements) and selling of the respective properties might require considerable time. Determining whether an impairment for any of the repossessed real estate should be recognised requires the Group's and the Bank's management to make significant assumptions and involves judgements. As a result of the Group's and the Bank's management impairment assessment, impairment charge amounting to EUR 60 thousand has been recognized in year 2018. Due to the above circumstances, we consider the impairment assessment of repossessed real estate to be a key audit matter.	Our audit procedures included, among others, the following: We obtained understanding about the management's approach to the accounting and assessment of the recoverable amounts applied to the respective repossessed assets. We assessed the ownership of the repossessed real estate by reviewing the respective country's land registry documents. We obtained and reviewed initial valuations and their updates of the repossessed real estate made by independent certified third party valuators. We assessed the independence and competence/ experience of the engaged third party valuators. We involved internal valuation specialists to assist us in reviewing the initial valuation reports and their updates on the selected largest repossessed real estate objects. Our internal valuation specialists reviewed and assessed the estimates and key assumptions used and methodologies applied to determine the recoverable amounts of the repossessed real estate. For the additional work done on the largest repossessed real estate located in Germany see the key audit matter "Recoverability of investment in and loan issued to the subsidiary Grunewald Residence Ltd". We assessed the classification and valuation of the assets according to IFRS. We also assessed whether the disclosures in Notes 3 (q), 3 (ee) and 19 to the financial statements comply with the IFRS requirements and considered whether the disclosures on the application of judgement in estimating the recoverable amount and the sensitivity of the results of those estimates reflect the risks associated with impairment of repossessed real estate.
Recoverability of investment in and loan issued to the subsidiary Grunewald Residence Ltd (the Bank's financial statements)	
In the Bank's financial statements as at 31 December 2018 the carrying amount of investment in the subsidiary, Grunewald Residence Ltd, was reported EUR 6 100 thousand. The loan issued to the subsidiary amounted to EUR 2 500 thousand. The core business of the subsidiary is holding the repossessed asset located in Germany taken over in the year 2017. The take-over of the asset triggered the reversal of the loan impairment amounting to EUR 2 500 thousand which was recognised by the Bank in the previous periods. As described in Note 15, the ultimate goal of the Bank's management is successful sale of the respective asset (in a development stage) once legal restrictions related to the	Our audit procedures included, among others, the following: We assessed the ownership of the subsidiary Grunewald Residence Ltd and land in Berlin, Germany, by obtaining the subsidiary incorporation documents and reviewing the Germany Land register documentation and the third-party purchase agreement of the land. We obtained and reviewed the initial valuation and its update of the repossessed real estate made by the independent certified third party valuator as a key evidence supporting recoverability of the investment in the subsidiary and related loan to the subsidiary. We assessed the independence and competence/ experience of the engaged third party valuator.

asset are resolved. In order to increase the value of the asset and also to strengthen the Grunewald Residence Ltd position in court, German architects have been contracted to develop the site project and obtain construction permits for the potential future development of the land when the legal restrictions are removed and the old buildings demolished. The determination of the recoverable amounts of the investment in the subsidiary and the loan to the subsidiary is a complex process and requires the management to make subjective judgements, including those in respect of resolution of the legal restrictions and also future operating cash flows, growth rates and discount rates related to the development of the repossessed asset. Due to the above circumstances, we consider recoverability of investment in the subsidiary and the loan issued to the subsidiary to be a key audit matter.	We also reviewed and assessed the offers received by the lawyers and insolvency administrator to buy the land plot. The received offers also included financing plans confirmed by the banks. We involved internal valuation specialists to assist us in reviewing the updated valuation report. Our internal valuation specialists reviewed and assessed the estimates and key assumptions used and methodologies applied to determine the recoverable amount of the land plot. We reviewed the legal opinion on the potential outcome of the legal proceedings in respect of the restrictions and assessed how the management had incorporated this information in its projections on estimation of recoverability of the investment in the subsidiary and loan issued to the subsidiary. We discussed the facts mentioned in the legal opinion with the Bank's management. We discussed with the management their intentions in respect of the repossessed asset, reviewed the agreements with lawyers and architects working on resolving the legal restrictions as well as future development of the asset. We reviewed documentation for the third party deposit that serves as a collateral for the loan issued to Grunewald Residence Ltd. We assessed the classification and valuation of the assets according to IFRS. We also assessed whether the disclosures in Notes 3 (ee), 15 and 19 to the financial statements comply with the IFRS requirements and considered whether the Bank's disclosures on the application of judgement in estimating the recoverable amount and the sensitivity of the results of those estimates reflect the risks associated with impairment of the investment in and loan issued to the subsidiary.

Reporting on other information

Management is responsible for the other information. The other information comprises:

- the Management Report, as set out on pages 3 to 7 of the accompanying Annual Report;
- the Statement on Management Responsibility, as set out on page 8 of the accompanying Annual Report;

but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except as described in the Other reporting responsibilities in accordance with the legislation of the Republic of Latvia section of our report.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed and in light of the knowledge and understanding of the Group and the Bank and their environment obtained in the course of our audit, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Other reporting responsibilities in accordance with the legislation of the Republic of Latvia

We have other reporting responsibilities in accordance with the Law on Audit Services of the Republic of Latvia with respect to the Management Report. These additional reporting responsibilities are beyond those required under the ISAs.

Our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Financial and Capital Market Commission's Regulations of the Republic of Latvia No. 46 "Regulations on the Preparation of Annual Accounts and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies".

Based solely on the work undertaken in the course of our audit, in our opinion:

- the information given in the Management Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

- the Management Report has been prepared in accordance with the requirements of the Financial and Capital Market Commission's Regulations of the Republic of Latvia No. 46 "Regulations on the Preparation of Annual Accounts and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies".

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of the financial statements that give a true and fair view 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.

In preparing the financial statements, management is responsible for assessing the Group's and the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group and the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's and the Bank's financial reporting process.

Building a better
working world

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's and the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group and the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other reporting responsibilities and confirmations required by the legislation of the Republic of Latvia and European Union when providing audit services to public interest entities

We were first appointed as auditors of the Group and the Bank on 29th September 2017 by Shareholders of the Bank.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank;
- as stipulated in paragraph 37^6 of the Law on Audit Services of the Republic of Latvia we have not provided to the Group and the Bank the prohibited non-audit services (NASs) referred to in EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit.

The responsible certified auditor on the audit resulting in this independent auditors' report is Diāna Krišjāne.

ERNST & YOUNG BALTIC SIA
License No. 17

Diāna Krišjāne
Chairperson of the Board
Latvian Certified Auditor
Certificate No. 124

Riga, 12 March 2019

Consolidated and Bank's Financial Statements

Consolidated and Bank's Statement of Comprehensive Income

	Notes	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Interest income	5	9,082,132	9,188,907	10,041,559	10,067,948
Interest expense	5	(3,508,867)	(3,508,867)	(4,226,074)	(4,226,074)
Net interest income	5	**5,573,265**	**5,680,040**	**5,815,485**	**5,841,874**
Allowances for loan impairment	13	890,288	889,592	324,507	324,507
Net interest income after allowances for loan impairment		**6,463,553**	**6,569,632**	**6,139,992**	**6,166,381**
Fee and commission income	6	6,404,352	6,404,638	7,579,321	7,579,442
Fee and commission expense	6	(789,557)	(789,447)	(1,303,580)	(1,303,580)
Net fee and commission income	6	**5,614,795**	**5,615,191**	**6,275,741**	**6,275,862**
Profit/(loss) from sale of financial assets at fair value through profit or loss, net		3,569	3,569	(3,286)	(3,286)
Loss from revaluation of securities at fair value through profit or loss, net		(4,310)	(4,310)	(127,793)	(127,793)
Profit from derivative financial instruments revaluation, net		587,563	587,563	308,132	308,132
Gain from trading in foreign currencies, net		1,988,672	1,988,672	1,937,941	1,937,941
Gain/(loss) from foreign exchange translation, net		(573,912)	(573,912)	594,669	594,669
Impairment loss on other assets		-	-	(157,866)	(157,866)
Other operating income	8	737,805	584,495	342,599	314,283
Total operating income		**14,817,735**	**14,770,900**	**15,310,129**	**15,308,323**
Administrative expense	7	(7,897,409)	(7,791,022)	(8,705,426)	(8,625,480)
Amortization and depreciation charges	16,17	(532,930)	(532,930	(505,203)	(505,203)
Other income		374,064	374,064	-	-
Other expense	9	(913,083)	(899,276)	(2,891,643)	(2,888,200)
Profit before corporate income tax		**5,848,377**	**5,921,736**	**3,207,857**	**3,289,440**
Corporate income tax	10	(216,521)	(216,521)	(617,152)	(617,152)
Net profit for the year attributable to:		**5,631,856**	**5,705,215**	**2,590,705**	**2,672,288**
shareholders of the Bank		5,645,143	-	2,590,705	-
non-controlling interests		(13,287)	-	-	-
Items that can be reclassified subsequently to profit or loss: Net gain from revaluation of available-for-sale financial assets		-	-	45,970	45,970
Items that cannot be reclassified subsequently to profit or loss: Gain/(loss) on equity instruments at fair value through other comprehensive income		49,141	49,141	-	-
Other comprehensive income		**49,141**	**49,141**	**45,970**	**45,970**
Total comprehensive income for the year attributable to:		**5,680,997**	**5,754,356**	**2,636,675**	**2,718,258**
shareholders of the Bank		5,694,284	5,754,356	2,636,675	2,718,258
non-controlling interests		(13,287)	-	-	-

The Consolidated and Bank's financial statements on pages 17 through 107 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by:

Aleksandrs Jakovlevs
Acting Chairman of the Board

Mark Bekker
Deputy Chairman of the Council

Riga, 12 March 2019

The accompanying notes on pages 22 through 107 form an integral part of these financial statements.

Consolidated and Bank's Statement of Financial Position

	Notes	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Assets					
Cash and balances with the Bank of Latvia	11	95,088,745	95,088,745	90,638,213	90,638,213
Balances due from banks	12	44,132,371	44,132,371	89,439,452	89,439,452
Loans and advances to customers	13	85,498,479	88,260,454	96,304,200	98,805,033
Financial assets at fair value through profit or loss	14	25,249,486	25,249,486	60,350,334	60,350,334
Available-for-sale financial assets	18	-	-	234,942	234,942
Equity instruments at fair value through other comprehensive income	18	284,083	284,083	-	-
Derivative financial instruments	26	-	-	65,756	65,756
Intangible assets	16	502,886	502,886	573,148	573,148
Property and equipment	17	13,460,695	13,460,695	13,822,007	13,822,007
Investment in subsidiary	15	-	6,100,000	-	6,600,000
Overpayment of corporate income tax		278,648	278,648	-	-
Other assets	19	18,372,400	9,168,296	15,281,163	6,628,282
Deferred expenses		221,050	221,050	254,265	254,265
Total assets		**283,088,843**	**282,746,714**	**366,963,480**	**367,411,432**
Liabilities					
Deposits from customers	21	217,830,443	217,837,626	296,482,449	296,830,563
Derivative financial instruments	26	-	-	652,318	652,318
Other financial liabilities	23	2,932,204	2,907,608	501,521	499,434
Deferred income and accrued expense	24	933,284	933,284	888,969	888,969
Debt securities	22	17,558,810	17,558,810	16,763,810	16,763,810
Subordinated loans	34	11,207,357	11,207,357	12,367,892	12,367,892
Current income tax liabilities		-	-	75,517	75,517
Total liabilities		**250,462,098**	**250,444,685**	**327,732,476**	**328,078,503**
Equity					
Share capital	26	32,334,756	32,334,756	32,334,756	32,334,756
Reserves		6	6	6	6
Revaluation reserve on available-for-sale financial assets		-	-	45,970	45,970
Revaluation reserve on equity instruments at fair value		95,111	95,111	-	-
Retained earnings		(289,841)	(127,844)	6,850,272	6,952,197
Equity attributable to equity holders of the parent		**32,140,032**	**-**	**39,231,004**	**-**
Non-controlling interests		486,713	-	-	-
Total equity		**32,626,745**	**32,302,029**	**39,231,004**	**39,332,929**
Total liabilities and equity		**283,088,843**	**282,746,714**	**366,963,480**	**367,411,432**
Off-balance sheet items					
Guarantees issued	27	6,934,513	6,934,513	8,931,032	8,931,032
Financial commitments	27	11,547,703	11,552,260	21,745,831	21,745,831
Assets under management	**35**	**69,510,343**	**69,510,343**	**88,244,813**	**88,244,813**

The Consolidated and Bank's financial statements on pages 17 through 107 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by:

Aleksandrs Jakovlevs
Acting Chairman of the Board

Mark Bekker
Deputy Chairman of the Council

Riga, 12 March 2019

The accompanying notes on pages 22 through 107 form an integral part of these financial statements.

Consolidated Statement of Changes in Equity

	Attributable to shareholders of the Bank							
	Share capital	Reserves	Retained earnings	Revaluation reserve on available-for-sale financial assets	Revaluation reserve on equity instruments at fair value	Total	Non-controlling interests	Total equity
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Balance as at 31 December 2016	**32,334,756**	**6**	**4,259,567**	-	**-**	**36,594,329**	-	**36,594,329**
Profit for the year	-	-	2,590,705	-	-	2,590,705	-	2,590,705
Change in the revaluation reserve	-	-	-	45,970	-	45,970	-	45,970
Total comprehensive income for the year	-	-	**2,590,705**	**45,970**	**-**	**2,636,675**	-	**2,636,675**
Balance as at 31 December 2017	**32,334,756**	**6**	**6,850,272**	**45,970**	**-**	**39,231,004**	-	**39,231,004**
Impact of adopting IFRS 9 (Note 3)	-	-	(5,833,059)	(45,970)	45,970	(5,833,059)	-	(5,833,059)
Restated opening balance under IFRS 9	**32,334,756**	**6**	**1,017,213**	**-**	**45,970**	**33,397,945**	-	**33,397,945**
Profit for the year	-	-	5,645,143	-	-	5,645,143	(13,287)	**5,631,856**
Change in the revaluation reserve	-	-	-	-	49,141	49,141	-	49,141
Total comprehensive income for the year	**-**	-	**5,645,143**	**-**	**49,141**	**5,694,284**	**(13,287)**	**5,680,997**
Dividends declared	**-**		(6,952,197)	**-**	**-**	(6,952,197)	-	(6,952,197)
Disposal of investment in subsidiary	**-**	**-**	**-**	**-**	-	**-**	500,000	500,000
Balance as at 31 December 2018	**32,334,756**	**6**	**(289,841)**	**-**	**95,111**	**32,140,032**	**486,713**	**32,626,745**

The accompanying notes on pages 22 through 107 form an integral part of these financial statements.

Bank's Statement of Changes in Equity

	Share capital	Reserves	Retained earnings	Revaluation reserve on available-for-sale financial assets	Revaluation reserve on equity instruments at fair value	Total
	EUR	EUR	EUR	EUR	EUR	EUR
Balance as at 31 December 2016	**32,334,756**	**6**	**4,279,909**	-	**-**	**36,614,671**
Profit for the year	-	-	2,672,288	-	-	2,672,288
Change in the revaluation reserve	-	-	-	45,970	-	45,970
Total comprehensive income for the year	-	-	**2,672,288**	**45,970**	**-**	**2,718,258**
Balance as at 31 December 2017	**32,334,756**	**6**	**6,952,197**	**45,970**	**-**	**39,332,929**
Impact of adopting IFRS 9 (Note 3)	-	-	(5,833,059)	(45,970)	45,970	(5,833,059)
Restated opening balance under IFRS 9	**32,334,756**	**6**	**1,119,138**	-	**45,970**	**33,499,870**
Profit for the year	-	-	5,705,215	-	-	5,705,215
Change in the revaluation reserve	-	-	-	-	49,141	49,141
Total comprehensive income for the year	-	-	**5,705,215**	**-**	**49,141**	**5,754,356**
Dividends declared	-	-	(6,952,197)	-	**-**	(6,952,197)
Balance as at 31 December 2018	**32,334,756**	**6**	**(127,844)**	**-**	**95,111**	**32,302,029**

The accompanying notes on pages 22 through 107 form an integral part of these financial statements.

Consolidated and Bank's Statement of Cash Flows

	Notes	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Cash flows from/ (used in) operating activities					
Interest received		9,277,373	9,383,754	10,800,555	10,826,110
Interest paid		(3,542,393)	(3,542,393)	(4,256,962)	(4,256,962)
Fees and commission received		6,404,352	6,404,638	7,579,321	7,579,442
Fees and commission paid		(789,557)	(789,447)	(1,303,580)	(1,303,580)
Expense from sale of available-for-sale financial assets paid		-	-	(2,781)	(2,781)
Income received from sale of securities at fair value through profit or loss		3,157	3,157	-	-
Income received from foreign exchange		1,989,673	1,989,673	1,936,941	1,936,941
Other operating income received		735,913	584,043	339,238	314,283
Personnel expenses paid		(6006,872)	(5,996,072)	(6,462,584)	(6,451,824)
Administrative and other operating expenses paid		(2,203,242)	(2,092,296)	(3,165,310)	(3,094,033)
Income tax paid		(570,686)	(570,686)	(1,328,235)	(1,328,235)
Cash flows generated from operating activities before changes in operating assets and liabilities		**5,297,718**	**5,374,371**	**4,136,603**	**4,219,361**
Changes in operating assets and liabilities					
Decrease in securities at fair value through profit or loss		36,649,804	36,649,804	52,509,083	52,509,083
(Increase)/ decrease in balances due from banks		4,480,395	4,480,395	(2,460,759)	(2,460,759)
(Increase)/ decrease in loans and advances to customers, net		22,496,240	22,234,797	(13,401,259)	(8,615,459)
(Increase)/ decrease in other assets		(2,348,949)	(1,823,228)	(2,401,016)	(1,037,169)
Decrease in deposits from customers, net		(84,866,578)	(85,207,509)	(90,614,806)	(96,847,211)
Increase/ (decrease) in other liabilities, net		(13,279,254)	(13,279,254)	2,159,494	2,159,494
Net cash flows (used in) operating activities		**(31,570,624)**	**(31,570,624)**	**(50,072,660)**	**(50,072,660)**
Cash flows to/ from investing activities					
Proceeds from partial sale of investment in subsidiary		503,788	503,788	-	-
Purchase of intangible assets		(91,548)	(91,548)	(181,665)	(181,665)
Purchase of property and equipment		(10,155)	(10,155)	(261,183)	(261,183)
Net cash flows generated from /(used in) investing activities		**402,085**	**402,085**	**(442,848)**	**(442,848)**
Cash flows to/ from financing activities					
Dividends paid		(4,295,953)	(4,295,953)	**-**	**-**
Net cash flows generated from /(used in) financing activities		**(4,295,953)**	**(4,295,953)**	**-**	**-**
Effect of exchange rates on cash and cash equivalents		(1,915,485)	(1,915,485)	(17,658,581)	(17,658,581)
Net increase/(decrease) in cash and cash equivalents		**(37,379,977)**	**(37,379,977)**	**(68,174,089)**	**(68,174,089)**
Cash and cash equivalents at the beginning of the year	20	176,558,476	176,558,476	244,732,565	244,732,565
Cash and cash equivalents at the end of the year	**20**	**139,178,499**	**139,178,499**	**176,558,476**	**176,558,476**

The accompanying notes on pages 22 through 107 form an integral part of these financial statements.

Notes to the financial statements

1. Incorporation and principal activities

AS "Reģionālā investīciju banka" (hereinafter – the Bank) provides financial services to corporate customers and private individuals. The Bank established the following representative offices: in Odessa, Ukraine, in 2005; in Dnepropetrovsk, Ukraine, in 2007; in Kiev, Ukraine, at the beginning of 2009, and, in Brussels, the capital of Belgium, in 2010. On December 12, 2018, following the changes in the client base of the Bank and in the course of optimization of the expenses, the Board of the Bank adopted a decision on the liquidation of representative offices in Kiev and Dnipro (Ukraine).

In August 2016, the Bank established a 100% subsidiary - the limited liability company *Grunewald Residence*, reg. No 40203014344, whose share capital is EUR 6,600,000. On December 19, 2018, the 500,000 of company's shares sold to third party, as a result total direct Bank's investment into this subsidiary, as at December 31, 2018 was 92.42%.

The Bank and the limited liability company *Grunewald Residence* together form a group (hereinafter - the Group), operating in the area of financial services and real estate.
The legal and office address of the Bank is:

J.Alunāna Street 2

LV-1010, Riga

Latvia

The legal and office address of SIA *Grunewald Residence* is:

J. Alunana Street 2

LV-1010, Riga

Latvia

The Bank has no other representative offices, subsidiaries or other entities, except for the above.

These financial statements were approved for issue by the Bank's Council and Board of Directors on

12 March 2019.

2. Operating environment of the Group and the Bank

Operations of the Bank are affected by tendencies in Ukrainian market, as the parent of the Bank is a Ukrainian public joint stock company – the bank *Pivdennij*, as well as significant portion of the loans issued by the Bank have been issued to Ukrainian companies and companies whose business is related to Ukraine.
The table below presents the total risk exposure of the Bank and the Group in Ukraine as at 31 December 2018 and 31 December 2017:

	31.12.2018 Group '000 EUR	31.12.2018 Bank '000 EUR	31.12.2017 Group '000 EUR	31.12.2017 Bank '000 EUR
Statement of financial position assets subject to Ukraine country risk:				
Balances due from banks	3,309	3,309	6,261	6,261
Loans issued and other receivables	36,101	36,101	36,058	36,058
Total	**39,410**	**39,410**	**42,319**	**42,319**
Off-balance sheet items subject to the Ukraine country risk:				
Off-balance sheet financial commitments	1,953	1,953	5,454	5,454
Total	**1,953**	**1,953**	**5,454**	**5,454**

2. Operating environment of the Group and the Bank *(cont'd)*

In 2018, Ukraine showed the highest growth rate over the last seven years. The interim data reveal that, in comparison with the previous year, in the first quarter the economy grew by 3.1%, in the second quarter– by 3.8% and in the third quarter – by 2.8%. At the same time, inflation, in comparison with the previous year (13.7%), gradually decreased and in 2018 reached 9.8%.

The upswing in the economic activity was facilitated both by internal and external factors. The growth could be observed in a greater number of industries than in 2017 when the construction industry played the role of a growth "locomotive".

In the previous year, with real income of population increasing, there was a noticeable growth in inland consumption demand, an increase in financial services and real estate segments as well as in the promising IT and communications segment. The construction industry also maintained its sound growth rate. After the considerable growth in 2017, the export industries slightly slowed down.

In the political sphere, Ukraine is facing a pre-election period now. In 2019, Ukraine is due to hold presidential and legislative elections, and on the eve of these events the political processes are very dynamic. Of course, certain topical political issues are suspended, for example, the liberalization of land market. However, on the whole Ukraine made important progress in the implementation of reforms in many significant areas in the previous year. International partners have acknowledged this progress; and thus in December 2018 the International Monetary Fund allocated another tranche of USD 1.4 billion, the European Union granted EUR 500 million for macroeconomic stability support, while a loan of EUR 349 million was granted to Ukraine under a World Bank guarantee. Moreover, in November Ukraine returned to international capital markets through two successful Eurobond issues with maturities slightly above 5 and 10 years for a total amount of USD 2 billion. This enabled the National Bank of Ukraine to increase national gold and foreign exchange reserves up to USD 20. 8 billion, which is the highest level of reserves over the last five years. Total amout of State debt and State guaranteed debt of Ukraine on 31.12.2018 was 78.32 bn USD (on 31.12.2017 76.31 bn USD).

Regarding the future economic prospects, both Ukrainian governmental authorities and most international financial institutions expect that the real GDP growth rate will slightly decline and will be in the range from 2.5% to 3.0%. In 2018, the international rating agency *Moody's* upgraded Ukrainian sovereign credit rating to Caa1 with stable outlook, while the agencies *Standard & Poor's* and *Fitch* approved Ukrainian sovereign credit rating at B- with stable outlook.

According to National Bank of Ukraine, the banking sector in Ukraine did not experience substantial domestic or external shocks affecting the industry during 2018 and generated a profit in 2018 for the first time since the crisis (UAH 14.8 billion over the first ten months of 2018).

Banks were actively raising their funds and lending in 2018. By actively offering their lending services to their clients Banks expecting their loan portfolios to increase in quality throughout 2019.

Over 2018 NPL ratio has been slowly decreasing, approximately by 0.2pp per months. However, the loan portfolio quality is still an issue. In 2018, the loan quality ratio was in the range from 56% to 58%, mainly due to poor-quality loans in the banks with public capital. In private banks, this ratio is significantly better (about 25%).

Liquidity risk remained low in the first half of 2018 and increased risk during the second half of 2018, mainly due to lower amounts of high-quality liquid assets on banks' balance sheets and a shortage of long term funding. At the same time, the first LCR calculations show most banks have a significant liquidity buffer. Ukrainian banks should make efforts to increase the ratio of term deposits and maturity of retail and corporate deposits.

Regulatory capital is growing despite a decrease in the equity caused by transition to IFRS9. The sector's total capital adequacy currently exceeds minimum requirements. As at the end of October, banks holding 70% of the industries net assets showed a capital adequacy ratio of above 15%.

Foreign exchange risk remains moderate due to the fact that Ukrainian banks still have highly dollarizes loan portfolios.

2. Operating environment of the Group and the Bank *(cont'd)*

Considering current macroeconomic prognoses for the year of 2019 it is expected that dynamics of profitability level of the banking sector will remain positive and the amount of loan provisions will be stabilizing if there are no sudden substantial external or internal shocks during the next year.

Impact on borrowers

The solvency of the borrowers of the Bank may be affected by the reduction of their liquidity. Deteriorating operating conditions for borrowers may also have an impact on the Management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent of the available information, the Management has properly reflected the revised estimates of expected future cash flows in its impairment assessments.

Impact on collateral

The amount of allowance for impaired loans is based on the Management's appraisals of these assets at the reporting date after taking into consideration the cash flows that may result from foreclosure less costs for obtaining and selling the collateral. As a result of possible economy downturn, the actual realizable value on foreclosure may differ from the value used in estimating the allowances for impairment.

3. Summary of significant accounting policies

A summary of significant accounting policies of the Group and the Bank, all of which were applied consistently throughout 2018 and 2017, are set out below:

(a) Changes in accounting policies

The Group and the Bank applied IFRS 15 and IFRS 9 for the first time. The nature and effect caused by the adoption of these new accounting standards are described below.

The Group and the Bank for the first time applied certain amendments to standards effective for annual periods beginning on or after 1 January 2018. The Group and the Bank have not applied any standards, interpretations or amendments which are issued, but not yet effective and not early adopted. The nature and effect of each amendment are disclosed below:

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* as of annual periods beginning on or after 1 January 2018. The Group and the Bank again have not disclosed the comparative information for the year 2017 relating to the financial instruments subject to IFRS 9. Therefore, the comparative information for the year 2017 is provided according to IAS 39 and it is not comparable to the information provided for the year 2018. The differences arising from the adoption of IFRS 9 are recognized directly in retained earnings as at 1 January 2018 and disclosed below:

a) Classification and measurement

In accordance with IFRS 9, all debt-based financial assets which do not meet the "solely payments of principal and interest" criterion, at initial recognition are measured at fair value through profit or loss. Under this criterion, the debt instruments which are not in line with "basic lending arrangement", e.g., instruments which contain embedded conversion options or non-recourse loans, are measured at fair value through profit or loss. Debt-based financial assets which do meet the "solely payments of principal and interest" criterion, at initial recognition are measured on the basis of a business model under which the instruments are managed:

- Instruments managed under the "hold to collect" business model are measured at amortized cost;
- Instruments managed under the "hold to collect and sell" business model are measured at fair value through other comprehensive income;
- Instruments managed under other business models, including financial assets held for trading, are measured at fair value through profit or loss.

Equity instruments at initial recognition are measured at fair value through profit or loss, unless the financial asset is not irrevocably designated at fair value through other comprehensive income.

Regarding capital expenditures at fair value through other comprehensive income, all realized and unrealized gains and losses, excluding income from dividends, are recognized in other comprehensive income as items that cannot be reclassified subsequently to profit or loss.

The current IFRS9 requirements practically do not change the classification and measurement of financial liabilities. Derivatives are still measured at fair value through profit or loss. Embedded derivatives are no longer separated from the host contract.

b) Impairment

The adoption of IFRS 9 has significantly changed the Group and Bank's accounting policy for loan impairment replacing the existing incurred loss model with a new expected credit loss model. Since 1 January 2018, the Group and the Bank together with loan commitments and financial guarantees have established allowances for expected credit loss of all loans and other debt-based financial assets which are not measured at fair value through profit or loss. In accordance with IFRS 9, equity instruments are not impaired.

Allowances are based on expected credit losses associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination.

If a financial asset meets the definition of purchased or originated credit-impaired financial assets (POCIFS), allowances are based on the changes in expected credit losses over the lifetime of the asset. For more detailed information on the impairment approach applied by the Bank see Note 4. The quantitative effect of the adoption of IFRS 9 on the figures as at 1 January 2018 is disclosed below.

c) Effect of transition to IFRS 9

The tables below show the effect of the adoption of IFRS 9 on the statement of financial position and retained earnings as at 1 January 2018, including the effect of replacing the existing incurred loss model under IAS 39 with a new expected credit loss model under IFRS 9.

The Bank has no influence on the change of classification in accordance with IFRS 9.

Notes to the financial statements *(cont'd)*

3. Summary of significant accounting policies *(cont'd)*

(a) Changes in accounting policies *(cont'd)*

The comparison of the carrying amounts under IAS 39 with the balances disclosed under IFRS 9 as at 1 January 2018:

	IAS 39 measurement				*IFRS 9*	
Assets	*Category*	*Amount*	*Remeasurement ECL*	*Re-classification*	*Amount*	*Category*
Cash and balances with the Bank of Latvia	L&R	90,638,213	(8,961)		90,629,252	Amortized cost
Balances due from banks	L&R	89,439,452	(71,047)	-	89,368,405	Amortized cost
Loans and advances to customers	L&R	98,805,033	(5,443,561)	-	93,361,472	Amortized cost
Financial assets at fair value through profit or loss	FVPL	60,350,334	-	-	60,350,334	FVPL
Available-for-sale financial assets	AFS	234,942	-	(234,942)		FVOCI (equity)
Equity instruments at fair value through other comprehensive income	-	-	-	234,942	234,942	FVOCI (equity)
Derivative financial instruments	FVPL	65,756	-	-	65,756	FVPL
Financial assets	FVPL	3,165,996	(361)	-	3,165,635	Amortized cost
Total assets		**342,699,726**	**(5,523,930)**		**337,175,796**	
Liabilities						
Deposits from customers	Amortized cost	296,830,563	-	-	296,830,563	Amortized cost
Derivative financial instruments	FVPL	652,318	-	-	652,318	FVPL
Other financial liabilities	Amortized cost	499,434	-	-	499,434	Amortized cost
Debt securities	Amortized cost	16,763,810	-	-	16,763,810	Amortized cost
Subordinated loans	Amortized cost	12,367,892	-	-	12,367,892	Amortized cost
Impairment allowance for off balance sheet liabilities	-	-	309,129	-	309,129	Amortized cost
Total liabilities		**327,114,017**	**309,129**	**-**	**327,423,146**	

L&R: Loans and receivables.
FVOCI:. Financial assets at fair value through other comprehensive income

HTM: Held-to-maturity.
FVPL: Financial assets/liabilities at fair value through profit or loss

AFS: Available-for-sale.

Impact of the transition to IFRS 9 on reserves and retained earnings is as follows:

	Reserves and retained earnings
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	6,952,197
Recognition of IFRS 9	(5,833,059)
Restated opening balance under IFRS 9 (1 January 2018)	**1,119,138**
Total change in equity due to adopting IFRS 9	**(5,833,059)**

3. Summary of significant accounting policies *(cont'd)*

(a) Changes in accounting policies *(cont'd)*

The tabular reconciliation of the initial allowances for loan losses under IAS 39 and allowances for loan commitments and financial guarantee contracts under IAS 37 Provisions, Contingent Liabilities and Contingent Assets with the allowance for expected credit losses (ECL) under IFRS 9 is provided below.

	Allowance under IAS 39 / IAS 37 at 31 December 2017	*Re-measurement*[i]	*ECL under IFRS 9 at 1 January 2018*
Impairment allowance for			
Cash and balances with the Bank of Latvia	-	8,961	8,961
Balances due from banks	-	71,047	71,047
Loans and advances to customers	27,097,534	5,443,561	32,541,095
Other assets	17,285	361	17,646
Off-balance sheet commitments	-	309,129	309,129
	27,114,819	**5,833,059**	**32,947,878**

IFRS 15 Revenue from Contracts with Customers

IFRS 15, issued in May 2014 and amended in April 2016, establishes a five-step model for accounting for revenue from contracts with customers. In accordance with IFRS 15, revenue is recognized in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. However, the standard is not applied to revenue related to financial instruments and lease and, accordingly, does not affect most of the Group and Bank's revenue, including interest income, gain/(loss) on transactions in securities lease income, covered by IFRS 9 *Financial Instruments* and IAS 17 *Leases*. The Group and the Bank earn fee and commission income of the following services: payment servicing, account servicing, payment cards servicing and asset management. As a result, the adoption of this standard does not affect the revenue of the Group and the Bank.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

Interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which the Group initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, the Group determines the transaction date for each payment or receipt of advance consideration. This interpretation does not have any impact on the Group and Bank's financial statements.

IAS 40 Transfers to Investment Property (amendments)

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. These amendments do not have any impact on the Group and Bank's financial statements.

3. Summary of significant accounting policies *(cont'd)*

(a) Changes in accounting policies *(cont'd)*

Amendments to IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice

The amendments clarify that an entity that is a venture capital organization, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss. If an entity that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, then it may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. These amendments do not have any impact on the Group and Bank's financial statements.

(b) Reporting currency

The financial statements are prepared in the euros (EUR), unless stated otherwise. The functional and presentation currency of the Bank and its subsidiary is the euro.

(c) Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union (hereinafter - IFRS), on a going concern basis. In preparation of the financial statements on a going concern basis, the Management considered the Group and Bank's financial position, access to financial resources and analyzed the impact of the recent financial crisis on the future operations of the Group and the Bank.

The financial statements have been prepared on a historical cost basis, except for financial assets at fair value through other comprehensive income and derivative financial instruments that are 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 the Management's best knowledge of current events and actions, the actual results ultimately may differ from those estimates.

The same accounting policies were used consistently in the preparation of the financial statements for the year 2018, if compared to those of 2017 except for IFRS 9 and IFRS 15.

(d) Basis of consolidation

Subsidiaries, namely, the companies, in which the Group directly or indirectly has the power to govern the financial and operating policies as well as the reallocation of income, are consolidated in the Group's financial statements. Investments in subsidiaries in the Bank's financial statements are stated at cost less impairment, if any). Subsidiaries are consolidated from the date on which control is transferred to the Group and excluded from the consolidated financial statements from the date that control ceases. Acquisition of subsidiaries is accounted for using the purchase method. The acquisition cost comprises the assets transferred, shares issued or liabilities taken over at fair value as at the purchase date, plus costs directly attributable to the acquisition. The excess of the net assets purchased over the purchase price is recorded as a goodwill. All intra-group transactions and balances and unrealized gains resulting from intra-group transactions are eliminated. Unrealized losses are also eliminated, except where costs cannot be recovered. Accounting policies of subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Group.

3. Summary of significant accounting policies *(cont'd)*

(e) Fair value measurement

The Group and the Bank measure financial instruments at fair value through profit or loss (FVTPL) and at fair value through other comprehensive income (FVTOCI.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group and the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group and the Bank use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;

Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the financial statements at fair value on a recurring basis, the Group and the Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Date of recognition

Regular way purchase or sale of financial assets is recognized on a trade date, i.e., on the date when the Group and the Bank entity commits themselves to purchase an asset or liability. Regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Initial measurement

The classification of financial instruments at initial recognition depends on the financial instrument's contractual terms and the business model selected for managing them. Financial instruments, except financial assets and financial liabilities stated at fair value through profit or loss, are initially measured at fair value plus or minus transaction costs.

3. Summary of significant accounting policies *(cont'd)*

(f) Initial recognition

Measurement categories of financial assets and liabilities

Since 1 January 2018, the Group and the Bank have classified all financial assets depending on the business model selected for managing assets and the asset's contractual terms, which are measured:

- at amortized cost;
- at fair value through OCI;
- at fair value through profit or loss.

The Group and the Bank classify and measure derivative financial instruments and financial assets held for trading at fair value through profit or loss. The Group and the Bank may measure financial instruments at fair value through profit or loss if such measurement eliminates or significantly reduces a measurement or recognition inconsistency.

Before 1 January 2018, the Bank classified financial assets in the following categories: loans and receivables (at amortized cost), financial assets at fair value through profit or loss, available-for-sale and held-to- maturity investments.

Financial liabilities, other than loans and borrowings and financial guarantees, are measured at amortized cost or at fair value through profit or loss if held for trading or are derivative financial instruments

Balances due from banks, loans to customers, investments in securities at amortized cost

Before 1 January 2018, the balances due from banks and loans to customers included non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the Group and the Bank intend to sell immediately or in the near term;
- those that the Group and the Bank upon initial recognition designate as at fair value through profit or loss or as held for trading;
- those for which the Group and the Bank may not recover substantially all of their initial investment, other than because of credit deterioration, which were designated as available for sale.

Since 1 January 2018, the Group and the Bank have only measured the balances due from banks, loans to customers and other financial investments at amortized cost when both of the following conditions are met:

- a financial asset is held under a business model whose objective is to hold assets to collect contractual cash flows;
- the contractual cash flows of an asset give rise to payments on specified dates that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

A more detailed information on the above conditions is provided below.

Business model assessment

The Group and the Bank determine the business model at a level that reflects the way groups of financial assets are managed together to achieve a particular business objective.

3. Summary of significant accounting policies *(cont'd)*

Business model assessment (cont'd)

The business model of the Group and the Bank is not determined on an instrument-by-instrument basis, rather it is assessed at a higher level of aggregated portfolios and is based on observable evidence, for example:

- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and the way those risks are managed;
- how managers of the business are compensated – e.g., whether the compensation is based on the fair value of the assets managed or the contractual cash flows collected;
- the expected frequency, volume and timing of sales also are significant aspects to be considered in the assessment carried out by the Group and the Bank.

The assessment of a business model is performed on the basis of scenarios that are reasonably expected to occur, excluding "worst case" or "stress case" scenarios. If cash flows, subsequent to initial recognition, are realized in a way that is different from the Group and Bank's initial expectations, the Group and the Bank do not change the classification of the remaining financial assets held in that business model, but consider this information in assessing the business model for newly generated or newly acquired financial assets newly generated or newly purchased financial assets.

SPPI test

As a second step in determining the appropriate classification category the Group and the Bank assess the financial asset's contractual terms in order to determine whether the financial asset meets the SPPI test.

For the purpose of this test, a principal is defined as fair value of a financial asset at initial recognition, which may change over the life of a financial instrument (for example, if there are repayments of principal or amortization of premium/discount).

In a lending arrangement, most significant interest components usually are consideration for the time value of money and credit risk. For the SPPI test purposes, the Group and the Bank applies judgment and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. In such cases the financial asset is measured at fair value through profit or loss.

Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss. Financial assets at fair value through profit or loss comprise debt securities held by the Group and the Bank for trading purposes. They are accounted for at fair value with all gains and losses from revaluation and trading reported in the statement of comprehensive income. Interest earned while holding trading securities is reported as interest income.
All regular way purchases and sales of financial assets held for trading are recognized at trade date, which is the date that the Group and the Bank commit to purchase or sell the asset.

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Group and the Bank have transferred substantially all risks and rewards of ownership.

3. Summary of significant accounting policies *(cont'd)*

Debt instruments measured at fair value through other comprehensive income (FVTOCI)

Since 1 January 2018, the Group and the Bank, in accordance with IFRS 9, has applied a new classification to debt instruments measured at FVTOCI when both of the following conditions are met:

- an instrument is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and sell financial assets;
- the financial asset's contractual terms meet the SPPI test.

Debt instruments designated at FVTOCI are subsequently measured at fair value recognizing gain or loss resulting from changes in the fair value in other comprehensive income. For debt instruments at fair value through FVTOCI, interest income and foreign exchange gain or loss are recognized in the statement of profit or loss and computed in the same manner as for financial assets measured at amortized cost. Upon derecognition, the cumulative fair value change recognized in OCI is recycled to profit or loss.

Expected credit loss (ECLs) on debt instruments measured at FVTOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to an allowance, which would be established if the assets were measured at amortized cost, is recognized in other comprehensive income as "accumulated impairment amount", with a corresponding amount debited to the statement of profit or loss. Other accumulated loss recognized in other comprehensive income is taken to the statement of profit or loss upon derecognition of the respective asset.

Equity instruments measured at FVTOCI

Since 1 January 2018, the Group and the Bank, upon initial recognition, have often elected to classify irrevocably its equity investments as equity instruments designated at fair value through OCI when they meet the definition of equity under IAS 32 *Financial Instruments: Presentation* and are not held for trading. The classification is determined on an instrument-by-instrument basis.

Gains and losses on these financial assets are never recycled to profit or loss. Dividends are recognized as other income in the statement of profit or loss when the right of payment has been established, except when the Group benefits from such proceeds as a recovery of part of the cost of the financial asset, in which case, such gains are recorded in other comprehensive income. Equity instruments designated at FVTOCI are not subject to impairment assessment. Upon disposal of these instruments, any remaining balance in the revaluation reserve relating to the asset disposed of is transferred directly to retained earnings.

Financial guarantees, letters of credit and undrawn loan commitments

The Group and the Bank provide financial guarantees, letters of credit and loan commitments. Financial guarantees, namely, premiums received, are initially recognized in the financial statements at fair value. After initial recognition, the Group's and Bank's liabilities arising from guarantees are measured at the higher of the amount initially recognized less cumulative amortization recognized in the statement of profit or loss, and – under IAS 37 (before 1 January 2018) - best estimate of the expenditure, required to settle any financial obligation arising from a guarantee, or – under IFRS 9 (from 1 January 2018) – according to the forward-looking ECL model. Undrawn loan commitments and letters of credit are liabilities whereby the Group and the Bank, during the commitment period, must issue a loan to the customer under agreed upon terms. Allowances for financial guarantee contracts were established, as in case of onerous contracts under IAS 37; however, since 1 January 2018, these contracts have been subject to the ECL model.

3. Summary of significant accounting policies *(cont'd)*

Held-to-maturity investments

Before 1 January 2018, non-derivative financial assets with fixed or determinable payments and fixed maturity were classified as held-to-maturity investments that the Group and the Bank have the positive intention and ability to hold to maturity. This category did not include investments to be held for an undefined period. Held-to-maturity investments subsequently were measured at amortized cost.
Any gains or losses were recognized in the statement of profit or loss when the investment was impaired as well through the amortization process.

Loans and receivables

Before 1 January 2018, loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were not intended for immediate sale or sale in the near term and were not designated as securities held for trading or stated as available-for-sale investment securities. Such assets were measured at amortized cost using the effective interest method. Any gains or losses were recognized in the statement of profit or loss when the loans and receivables were derecognized or impaired as well through the amortization process.

Financial assets at fair value through profit and loss

Before 1 January 2018, financial assets at fair value through profit or loss consist of financial assets classified as held for trading and financial assets which, upon initial recognition, have been designated at fair value through profit or loss (fair value option). Financial assets are classified as held for trading if they are held with the intention to be sold in the shortterm and for the purpose of generating profits. Derivatives are classified as held for trading unless designated as hedging instruments. The fair value option can be applied to contracts including one or more embedded derivatives, investments that are managed and evaluated on a fair value basis and situations in which such designation reduces measurement inconsistencies.

Available-for-sale financial assets

Before 1 January 2018, available-for-sale financial assets were those non-derivative financial assets that were designated as available for sale or were not classified in any of the above categories. After initial recognition, available-for-sale financial assets were measured at fair value; any gains and losses were recognized in other comprehensive income, until the investment was derecognized or impaired upon which the cumulative gains or losses recognized in other comprehensive income were reclassified to the statement of profit or loss. However, interest calculated by using the effective interest method were recognized in the statement of profit or loss.

(g) Income and expense recognition

Interest income and expense are recognized in the statement of comprehensive income for all interest bearing instruments on an accrual basis using the effective interest method.
The effective interest method is a method for calculating the amortized cost of a financial asset or a financial liability based on the recognition of interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

3. Summary of significant accounting policies *(cont'd)*

From 1 January 2018, the Group and the Bank calculates interest revenue on debt financial assets measured at amortized cost or at FVOCI by applying the EIR to the gross carrying amount of financial assets other than credit-impaired assets. When a financial asset becomes credit-impaired, the Group and the Bank calculates interest revenue by applying the effective interest rate to the net amortised cost of the financial asset. If the financial assets cures and is no longer credit-impaired, the Group and the Bank reverts to calculating interest revenue on a gross basis.

Commissions received or incurred in respect of origination of financial assets or funding are deferred and recognized as an adjustment to the effective interest rate applied to the asset or liability. Commissions on servicing of settlement accounts are recognized in the statement of comprehensive income on a regular basis throughout the duration of the customer contract. Other fees and commissions, including those related to trust activities, are credited and/or charged to the statement of comprehensive income as earned / incurred.

(h) Foreign currency translation

Functional and presentation currency

The functional currency of the Group and the Bank companies is the currency of the primary economic environment in which the Group and the Bank operates. The financial statements are presented in the euros (EUR), which is the Bank's functional and the Group's presentation currency.

Transactions and balances

Foreign currency transactions have been translated into the euro applying the rate determined by the conversation procedure between central banks of the European System of Central Banks and other central banks and which is published on the European Central Bank's website. To those foreign currencies, for which the ECB does not publish the EUR reference rate, the foreign currency exchange rates published by Bloomberg are applied. Any gain or loss resulting from a change in exchange rates is included in the statement of comprehensive income as profit or loss from revaluation of foreign currency positions.

During the preparation of the financial statements of the Group and the Bank, the most commonly used currency exchange rates (foreign currency units against one EUR) were as follows:

Reporting date	USD
31 December 2018	1.1450
31 December 2017	1.1993

(i) Income taxes

Income taxes include current and deferred taxes. Until 31 December 2017, current corporate income tax had been applied at the statutory rate of 15%.

Legal entities have not been required to pay income tax on earned profits starting from 1 January 2018 in accordance with amendments made to the Corporate Income Tax Law of the Republic of Latvia. Corporate income tax is paid on distributed profits and deemed profit distributions. Consequently, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. Starting from 1 January 2018, both distributed profits and deemed profit distributions have been subject to the tax rate of 20 per cent of their gross amount, or 20/80 of net expense. Corporate income tax on dividends is recognized in the consolidated statement of profit or loss as expense in the reporting period when respective dividends are declared, while, as regards other deemed profit items, at the time when expense is incurred in the reporting year.

3. Summary of significant accounting policies *(cont'd)*

(i) Income taxes (cont'd)

No provision is recognized for income tax payable on a dividend distribution before dividends are declared but information on the contingent liability is disclosed in the notes to the consolidated financial statements.

(j) Deferred tax assets and liabilities

Deferred tax is provided using the liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying value for accounting purposes. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend is recognized.

Deferred tax assets and liabilities were not recognized as at 31 December 2017 in accordance with amendments to the legislation of the Republic of Latvia, which entered into force on 1 January 2018. Accordingly, deferred tax assets which were calculated and recognized for Latvian companies in previous reporting periods were reversed in the financial statements for the year ended 31 December 2017 through the statement of profit or loss or other comprehensive income, depending on whether deferred tax liabilities or assets were recognized initially in the statement of profit or loss or other comprehensive income.

(k) Cash and cash equivalents

Cash and cash equivalents comprise cash and demand deposits with the Bank of Latvia and other credit institutions, due to and from other credit institutions with original maturity of 3 months or less.

(l) Due from other banks

Amounts due from other banks are recorded when the Group and the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortized cost.

(m) Loans and allowances for loan impairment

Before 1 January 2018 Balances due from banks and loans issued are accounted for as loans and advances to customers. Loans and advances to customers are non-derivative financial assets with fixed or determinable payments that are not quoted in active markets.
Loans and advances to customers are initially recognized at fair value plus transaction costs which are directly attributable to the acquisition of the financial asset. After initial measurement, amounts due from banks and loans and advances to customers are subsequently measured at amortized cost using the EIR methodology. All loans and advances to customers are recognized when cash is advanced to borrowers and derecognized upon repayment.

3. Summary of significant accounting policies *(cont'd)*

(m) Loans and allowances for loan impairment (cont'd)

From 1 January 2018, the Group and Bank only measures amounts due from credit institutions, loans to customers and other financial investments at amortized cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows;
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).

Impairment of financial assets under IAS 39

Before 1 January 2018, the Bank assessed at each reporting date whether there was any objective evidence that loans and advances to customers were impaired. If any such evidence existed, the loan impairment loss which had been incurred due to the deterioration of loan quality was measured as the difference between the asset's carrying amount and its recoverable amount, being the present value of the expected cash flows (excluding future credit losses that have not been incurred), including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate.

The collective (portfolio) allowances related to the existing credit losses, as well as 'incurred, but not yet identified losses'. Collective loan impairment existed if after the initial recognition of loans a decrease in the future credit cash flows which could be measured reliably, notwithstanding that this decrease could not yet be attributed to individual loans. The amount of collective impairment was estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group, changes in the value of collateral as well as general economic and market conditions and events prior to the end of the reporting period which might have an adverse impact on the future cash flows intended for the repayment of loans.

The primary factors the Group and the Bank considered in determining whether a financial asset was impaired are its overdue status and realisability of related collateral, if any.

The following are the other criteria also used to determine whether there were objective evidence that an impairment loss had occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information obtained by the Group and the Bank;
- the borrower considers bankruptcy or a financial reorganization;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

The carrying amount of the asset was reduced by the allowance amount and the respective loss was recognized in the statement of comprehensive income.

The assessment of the evidence for impairment and the determination of the amount of provision for impairment or its reversal required the application of the Management's judgment and estimates. The Management's judgments and estimates considered relevant factors including, but not limited to, the identification of non-performing loans and high-risk loans, the Group and Bank's historical loan loss experience, known and inherent risks in the portfolio of loans, adverse situations that affected the borrowers' ability to repay, the estimated value of any underlying collateral and current economic conditions as well as other relevant factors affecting loan and advance recoverability and collateral values.

For information on impairment assessment under IFRS 9, see Note 4.

3. Summary of significant accounting policies *(cont'd)*

(n) Forborne exposures

When loans and advances to customers cannot be recovered, they are written off and charged against the existing provisions for loan impairment losses. They are not written off, in full or in part, only when the Group and the Bank have no reasonable expectation of recovery.

Where possible, the Group and the Bank seek to restructure loans rather than obtain collateral. Restructuring can involve an agreement on postponing the repayment or an agreement on new loan terms.

Since 1 January 2018, the Group and the Bank have derecognized a financial asset, e.g., a loan to customer, if a new agreement has been reached on such terms and conditions of the loan that it actually becomes a new loan with the difference recognized as gain or loss on derecognition to the extent no impairment loss is presented. Forborne exposures are debt contracts in respect of which forbearance measures have been applied. Forbearance measures consist of concessions towards a debtor that is experiencing or about to experience difficulties in meeting its financial commitments ("financial difficulties").Forborne exposures are classified under Stage 2 for the ECL assessment purposes.

In order to decide whether forborne loans are to be classified as Stage 3 assets for ECL assessment purposes, the Bank assesses the following:

– The adequacy and observance of the loan payment schedule (initial and further payment schedules), which, inter alia, includes the repeated non-observance of the payment schedule, changes to payment schedules, to avoid any delays, or the payment schedule is based on forecasts which are not based on macroeconomic forecasts or realistic assumptions regarding the borrower's possibilities of repaying debt obligations;
– Whether a loan agreement includes terms which postpone the deadline of regular repayments of exposure in a way that hinders the assessment of conformity to the set classification, for example, if the repayment periods of the principal amount are postponed for more than two years.

Other criteria for forborne loans to be classified as Stage 3 assets are:
- Loan forbearance which will most likely diminish financial commitments;
- New forbearance measures are set for a forborne exposure;
- The number of days past due for a forborne exposure exceeds 30 days;
- The borrower is classified as unlikely to pay.

If there are changes which do not result in derecognition, the Group and the Bank also reassess whether there is no significant increase in credit risk and whether the assets should be classified as credit-impaired assets. If the assets are classified as credit-impaired assets they will remain under Stage 3 at least for a 12-month trial period to be reclassified to Stage 2, and 24-months to be reclassified to Stage 1. The forborne exposure is reclassified out of Stage 3 if regular payments are made according to the changed payment terms and if such payments constitute an amount above an insignificant share of the principal or interest.

(o) Sale and repurchase agreement

Sale and repurchase agreements are accounted for as financing transactions. Under sale and repurchase agreements, where the Group and the Bank are transferors, assets transferred remain on the Group and Bank's statement of financial position and are subject to the Group and Bank's usual accounting policies, with the purchase price received included as a liability owed to the transferee. Where the Bank is a transferee, the assets are not included in the Group and Bank's statement of financial position, 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 recognized in the statement of comprehensive income over the term of the agreement using the effective interest method.

3. Summary of significant accounting policies *(cont'd)*

(p) Derivative financial instruments

Derivative financial instruments comprise various derivatives, inter alia, options, forwards, futures and foreign currency and capital market transactions. Such financial instruments are held for trading and stated at fair value. Fair values are based on quoted market prices or pricing models where the actual market or contractual prices of the existing instruments as well as other factors are considered. All derivatives are carried as financial assets when fair value is positive and as financial liabilities when fair value is negative. Any gain or loss arising from these instruments is taken to the statement of profit or loss as net gain/ (loss) from financial instruments designated at fair value through profit or loss or as foreign currency exchange gain/ (loss) depending on the nature of the respective instrument.

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

IAS 39 required that derivatives embedded in financial assets, financial liabilities or non-derivative host contracts be recognized as separate derivative financial instruments and stated at fair value when they met the definition of derivative financial instruments, their economic risks and characteristics were not closely related to those of the host contract, and the host contact itself was note held for trading or stated at fair value through profit or loss. The embedded derivatives separated from the host contract were stated at fair value in the trading with fair value changes recognized in the [consolidated] statement of profit or loss.

Since 1 January 2018, upon the adoption of IFRS 9, this has been the way in which the Group and the Bank account for derivatives embedded in financial liabilities and non-derivative host contracts. The classification of financial assets is based on the business model and SPPI assessment, without separation of embedded derivatives (see also note 3).

(q) Repossessed collateral

Repossessed collateral represents real estate repossessed by the Group and the Bank for the purpose of selling as collateral for the outstanding loans and is disclosed under other non-financial assets. The repossessed real estate is stated at inventories at lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

(r) Intangible assets

The acquired computer software licenses are recognized as intangible assets at cost, including any expenditure that is directly attributable to preparing the asset for its intended use. Intangible assets are amortized over their estimated useful lives, not exceeding 5 years, on a straight-line basis.

3. Summary of significant accounting policies *(cont'd)*

(s) Property, plant and equipment

The items of property and equipment are stated at cost less accumulated depreciation and impairment. The cost includes expenditure directly attributable to the acquisition of the asset.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the Bank and the cost of the item can be measured reliably.

Such costs are depreciated over the asset's remaining useful life. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset to write down the cost of property and equipment to their residual values at the end of the useful life. The estimated useful lives are, as follows:

Land	is not depreciated
Building	50 years
Office equipment	10 years
Computers	3 years
Transport vehicles	5 years

In 2017, the Group and the Bank changed the accounting method for buildings and land under the property and equipment category to measurement at a revalued amount. The revalued amount is the fair value at the revaluation date less subsequent accumulated depreciation and impairment loss. The fair value of land and buildings is determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers at the end of the reporting year. Revaluation gains are recorded under the heading of revaluation surplus and recognized in other comprehensive income. A revaluation loss is initially taken to the revaluation surplus (and recorded in other comprehensive income) related to these assets, if any, and subsequently included in profit or loss for the reporting period (see Note 17).

The carrying values of property and equipment (except for the buildings and land) are reviewed for impairment on a periodical basis. Where the carrying value of an asset exceeds the estimated recoverable amount and the respective changes in the value are not considered to be temporary, the value of the corresponding asset is written down to its recoverable amount.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of comprehensive income.

(t) Derecognition of financial assets and liabilities

Financial assets (or, where applicable, a portion of a financial asset or a part of a group of similar assets) are recognized when:

- the contractual rights to the cash flows from the financial asset have expired;
- the Group and the Bank have transferred the contractual rights to the cash flows from the financial asset or retain the contractual rights to the cash flows from the financial asset, but assume an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and
- either (a) the Group and the Bank have transferred substantially all the risks and rewards of the asset, or (b) the Group and the Bank have neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Financial assets have been written off, in full or in part, only when the Group and the Bank have no reasonable expectation of recovery. If the amount to be written off exceeds the cumulative loss amount, the difference is first considered as increase in allowance which then is set off against the gross carrying amount. Any further recovery is included in credit loss expense. A write-off constitutes a derecognition event.

3. Summary of significant accounting policies *(cont'd)*

(t) Derecognition of financial assets and liabilities *(cont'd)*

Financial liabilities are derecognized when the obligation specified in the contract is either discharged or cancelled or expires.

Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognized in profit or loss (see also note 3(m)).

(u) Leases

Finance lease – the Group and the Bank as lessees

At the commencement of the lease term, the Bank and the Group recognize finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the Group and Bank's incremental borrowing rate is used. Any initial direct costs of the lessee are added to the amount recognized as an asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

The costs directly attributable to activities performed by the lessee for a finance lease are added to the amount recognized as an asset.

Finance lease – the Group and the Bank as lessors

At the commencement of the lease term, the Group and the Bank recognize lease receivables at an amount equal to the net investment in the lease. The recognition of finance income is based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Initial direct costs are included in the initial measurement of the lease receivables.

Operating lease – the Group and the Bank as lessees

Leases where the lessor retains a significant portion of the risks and rewards inherent to ownership are classified as operating leases. Lease payments under an operating lease are recognized as an expense on a straight-line basis over the lease term and included in other operating expense.

Operating lease – the Group and the Bank as lessors

The Group and the Bank present assets subject to operating leases in their balance sheets according to the nature of the asset. Lease income from operating leases is recognized in income on a straight-line basis over the lease term. Total costs of incentives provided to the lessee are recognized as a reduction of lease income on a straight-line basis over the lease term. Any initial direct costs incurred specifically to earn revenues from an operating lease included in the carrying amount of the leased asset.

(v) Deposits from customers

Deposits from customers are non-derivative liabilities to individuals, state or corporate customers and are carried at amortized cost.

3. Summary of significant accounting policies *(cont'd)*

(w) Borrowings

Borrowings are recognized initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method.

(x) Debt securities issued

The Group and the Bank recognize the issued debt securities at the date when the respective funds are received. After initial recognition when these financial liabilities are stated at fair value, including direct transaction costs, those are subsequently carried at amortized cost using the effective interest method. When issued debt securities are sold at a discount, the difference is amortized applying the effective interest method until the debt matures and charged to the statement of comprehensive income as interest expense.

(y) Provisions

Provisions are recognized when the Group and the Bank have a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The assessment of provisions requires the application of Management's judgment and assumptions on the probability of an outflow of resources, the probability of recovery of resources from related sources including collateral agreements and the amounts and timing of such outflows.

(z) Dividends

Dividends are recorded in equity in the period in which they are declared. Dividends declared after the reporting date and before the financial statements are authorized for issue are disclosed in the subsequent events note. Profit distribution and other appropriations are carried out according to the Group and Bank's financial statements. The legislation of the Republic of Latvia stipulates retained earnings to be the basis of dividend payment.

(aa) Employee benefits

The Group and the Bank makes the State statutory social insurance contributions for state pension insurance and to the state funded pension scheme in accordance with the legislation of Latvia The State funded pension scheme is a defined contribution plan under which the Group and the Bank pay fixed contributions determined by the law and it will have no legal or constructive obligations to pay further contributions if the State pension insurance system or the State funded pension scheme is not able to settle the liabilities to employees.

Short-term employee benefits, including salaries and state statutory social insurance contributions, bonuses and paid vacation benefits, are included in administrative expenses on an accrual basis.

(bb) Off-balance sheet commitments

In the ordinary course of business, the Group and the Bank enter into off-balance sheet commitments, related to undrawn credit lines, letters of credit and financial guarantees. Financial guarantees represent irrevocable commitments to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Before 1 January 2018 financial guarantees and commitments to provide a loan are initially recognized at their fair value, which is normally evidenced by the amount of fees received. This amount is amortized on a straight line basis

3. Summary of significant accounting policies *(cont'd)*

(bb) Off-balance sheet commitments *(cont'd)*

over the life of commitment, except for commitments to originate loans if it is probable that the Group and the Bank will enter into a specific lending arrangement and do not expect to sell the resulting loan shortly after the origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition (see also Note 3(f)). . At each reporting date, the commitments are measured at the higher of (i) the remaining unamortized balance of the amount at initial recognition and (ii) the best estimate of expenditure required for settling the commitment at the reporting date. Since 1 January 2018, these contracts have been subject to the ECL model. The provisions for off-balance sheet transactions are established in accordance with the principles described in the paragraph on provisions of Note 3(f).

(cc) Trust operations

Funds managed or held in custody by the Group and the Bank on behalf of individuals, trusts and other institutions are not regarded as assets of the Group and the Bank and, therefore, are disclosed in the off-balance sheet.

Accounting for trust operations is separated from the Group and Bank's own accounting system, thus ensuring separate accounting in a separate trust balance sheet for assets of each client, by client and by type of assets under management.

(dd) Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

(ee) Significant accounting estimates and assumptions

Fair value of financial instruments

Where the fair value of financial assets and financial liabilities, as disclosed in the statement of financial position, cannot be established using quoted market prices in an active market, the fair value is estimated using various valuation techniques, including mathematical models. The data used in such models are obtained from observable markets, if possible, in case it is not possible a certain judgment is required for determining the fair value (see also Note 3(e)).

Impairment loss on financial assets

The Group and the Bank assess their assets for impairment on a regular basis. To estimate impairment loss both in accordance with IFRS 9 and IAS 39 for all categories of financial assets, in determining the impairment loss and assessing significant increases in credit risk, the value and timing of future cash flows and collateral must be assessed (see also Note 3(b)).

Impairment of available-for-sale financial assets

Before 1 January 2018 The Group and the Bank regularly assess whether significant impairment exists. If any objective evidence of significant and permanent impairment exists, the accumulated fair value revaluation reserve is recognized in the statement of comprehensive income as impairment of financial instruments.

Impairment loss recognized in the statement of comprehensive income is not reversed through profit or loss. If, in a subsequent period, the fair value of a financial instrument increases and the increase can

3. Summary of significant accounting policies *(cont'd)*

(ee) Significant accounting estimates and assumption *(cont'd)*

be objectively related to an event occurring after the impairment loss was recognized in the statement of comprehensive income, the impairment loss is reversed, with the amount of the reversal recognized through profit or loss.

Initial recognition of related party transactions

In the ordinary course of business, the Group and the Bank perform transactions with related parties. IAS 39 requires initial recognition of financial instruments at fair value. Cases where the transactions carried out do not have an active market are subject to the Management's judgment in determining interest rates on transactions and their correspondence with market interest rates. The assessment is based on similar types of transactions with unrelated parties and effective interest rate analysis.

Impairment of investments in subsidiaries (the Bank)

In the Bank's financial statements, investments in subsidiaries are stated at cost. The Bank compares the cost of the investment with the carrying amount of the subsidiary's net assets on a regular basis to ascertain whether there are no indications of impairment. If any indications of impairment are identified, the recoverable amount of the investment is calculated on the basis of the estimated future free cash flows of the subsidiary to equity. The future cash flows are based on the budgets and forecasts of the subsidiary the reliability of which is assessed. The discount rate equals the Return on equity (ROE) rate. Impairment loss is recognized when the decrease in the value of the investment in the subsidiary is substantial and sustained.

Impairment of non-financial assets

Assessment of any possible indicators of impairment of non-financial assets is done at each reporting date or more frequently if events or changes in circumstances indicate to feasible impairment of a non-financial asset. If any such indication exists, an estimate of the asset's recoverable amount is made. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down to its recoverable amount. This written down amount constitutes an impairment loss.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The increase will effectively be the reversal of an impairment loss.

Information on impairment assessment under IFRS 9 is presented in Note 4.

The tables below presents the ECL sensitivity of PD and LGD fluctuations at the end of the reporting period with all other variables held constant (in thousand EUR):

4YPD	Effect on ECL	**5YLGD**	Effect on ECL
	427		295
Total	427	**Total**	295

The table below presents the ECL sensitivity of stage 3 loans depended on collateral, if price will increase or drop at the end of the reporting period with all other variables held constant (in thousand EUR):

31.12.2018	Effect on ECL	
	+10%	-10%
ECL	(25)	100
Total	(25)	100

3. Summary of significant accounting policies *(cont'd)*

(ff) Adoption of new or revised standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year except for the following amended IFRSs which have been adopted by the Group and the Bank as of 1 January 2018:

IFRS 9 Financial Instruments

The final version of IFRS 9 Financial Instruments reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. Management has made an assessment of the effect of the standard and describes in note "Changes in accounting policies"

IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a five-step model that will apply to revenue earned from a contract with a customer (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities (e.g., sales of property, plant and equipment or intangibles). Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates. However, the standard does not apply to revenue associated with financial instruments and leases, and therefore, does not impact the majority of the Group's and the Bank's revenue including interest revenue, gains/(losses) on operations with securities, lease income which are covered by IFRS 9 Financial Instruments. As a result, the majority of the the Group's and the Bank's income are not impacted by the adoption of this standard,

IFRS 15: Revenue from Contracts with Customers (Clarifications)

The objective of the Clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 Revenue from Contracts with Customers, particularly the accounting of identifying performance obligations amending the wording of the "separately identifiable" principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The Clarifications also provide additional practical expedients for entities that either apply IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. The Group and the Bank does not have any transition effect on annual financial statements.

IFRS 2: Classification and Measurement of Share based Payment Transactions (Amendments)

The Amendments provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, for share-based payment transactions with a net settlement feature for withholding tax obligations and for modifications to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. These amendments are not applicable to the Group and the Bank.

IAS 40: Transfers to Investment Property (Amendments)

The Amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The Amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence

3. Summary of significant accounting policies *(cont'd)*

(ff) Adoption of new or revised standards and interpretations *(cont'd)*

of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. These amendments are not applicable to the Group and the Bank.

IFRIC INTERPETATION 22: Foreign Currency Transactions and Advance Consideration

The Interpretation clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when an entity recognizes a non-monetary asset or a non-monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. These amendments are not applicable to the Group and the Bank.

The IASB has issued the Annual Improvements to IFRSs 2014 – 2016 Cycle, which is a collection of amendments to IFRSs. These amendments are not applicable to the Group and the Bank.

IFRS 1 First-time Adoption of International Financial Reporting Standards: This improvement deletes the short-term exemptions regarding disclosures about financial instruments, employee benefits and investment entities, applicable for first time adopters.

IAS 28 Investments in Associates and Joint Ventures: The amendments clarify that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

IFRS 16: Leases

The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases on their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged.

The Group and the Bank plans to adopt IFRS16 retrospectively with the cumulative effect of initially applying IFRS 16recognised at the date of initial application. The Group and the Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. Preliminary estimated effect of adoption of IFRS16 is as follows:

	01.01.2019	
	Group EUR	Bank EUR
Assets		
Property and equipment (right of use assets)	109,733	109,733
Total assets	**109,733**	**109,733**
Liabilities		
Other liabilities (lease liabilities)	109,733	109,733
Total liabilities	**109,733**	**109,733**
Net impact on equity	-	-

3. Summary of significant accounting policies *(cont'd)*

(ff) Adoption of new or revised standards and interpretations *(cont'd)*

Amendment in IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28, in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss is recognized when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. In December 2015 the IASB postponed the effective date of this amendment indefinitely pending the outcome of its research project on the equity method of accounting. The amendments have not yet been endorsed by the EU.

IFRS 9: Prepayment features with negative compensation (Amendment)

The Amendment is effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The Amendment allows financial assets with prepayment features that permit or require a party to a contract either to pay or receive reasonable compensation for the early termination of the contract (so that, from the perspective of the holder of the asset there may be 'negative compensation'), to be measured at amortized cost or at fair value through other comprehensive income. These amendments are not applicable to the Group and the Bank.

IAS 28: Long-term Interests in Associates and Joint Ventures (Amendments)

The Amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The Amendments relate to whether the measurement, in particular impairment requirements, of long term interests in associates and joint ventures that, in substance, form part of the 'net investment' in the associate or joint venture should be governed by IFRS 9, IAS 28 or a combination of both. The Amendments clarify that an entity applies IFRS 9 Financial Instruments, before it applies IAS 28, to such long-term interests for which the equity method is not applied. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long- term interests that arise from applying IAS 28. These Amendments have not yet been endorsed by the EU.

IFRIC INTERPETATION 23: Uncertainty over Income Tax Treatments

The Interpretation is effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The Interpretation provides guidance on considering uncertain tax treatments separately or together, examination by tax authorities, the appropriate method to reflect uncertainty and accounting for changes in facts and circumstances. These amendments are not applicable to the Group and the Bank.

IAS 19: Plan Amendment, Curtailment or Settlement (Amendments)

The Amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Amendments require entities to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after a plan amendment, curtailment or settlement has occurred. The Amendments also clarify how the accounting for a plan amendment, curtailment or settlement affects applying the asset ceiling requirements. These Amendments have not yet been endorsed by the EU.

3. Summary of significant accounting policies *(cont'd)*

(ff) Adoption of new or revised standards and interpretations *(cont'd)*

Conceptual Framework in IFRS standards

The IASB issued the revised Conceptual Framework for Financial Reporting on 29 March 2018. The Conceptual Framework sets out a comprehensive set of concepts for financial reporting, standard setting, guidance for preparers in developing consistent accounting policies and assistance to others in their efforts to understand and interpret the standards. IASB also issued a separate accompanying document, Amendments to References to the Conceptual Framework in IFRS Standards, which sets out the amendments to affected standards in order to update references to the revised Conceptual Framework. Its objective is to support transition to the revised Conceptual Framework for companies that develop accounting policies using the Conceptual Framework when no IFRS Standard applies to a particular transaction. For preparers who develop accounting policies based on the Conceptual Framework, it is effective for annual periods beginning on or after 1 January 2020.

IFRS 3: Business Combinations (Amendments)

The IASB issued amendments in Definition of a Business (Amendments to IFRS 3) aimed at resolving the difficulties that arise when an entity determines whether it has acquired a business or a group of assets. The Amendments are effective for business combinations for which the acquisition date is in the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period, with earlier application permitted. These Amendments have not yet been endorsed by the EU.

IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors: Definition of 'material' (Amendments)

The Amendments are effective for annual periods beginning on or after 1 January 2020 with earlier application permitted. The Amendments clarify the definition of material and how it should be applied. The new definition states that, 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity'. In addition, the explanations accompanying the definition have been improved. The Amendments also ensure that the definition of material is consistent across all IFRS Standards. These Amendments have not yet been endorsed by the EU. The IASB has issued the Annual Improvements to IFRSs 2015 – 2017 Cycle, which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. These annual improvements have not yet been endorsed by the EU.

- IFRS 3 Business Combinations and IFRS 11 Joint Arrangements: The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
- IAS 12 Income Taxes: The amendments clarify that the income tax consequences of payments on financial instruments classified as equity should be recognized according to where the past transactions or events that generated distributable profits has been recognized.
- IAS 23 Borrowing Costs: The amendments clarify paragraph 14 of the standard that, when a qualifying asset is ready for its intended use or sale, and some of the specific borrowing related to that qualifying asset remains outstanding at that point, that borrowing is to be included in the funds that an entity borrows generally.

3. Financial and other risk management

Risk management

Risk management is one of the Group and Bank's strategic tasks. Risk management strategy has been developed for the Group and Bank's risk management which covers management of the following risks: credit risk, operational risk, market risk, interest rate risk, foreign currency risk, liquidity risk, concentration risk, country risk, money laundering and terrorist financing risk and other risks.

For the purpose of managing these risks, internal risk management policies and procedures have been developed which are approved by the Council and/or Board of the Bank and implemented by the responsible units of the Group and the Bank.

The Board of the Bank is responsible for the development and effective functioning of the risk management system as well as ensuring the identification and management of the Bank's risks, including risk estimation, evaluation, oversight and preparation of reports through implementing the risk identification and management policy set by the Council of the Bank and other documents relating to risk management.

Risk Director is responsible for the risk control function in the Group and the Bank, oversees the risk management system and co-ordinates actions of all structural units of the Group and the Bank related to risk management. The main unit responsible for determination, evaluation and oversight of risks is the Risk Management Department, which is an independent unit whose functions are separated from the functions of the business units.

The risk management system is being constantly improved in accordance with the Group and the Bank's activities and external conditions influencing these activities. The regular oversight of this process is performed by the Internal Audit Department.

(a) Credit risk

Credit risk is the risk of incurring losses in the event that a borrower (debtor) or a business partner is unable to fulfil its obligations to the Group and the Bank in accordance with the provisions of the contract. Credit risk is present in the Group and Bank's operations where the Group and the Bank make claims against another person and which are reflected in the Group and the Bank's statement of financial position and under off-balance sheet items.

The Bank's principles for evaluation, oversight and acceptance of credit risk are described and approved in its Loan Policy, Business Partner Risk Policy and Investment Portfolio Policy.

The Group and the Bank divide up and oversees their credit risk by setting limits of various types and categories: acceptable risk limits for each borrower, a group of related borrowers, geographical regions, business sectors, type and value of collateral, currency, term and ratings granted by international agencies and other sources of possible concertation risk.

Credit risk exposures are monitored on a revolving basis through regular assessments of borrowers' ability to meet interest and principal maturities and limits are adjusted as appropriate. The Group and the Bank's exposure to credit risk is managed and minimized by obtaining collaterals and guarantees against credit exposures that are registered in the name of the Bank. The fair values of both are also reviewed on a regular basis.

Credit–related commitments risks

The Bank makes available to its customers guarantees that may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to similar risks to loans and are mitigated by the same control processes and policies.

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(a) Credit risk *(cont'd)*

The table below presents credit risk exposures relating to assets and off-balance sheet items:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Assets subject to credit risk:				
Balances on demand with the Bank of Latvia	95,088,745	95,088,745	90,638,213	90,638,213
Loans to banks	44,132,371	44,132,371	89,439,452	89,439,452
Loans to customers	85,498,479	88,260,454	96,304,200	98,805,033
Financial assets at fair value through profit or loss	25,249,486	25,249,486	60,350,334	60,350,334
Derivative financial instruments	-	-	65,756	65,756
Other financial assets	5,885,247	5,869,670	3,878,758	3,280,184
Total	**255,854,328**	**258,600,726**	**340,676,713**	**342,578,972**
Off-balance sheet items subject to credit risk:				
Contingent liabilities	6,934,513	6,934,513	8,931,032	8,931,032
Financial commitments	11,547,703	11,552,260	21,745,831	21,745,831
Total	**18,482,216**	**18,486,773**	**30,676,863**	**30,676,863**

The Group and the Bank regularly review the quality of the loan portfolio with the aim to identify loss events. In case a loss event is identified, it is assessed whether impairment should be recognized.

Impairment assessment

Since 1 January 2018, the Group and the Bank have estimated expected credit losses (ECL), to eliminate expected present value of the cash shortfalls discounted to approximate it to ECL. Cash shortfall is the difference between the cash flows that are due to the entity in accordance with the contractual terms of a financial instrument and the cash flows that the entity expects to receive. ECL calculation techniques and key elements are provided below:

PD	Probability of default. This is an estimate of the likelihood of default over a given time horizon.
EAD	Exposure at Default. This is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, notwithstanding whether based on a contract or otherwise, and expected drawdowns on committed facilities
LGD	Loss Given Default. This is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It is usually expressed as a percentage of the EAD.

ECL allowance is based on the estimate of losses that result from all possible default events over the period of 12 months (12m ECL), unless credit risk has increased significantly since the initial recognition of exposure, in which case the allowance is based on the risk of default over lifetime (lifetime ECL). 12 - month ECLs are the portion of the lifetime ECLs that represent the ECLs resulting from default events on a financial instrument that are possible within 12 months after the reporting date. Both lifetime ECLs and 12-month ECLs are measured on an individual or collective basis depending on the type of underlying portfolios of financial instruments.

The Bank reflects the use of undrown loan and credit cards commitments in future applying the credit conversion factor 75% which reflects the size of the currently non-used obligations, which will be used during a certain period. The credit conversion factor is determined using relevant historical information and predicted information.

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(a) Credit risk *(cont'd)*

The Group and the Bank have established a policy for assessing at the end of each reporting period whether there has been a significant increase in credit risk since initial recognition, considering the change in the risk of default occurring over the expected life of the financial instrument.

The Group and the Bank are continuously monitoring all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or lifetime ECL, the Group and the Bank assesses whether there has been a significant increase in credit risk since initial recognition. The Group and the Bank considers that an exposure might have a significant increase in credit risk when it -is past due 1 day or more. In that case The Group and the Bank consider a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming restructured due to credit event. In certain cases, the Group and the Bank may also consider that events explained in "Definition of default" section below are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

When estimating ECLs on a collective basis for a group of similar assets, the Group and the Bank apply the same principles for assessing whether there has been a significant increase in credit risk since initial recognition.

Grouping financial assets measured on a collective basis

Dependent on the factors below, the Group and the Bank calculate ECLs either on a collective or on an individual basis.

Asset classes where the Group and the Bank calculate ECL on an individual basis include:

- All Stage 3 assets which exceed the materiality threshold (i.e. the balance of exposure exceeds EUR 1 million) or defaulted prior to 2018 , regardless of the class of financial assets;
- Due from other banks;

Asset classes where the Group and the Bank calculate ECL on a collective basis include:

- All Stage 1 and 2 assets.
- Stage 3 assets defaulted in 2018, which do not exceed the materiality threshold (EUR 1 million), are assessed within a group.

Under the above procedure, the Group and the Bank organize their loans as Stage 1, Stage 2 and Stage 3 as described below:

Stage 1:	Upon initial recognition of a loan, the Group and the Bank recognize loss allowance based on 12 -month ECLs. Stage 1 can also include exposures moved from Stage 2 if seeing decrease of the respective credit risk.
Stage 2:	Assets with significant increase in credit risk since initial recognition. For these assets the Group and the Bank recognize loss allowance based on lifetime ECL. Stage 2 can also include exposures moved from Stage 3 if seeing decrease of the respective credit risk.
Stage 3:	Financial assets that have objective evidence of impairment at the reporting date. For these assets the Group and the Bank recognize loss allowance based on lifetime ECL.

4. Financial and other risk management *(cont'd)*

(a) Credit risk *(cont'd)*

Definitions of default and cure

The Group and the Bank consider a financial instrument in default and, accordingly Stage 3 (credit-impaired financial asset) for ECL calculations, when contractual payments are 90 days past due. The Group and the Bank consider the amounts due from banks in default and act, without delay, if the demanded daily payments are not settled by the end of the business day as specified in individual contracts.

In performing a qualitative assessment as to whether a customer complies with their obligations, the Group and the Bank also consider various events that can indicate an inability to pay (default events). In such cases, the Group and the Bank carefully consider whether it can be deemed that the customer does not comply with their obligations and whether the respective exposure should be classified in Stage 3 or Stage 2. Such events are:

- Internal rating of the borrower indicating default or partial default;
- A borrower asks an emergency funding from the Group and the Bank;
- Significant decrease in the value of underlying collateral if recovery of the loan is expected from collateral;
- Significant decrease in the borrower's turnover or loss of their key customer;
- Breach of the contractual terms not repudiated by the Group and the Bank;
- Debtor (or any legal entity of the debtor's group) files for bankruptcy;
- Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties.

The policy of the Group and the Bank is to consider a financial instrument as "cured" (when it no longer meets any of the default criteria) and, accordingly, to move it from Stage 3 if any of the default criteria other then restructuring has not been in force at least for a consecutive period of 12 months to be reclassified to Stage 2, and at least 24 months be reclassified from Stage 3 to Stage 1. A decision on whether the cured asset should be classified as Stage 1 or Stage 2 asset depends on the updated credit category over the cure period and whether it indicates a significant increase in credit risk in comparison with initial recognition.

Internal rating and PD estimation

The number of days past due is used as the principal indicator for calculation of PD and internal credit rating for calculation of provisions. The PD rate is calculated for each of the following groups of delay:

- not past due;
- increased credit risk;
- past due for 1-30 days;
- past due for 31-60 days;
- past due for 61-90 days;
- forborne not past due;
- forborne past due 1-30 days;
- non performing exposures.

PD rates are calculated using Markov's transmission matrices (TM) which reflect the movement of the lending portfolio between the groups of delays within one month. The transfer to another category is determined by using the number of migrations of loans. The calculation is based on TM data for 36 months before the end of the reporting period.

4. Financial and other risk management *(cont'd)*

(a) Credit risk *(cont'd)*

Exposure at default

An exposure at default (EAD) equals to the gross carrying amount of the financial instruments subject to impairment assessment and it refers both to the customer's ability to increase risk, while approximating a default event, and the potential early repayment. In order to measure EAD for Stage 1 exposure, the Group and the Bank assess the possible defaults over 12 months to calculate 12mECL. For Stage 2 and Stage 3, in case of default, events over the lifetime of the respective instruments are considered.

The Group and the Bank determine EAD, by modeling the range of possible outcomes over various horizons in several scenarios. Subsequently, PD, as defined in IFRS 9, is assigned to each economic scenario on the basis of the outcomes of the model used by the Group and the Bank.

Loss given default

The Bank and the Group assess the LGD values and the Bank's Asset and Liability Committee reviews and approves thereof at least quarterly as well as whenever the Bank becomes aware of information indicating significant deterioration in the quality of an asset or contingent liability.

The credit risk assessment is based on a standardized LGD assessment approach as a result of which a certain LGD rate is obtained. Such LGD rates consider the expected EAD in comparison with the amount expected to be recovered or obtained from collateral.

Forward- looking information

In calculating ECL, the Group and the Bank considers if necessary adjustments are needed in respect to the relevant forward looking information. The Group and the Bank obtains forward-looking information from reliable third party sources (such as external rating agencies, governmental bodies and international financial institutions). The Group and the Bank assess:

- every sector of economy, in which the Bank has significant credit risk exposures;
- macroeconomic data at a national level in every region, in which the Bank has significant credit risk exposures;
- relevant trends on immovable property market;
- other relevant information.

(b) Market risk

The Group and the Bank are exposed to market risks which arise from open positions in interest rate and currency, all of which are exposed to general and specific market movements.
The Group and the Bank manage market risks by diversifying the financial instruments portfolio, setting limits on different types of financial instruments and applying sensitivity tests which show the impact of particular risks on the Group and Bank's assets and equity.
Basis of the market risk management:

- Assessment and analysis of securities portfolio;
- Analysis and monitoring of issuers' financial position;
- Establishing internal limits/ diversification (stop-loss to issuers, countries, regions, terms, credit rating categories);
- Monitoring of the compliance of the internal limits.

4. Financial and other risk management *(cont'd)*

(c) Currency risk

The Group and the Bank are exposed to the risk of changing foreign currency exchange rates which impacts both the financial performance and the cash flows of the Group and the Bank. The Group and the Bank control assets and liabilities denominated in foreign currencies to avoid unreasonable foreign currency exchange rate risk. Currency risk is calculated for each currency separately taking into account the amount of liabilities and requirements of the Group and the Bank. The Board determines the Group and Bank's open position limits on certain currencies which are monitored daily. The Latvian banking legislation requires that open positions in each foreign currency may not exceed 10% of the Group and Bank's equity and that the total foreign currency open position may not exceed 20% of the equity. In 2018 and 2017 the Group and the Bank complied with these limits (see Note 29). The Group and the Bank have no significant open positions in "exotic" currencies.

The Group and Bank's foreign currency risk assessment is based on the following main principles:

- Assessment is made of changes in the Group and Bank's assets, liabilities and off-balance sheet items as a result of exchange rate fluctuations;
- How the Group and Bank's revenue/costs change with exchange rate fluctuations;
- Performing currency risk stress tests.

Basis of the currency risk management:

- Assessing currency risk;
- Setting of limits and restrictions;
- Monitoring of adherence to internal limits;
- Performing exchange rate stress tests and analyzing the obtained results;
- Entering into hedge relationships, if necessary.

The Group and the Bank define and control daily and weekly maximum loss limits via involving in currency trading.

As part of a quarterly currency risk management process, assessment of the foreign exchange risk is performed (assessment how the statement of financial position and off-balance sheet items change with the changes in foreign currency exchange rates, how the income/expenses of the Group and the Bank change with the foreign currency exchange rate changes) and the results of such evaluation are submitted to the Management of the Group and the Bank. Once a year a currency risk stress testing and the analysis of its results are performed, serving as the basis of proposals for changes in the foreign currency risk management policy which are made to the Management of the Group and the Bank, if necessary.

The table below presents the sensitivity of profit/ loss to currency exchange rate fluctuations at the end of the reporting period with all other variables held constant (in thousand EUR):

31.12.2018	Effect on profit/ loss and equity		31.12.2017	Effect on profit/ loss and equity	
	+10%	-10%		+10%	-10%
USD	40	(40)	**USD**	(22)	20
Total	40	(40)	**Total**	(22)	20

(d) Interest rate risk

Interest rate risk is the sensitivity of the Group and Bank's financial position to a change in market interest rates. In the normal course of business, the Group and the Bank encounter interest rate risk as a result of differences within maturities or interest re-fixing dates of respective interest-sensitive assets and liabilities. The risk is controlled by the Bank's Asset and Liability Committee which sets limits on the level of mismatch of interest rate reprising and evaluates interest rate risk undertaken by the Group and the Bank (see Note 31).

4. Financial and other risk management *(cont'd)*

(d) Interest rate risk *(cont'd)*

Basis of the interest rate management:

- Assessing sensitivity of interest rate risk;
- Setting of internal limits (limit of reduction in economic value and for total duration of securities portfolio);
- Monitoring of adherence to internal limits;
- Performing interest rate stress tests and analyzing the obtained results;
- Entering into hedge relationships, if necessary.

Interest rate risk identification and assessment are made in a way as to further examine all types of interest-rate risks. To limit the interest rate risk, limits are set to both impairment of economic value and the modified duration of securities portfolio.

As part of interest rate risk assessment, impact of interest rate changes on the economic value of the Group and the Bank is performed regularly, including interest rate risk assessment from income perspective and interest rate risk assessment from the perspective of economic value, and on that basis, follow up control of the set limits is carried out. Moreover, interest rate risk stress testing is performed, based on which changes are proposed in the interest rate risk management policies, if needed. Results of interest rate risk assessment are reported to the Management of the Group and the Bank.

Assets/ liabilities/ off-balance sheet items with specified maturity are split into maturity groups as follows:

- Shorter from the remaining repayment/ settlement/ maturity term – for financial instruments with fixed interest rate;
- For a period until the next interest rate change date or interest repricing date – for financial instruments with variable interest rate;
- Maturity of deposits is shown as being not longer than five years.

Assets/ liabilities/ off-balance sheet items with no specified maturity are split into maturity groups as follows:

- Settlement accounts, for which interest is paid, are classified as sensitive to the changes in interest rates and presented as "on demand";
- Derivatives are presented under both long off-balance-sheet position and short off-balance-sheet position.

The following changes in interest rates are applied to the sensitivity analysis: all items except for deposits are subject to rate changes of +/-100 base points, while deposits are subject to rate changes of +/-50 base points.

The table below presents the sensitivity of revenue and equity to interest rate fluctuations as described above with all other variables held constant (in thousand EUR):

31.12.2018	Effect on profit/ loss and equity		31.12.2017	Effect on profit/ loss and equity	
USD	(143)	143	**USD**	(516)	516
EUR	(194)	194	**EUR**	(120)	120
Total	**(337)**	**337**	**Total**	**(636)**	**636**

(e) Liquidity risk

The Group and the Bank are exposed to daily calls on its available cash resources from short-term liquid investments. The relationship between the maturity of assets and liabilities, as well as off-balance sheet items, is indicative of liquidity risk and the extent to which it may be necessary to raise funds to meet outstanding obligations.

4. Financial and other risk management *(cont'd)*

(e) Liquidity risk *(cont'd)*

The Group and the Bank do not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The Board sets limits on the minimum proportion of maturing funds available to meet such calls and at the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types (see Note 30). An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and the Bank and their exposure to changes in interest rates and exchange rates.

The matching and controlled mismatching of the maturities of assets and liabilities are fundamental to the daily liquidity management of the Group and the Bank.

The Group and the Bank use the following methods for evaluation of liquidity risk:

- Preparation of maturity analysis (for all currencies and separately for individual currencies);
- Calculation of the liquidity ratio, monitoring of adherence to liquidity ratio regulations;
- Stress testing.

Basis of the liquidity risk management:

- Being in compliance with liquidity ratio regulations;
- Setting of the liquidity net position limit;
- Setting of restriction on attracting deposits;
- Monitoring of adherence to liquidity limits;
- Conducting liquidity stress tests and analysis of the obtained results;
- Recommendations for resolving liquidity problems.

In accordance with the FCMC requirements, the Bank maintains sufficient liquid assets to meet its liabilities in the amount which is not less than 60% of the Bank's current liabilities.

(f) Capital adequacy

Capital adequacy refers to the sufficiency of the Group and Bank's own funds to cover risks resulting from the Group and Bank's operating activities.

In order to calculate the capital for risks to which minimal capital requirements are set, according to the Financial and Capital Market Commission's (FCMC) regulations on preparation of report on minimal capital requirements, capital requirements are calculated using the following approaches and methods:

- Credit risk capital requirements are calculated using the standardized approach;
- The Financial Collateral Simple Method is used in order to decrease credit risk;
- The Bank calculates the portfolio own funds requirements for CVA risk applying the standardized method specified in Article 384 of EU Regulation NO 575/2013;
- Foreign currency risk capital requirements, commodities risk capital requirements and capital requirements for position risk of debt securities and equities are calculated using the standardized approach;
- Capital requirements for general risk of debt securities are calculated using the maturity method;
- Capital requirements for operational risk are calculated using the basic index approach.

The Group and the Bank also evaluate whether compliance with the minimal capital requirements ensures that the capital of the Group and the Bank is sufficient to cover all possible losses associated with all of the above mentioned risks.

4. Financial and other risk management *(cont'd)*

(f) Capital adequacy (cont'd)

Moreover, the Group and the Bank have developed internal documentation and regulations according to which they determine the amount of necessary capital for substantial risks to which minimal capital requirements are not set (e.g., interest rates risk, liquidity risk, country risk, and other substantial risks).

Calculated in accordance with the FCMC requirements, the Group and Bank's capital adequacy ratio as at 31 December 2018 was 26,96% and 27,21% (31 December 2017: 29.74% and 30.12%), which is above the minimum set by European Parliament and the Council Regulation (EU) No 575/2013 requiring capital retention reserve amount (10.5%), being a sum of equity against risk weighted assets and off-balance sheet items being minimum of 8% and capital retention reserve above 2.5% (see Note 28). On 1 December 2017, the Financial and Capital Market Commission recalculated individual capital adequacy requirements placed on the Group and the Bank and determined it to be 13.20%. The Group and the Bank observed and complied with the individually determined capital adequacy requirements both in 2018 and 2017

(g) Operational risk

Operational risk is the possibility of incurring losses as a result of inadequate or unsuccessful developments in the Group and Bank's internal processes, human and systemic actions, or influence of external conditions. Operational risk is defined as the risk of a reduction in the Group and Bank's revenue/ incurring of additional costs (and a resulting reduction of the equity) due to erroneous transactions with customers/business partners, information processing, adoption of ineffective decisions, insufficient human resources or insufficient planning for the influence of external conditions.

The Group and the Bank have established and maintain an Operational Risk Event and Loss database in which internal data on operational risk events and associated losses are collected, processed and organized.

Basis of the operational risk management:

- Monitoring of operational risk;
- Management and minimizing of operational risk:
- Development of internal regulations which eliminate/ reduce the possibility of operational risk events;
- Compliance with the principle of separation of duties;
- Monitoring of compliance with the internal limits;
- Compliance with the procedure for using IT and other resources of the Bank;
- Adequate staff training;
- Review of transactions and account documentation on a regular basis.

(h) Concentration risk

Transaction concentration risk

Transaction concentration risk is any risk transaction or group of risk transactions that could cause the Group and the Bank to suffer such losses that may endanger the liquidity of the Group and the Bank or their ability to continue as a going concern. Concentration risk arises from significant risk transactions with customers or groups of inter-related customers or risk transactions with customers with common risk factors (e.g., economy sector, geographical region, currency, the instrument used for decrease of credit risk (one type of collateral or one provider of collateral, etc.)).

In order to control transaction concentration risk the Group and the Bank have set limits on investments into various types of assets, instruments, markets, etc. Limit is a numerical threshold applied to various types of investments serving as an instrument for limiting and controlling the risk.

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(h) Concentration risk *(cont'd)*

Country risk

Country risk is one of significant transaction concentration risks. Country risk – country partner risk – is the possibility of incurring losses if the Group and Bank's assets are located in a country where, due to changes in its economic and political factors, the Group and the Bank may experience problems in recovering its assets within the agreed time and amount. The reasons of default by partners and issuers are primarily currency devaluation, unfavorable legislative changes, creation of new restrictions and barriers as well as other, including force majeure, factors.

In order to manage concentration risks the following limits were set:

- Country risk limits;
- Credit rating group limits;
- Financial market operations risk limits;
- Limits on open currency positions and cash, limits on allowable loss on trading with foreign currencies;
- Limits on allowable loss from trading with financial instruments portfolios;
- Limits on large exposures;
- Limits on transactions with parent bank;
- Limits on lending programs.

Control, analysis and review of fulfilment of these limits are performed.

International rating agency data (including credit ratings and their dynamics), economic indicators of the country and other relevant information sources are used for risk analysis.

	Latvia		OECD		Non-OECD		31.12.2018	31.12.2018
	Group EUR	Bank EUR	Group EUR	Bank EUR	Group EUR	Bank EUR	Group EUR	Bank EUR
Financial assets								
Cash and balances with the Bank of Latvia	95'088'745	95'088'745	-	-	-	-	95'088'745	95'088'745
Balances due from banks	688	688	21'908'739	21'908'739	22'222'944	22'222'944	44'132'371	44'132'371
Loans and advances to customers	19'134'227	21'896'202	17'572'917	17'572'917	48'791'335	48'791'335	85'498'479	88'260'454
Financial assets at fair value through profit or loss	1'273'368	1'273'368	23'443'610	23'443'610	532'508	532'508	25'249'486	25'249'486
Equity instruments at fair value through other comprehensive income	-	-	284'083	284'083	-	-	284'083	284'083
Other financial assets	1'147'633	1'147'633	4'653'398	4'637'821	84'216	84'216	5'885'247	5'869'670
Total assets	**116'644'661**	**119'406'636**	**67'862'747**	**67'847'170**	**71'631'003**	**71'631'003**	**256'138'411**	**258'884'809**

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(h) Concentration risk *(cont'd)*

	Latvia		OECD		Non-OECD		31.12.2018	31.12.2018
	Group	Bank	Group	Bank	Group	Bank	Group	Bank
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Liabilities								
Deposits from customers	51'069'820	51'077'003	57'391'149	57'391'149	109'369'474	109'369'474	217'830'443	217'837'626
Other financial liabilities	2'824'170	2'824'170	53'458	28'862	54'576	54'576	2'932'204	2'907'608
Deferred income and accrued expense	916'982	916'982	16'254	16'254	48	48	933'284	933'284
Debt securities	-	-	16'784'496	16'784'496	774'314	774'314	17'558'810	17'558'810
Subordinated loans	366'899	366'899	370'562	370'562	10'469'896	10'469'896	11'207'357	11'207'357
Total liabilities	**55'177'871**	**55'185'054**	**74'615'919**	**74'591'323**	**120'668'30**	**120'668'30**	**250'462'098**	**250'444'685**

	Latvia		OECD		Non-OECD		31.12.2017	31.12.2017
	Group	Bank	Group	Bank	Group	Bank	Group	Bank
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Financial assets								
Cash and balances with the Bank of Latvia	90'638'213	90'638'213	-	-	-	-	90'638'213	90'638'213
Balances due from banks	13'580'327	13'580'327	41'713'997	41'713'997	34'145'128	34'145'128	89'439'452	89'439'452
Loans and advances to customers	25'199'987	27'700'820	15'454'068	15'454'068	55'650'145	55'650'145	96'304'200	98'805'033
Financial assets at fair value through profit or loss	1'505'882	1'505'882	58'296'586	58'296'586	547'866	547'866	60'350'334	60'350'334
Equity instruments at fair value through other comprehensive income	-	-	234'942	234'942	-	-	234'942	234'942
Derivative financial instruments	9'271	9'271	1'001	1'001	55'484	55'484	65'756	65'756
Other financial assets	514'583	514'583	3'206'012	2'607'438	158'163	158'163	3'878'758	3'280'184
Total	**131'448'263**	**133'949'096**	**118'906'606**	**118'308'032**	**90'556'786**	**90'556'786**	**340'911'655**	**342'813'914**

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(h) Concentration risk *(cont'd)*

	Latvia		OECD		Non-OECD		31.12.2017	31.12.2017
	Group	Bank	Group	Bank	Group	Bank	Group	Bank
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Liabilities								
Deposits from customers	17'418'716	17'766'830	104'244'174	104'244'174	174'819'559	174'819'559	296'482'449	296'830'563
Derivative financial instruments	652'318	652'318	-	-	-	-	652'318	652'318
Other financial liabilities	439'267	439'267	47'785	45'698	14'469	14'469	501'521	499'434
Deferred income and accrued expense	886'601	886'601	-	-	2'368	2'368	888'969	888'969
Debt securities	-	-	16'024'554	16'024'554	739'256	739'256	16'763'810	16'763'810
Subordinated loans	350'287	350'287	2'021'748	2'021'748	9'995'857	9'995'857	12'367'892	12'367'892
Current income tax liabilities	75'517	75'517	-	-	-	-	75'517	75'517
Total liabilities	**19'822'706**	**20'170'820**	**122'338'261**	**122'336'174**	**185'571'50**	**185'571'509**	**327'732'476**	**328'078'503**

Basis of the risk management:

- Setting of internal limits by regions, countries, and by transaction types in individual countries;
- Monitoring of adherence to internal limits;
- Analysis and monitoring of country risk;
- Review of internal limits.

Asset, liability and off-balance sheet country risk applies to the country which is considered to be the primary country where the customer conducts its business activities. If a loan is granted to a resident of another country using collateral which is physically located in a country other than the resident country of the legal entity, the country risk is transferred to the country where the loan collateral is actually located.

(i) Money laundering and terrorist financing risk

The main policies and procedures as well as control mechanisms of the Group and the Bank in the area of the anti-money laundering and terrorist financing are based on the following documents:

- Laws and regulations of the Republic of Latvia in the area of anti-money laundering and terrorist financing;
- FATF (Financial Action Task Force) recommendations;
- Wolfsberg for Private and Correspondent Banking principles;
- Documents signed by the Bank: the Basel Committee Principles; EU directives; US Patriot Act.

The Group and Bank's internal regulations include the following programs:

- Money Laundering and Terrorist Financing Risk Management Strategy 2018-2020;
- Sanctions Compliance Program of AS "Reģionālā investīciju banka" 2018-2020;
- Program for customer identification and examination and for determination and identification of ultimate beneficial owner;
- Program for mandatory monitoring of customer operations and identification of unusual transactions and activities;
- Program for customer information verification;
- Program for documentary recording of the necessary information;

Notes to the financial statement *(cont'd)*

4. Financial and other risk management *(cont'd)*

(i) Money laundering and terrorist financing risk (cont'd)

- Program for information and documentation maintenance;
- Program for the training of the Bank's employees in the area of AML/CFT/Sanctions;
- Program governing the suspension of work regarding operations with cash or other assets.

In meeting the above mentioned regulatory requirements and implementing the policy "Know Your Customer", the Bank performs customer investigation during which it:

- Identifies and verifies ultimate beneficial owners;
- Obtains information on the nature of the intended cooperation;
- Obtains information on the customer's business or personal life as well as about the origin of funds;
- Establishes the customer risk group;
- Obtains information on the ultimate beneficial owner;
- Obtains information on the objective of the transaction and its expected nature;
- Monitors transactions and obtains information and documents supporting the account transactions;
- Ensures security of the documentations, data and information obtained during the customer investigation as well as updates it on a regular basis.

A more detailed description of the money laundering and terrorist financing risk management is provided in the Policy for the Prevention of Money Laundering and Terrorist Financing as well as in the Group and Bank's instructions.

The Bank continuously improves its internal regulatory framework, following the changes in regulatory enactments, which had been made in the AML/CFT/Sanction sphere in 2018 based on the newly adopted amendments to the Law on the Prevention of Money Laundering and Terrorism Financing.

According to those amendments, it is prohibited to cooperate (to open new accounts or to work with existing customers) with "shell companies" meeting high-risk characteristics, namely, features specified in point (a)* and (b)** simultaneously of the paragraph 1 of clause 15^1 of the Law.

* a)- has no affiliation of a legal person to an actual economic activity or the operation of a legal person forms a minor economic value or no economic value at all, and the subject of the Law has no documentary information at its disposal that would prove the contrary;

** b)- laws and regulations of the country where the legal person is registered do not provide for an obligation to prepare and submit financial statements for its activities to the supervisory institutions of the relevant state, including the annual financial statements.

The Bank has updated and implemented new Money Laundering and Terrorist Financing Risk Management Strategy 2018-2020, which aims to comply with the amendments to the Law.

Bank has been implementing the requirements of AML / CFT norms in the Bank's AML/CFT procedures, instructions and thematic methodologies, where additional criteria such as obtaining and analyzing of the financial statements, tax and annual income statements are considered in the EDD process.

Mentioned amendments to the Law is another phase of the Bank's endeavor to reduce the level of ML/TF risk inherent in the Bank's customer base.

The Bank continues ongoing improvement of IT systems ensuring automated AML/TF risk management processes (processing and management of customer information; scoring; sanction screening; transaction monitoring; identification of suspicious and unusual transactions, etc.)

Notes to the financial statements *(cont'd)*

5. Interest income and expense

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Interest income				
Loans and advances to legal entities	6,336,507	6,443,282	6,784,096	6,810,485
Loans and advances to private individuals	789,894	789,894	873,045	873,045
Balances due from banks	1,311,174	1,311,174	1,341,650	1,341,650
Debt securities held for trading	624,119	624,119	1,025,641	1,025,641
Other interest income	20,438	20,438	17,127	17,127
Total interest income	**9,082,132**	**9,188,907**	**10,041,559**	**10,067,948**
Interest expense				
Due to private individuals	(64,996)	(64,996)	(57,759)	(57,759)
Due to legal entities	(1,058,098)	(1,058,098)	(1,370,564)	(1,370,564)
Subordinated loans	(998,741)	(998,741)	(1,052,258)	(1,052,258)
Debt securities issued	(762,614)	(762,614)	(798,784)	(798,784)
Other interest and related expense	(624,418)	(624,418)	(946,709)	(946,709)
Total interest expense	**(3,508,867)**	**(3,508,867)**	**(4,226,074)**	**(4,226,074)**
Net interest income	**5,573,265**	**5,680,040**	**5,815,485**	**5,841,874**

Other interest and related expense include payments to the deposit guarantee fund of 149,048 EUR (2017: EUR 209,666), which are calculated in accordance with the Deposit Guarantee Law and FCMC regulations "Report on Regulatory Provisions for Determining Adjustment Factors for Covered Deposits Preparation and Payments to the Deposit Guarantee Fund and recognized in the period for which the calculation is performed; financial stability fee of EUR 43,855 (2017: EUR 137,793) and negative interest rate applied to correspondent accounts of EUR 431,515 (2017 EUR: 483,659).

6. Fee and commission income and expense

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Fee and commission income				
Money transfers	1,769,745	1,770,031	3,662,210	3,662,331
Fees on registration of changes in loan agreements	4,315	4,315	1,538	1,538
Commission income on asset management	510,375	510,375	344,172	344,172
Account servicing	2,575,193	2,575,193	1,195,829	1,195,829
Commissions on letters of credit	428,467	428,467	467,031	467,031
Commission income on transactions with securities	91,493	91,493	64,208	64,208
Commission income on current accounts servicing	5,405	5,405	16,140	16,140
Income from general services	71,478	71,478	150,361	150,361
Other commissions (DIGIPAS)	34,271	34,271	46,655	46,655
Interbank commission income	239,910	239,910	287,666	287,666
Commission on transactions with settlement cards	656,926	656,926	908,173	908,173
Income from currency exchange	292	292	410,072	410,072
Other income	16,482	16,482	25,266	25,266
Total fee and commission income	**6,404,352**	**6,404,638**	**7,579,321**	**7,579,442**
Fee and commission expense:				
Money transfers	(768,908)	(768,798)	(1,253,066)	(1,253,066)
Other expense	(20,649)	(20,649)	(50,514)	(50,514)
Total fee and commission expense	**(789,557)**	**(789,447)**	**(1,303,580)**	**(1,303,580)**
Net fee and commission income	**5,614,795**	**5,615,191**	**6,275,741**	**6,275,862**

7. Administrative expense

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Remuneration paid to personnel	4,189,453	4,189,453	4,532,266	4,532,266
State statutory social insurance contributions	1,198,426	1,196,400	1,268,868	1,266,814
Remuneration paid to the Members of the Council and the Board	618,631	610,220	661,449	652,743
Communications expense	519,350	519,350	475,343	475,343
Set-up and maintenance costs of information systems	258,005	258,005	248,988	248,988
Consulting and professional fees	262,385	196,528	230,838	224,441
Non-deductible VAT	153,601	153,601	190,144	190,144
Fee paid to the certified auditor*	111,010	111,010	74,675	74,675
Public utilities	96,348	96,348	113,977	113,977
Business trips	74,766	74,053	166,486	165,627
Real estate tax	67,399	67,399	69,680	66,237
Postal charges	38,349	38,349	48,585	48,585
Health insurance	36,045	36,045	36,976	36,976
Operating lease expense	28,361	28,361	51,081	51,081
Office and equipment maintenance	20,279	20,279	83,551	83,551
Stationary	19,400	19,400	36,858	36,858
Transportation	10,801	10,801	24,843	24,843
Advertising and marketing	12,037	12,037	16,476	16,476
Security	1,487	1,487	1,527	1,527
Other administrative expense	181,276	151,896	372,815	314,328
	7,897,409	**7,791,022**	**8,705,426**	**8,625,480**

The average number of staff employed by the Group and the Bank in 2018 was 191, including 4 Members of the Board, 5 Members of the Council and 182 other employees (2017: 215, including 4 members of the Board, 5 Members of the Council and 206 other employees). The remuneration paid to the Members of the Council and the Board is disclosed in Note 32.

* The total fee paid to the certified auditor for the types of services provided by the auditor was as follows: statutory annual audit of consolidated and separate financial statements - EUR 82,810 (2017: EUR 49,000), other audit tasks - EUR 7,500 (2017: EUR 2,000); to other specialists - EUR 20,700 (2017: EUR 23,675).

8. Other operating income

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Rentals	209,533	167,773	222,153	218,793
Penalties	381,500	381,500	83,249	83,249
Other income	146,772	35,222	37,197	12,241
Total other operating income	**737,805**	**584,495**	**342,599**	**314,283**

Notes to the financial statements *(cont'd)*

9. Other expense

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Payments to funds and membership fees	(296,799)	(296,799)	(248,720)	(248,720)
Loss from revaluation of property and equipment *	-	-	(935,872)	(935,872)
Loss from revaluation of other non-financial assets **	-	-	(1,031,940)	(1,031,940)
Gain/ (loss) on loan realization, net	(214,581)	(214,581)	-	-
Gain /(loss) on disposal of repossessed collateral, net	(387,002)	(387,002)	(35,569)	(35,569)
Other expense	(13,807)	-	(3,443)	-
Penalties***	(894)	(894)	(636,099)	(636,099)
Total other expense	**(913,083)**	**(899,276)**	**(2,891,643)**	**(2,888,200)**

* In 2017 the Bank performed the revaluation of the building on the basis of a valuation carried out by an independent certified valuator. As a result the Bank recognized an impairment of EUR 935,872.** In 2017 impairment of non-financial assets of EUR 1,031,940 was recognized. *** In 2017 the FCMC and the Bank entered into an administrative agreement which provided for a penalty of EUR 570,835 as well as measures for eliminating the identified weaknesses. In 2017, the Bank paid a penalty of EUR 65,264 to Visa Europe Limited for exceeding the reclamation threshold.

10. Corporate income tax

	2018 Group EUR	2018 Bank EUR	2017 Group EUR	2017 Bank EUR
Corporate income tax for the reporting year	2,098	2,098	637,006	637,006
*Amount of tax paid abroad	214,423	214,423	211,063	211,063
Change in deferred corporate income tax	-	-	(230,917)	(230,917)
Total corporate income tax	**216,521**	**216,521**	**617,152**	**617,152**

* The amount of tax paid abroad consists of withholding tax paid in Ukraine. Corporate income tax from dividends calculated in Latvia can be reduced by the amount of tax paid abroad, if the payment is certified by the documents approved by a foreign tax authority, stating the amount of taxable income and the amount of tax withheld abroad. Tax can be reduced by the amount of tax withheld abroad, however, limited to the amount, which would be payable in Latvia for the amount of revenue generated abroad. Amounts of withholding tax, exceeding the tax calculated in Latvia, cannot be carried forward to the future periods, therefore, are recognized as tax expense in the current period.

11. Cash and balances with the Bank of Latvia

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Cash	925,139	925,139	1,025,419	1,025,419
Balances on demand with the Bank of Latvia	94,173,023	94,173,023	89,612,794	89,612,794
ECL allowances	(9,417)	(9,417)	-	-
	95,088,745	**95,088,745**	**90,638,213**	**90,638,213**

Balances on demand with the Bank of Latvia represent the Group and Bank's correspondent account balance.

11. Cash and balances with the Bank of Latvia (cont'd)

All cash balances are allocated in Stage 1. Changes in ECL allowances can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Allowances for balances due from the Bank of Latvia as at 1 January 2018	8,961	8,961	-	-
Increase/(decrease) in the reporting year	456	456	-	-
Allowances for balances due from the Bank of Latvia as at 31 December 2018	9,417	9,417	-	-

Demand deposits with the Bank of Latvia include reserves, which are held in accordance with the Regulations of the Bank of Latvia. These Regulations prescribe the minimum level of the Bank's average correspondent account balance per month, while at any given day these funds can be freely accessed and used by the Bank.

The minimum level of the Bank's correspondent account for the period from 19 December 2018 to 29 January 2019 was set at EUR 1,924,768 (2017: EUR 2,980,303). The Bank was in compliance with the reserve requirement of the Bank of Latvia in 2018 and 2017.

12. Balances due from banks

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Due from banks registered in Latvia	688	688	13,580,328	13,580,328
Due from banks registered in non-OECD countries	22,224,467	22,224,467	34,145,126	34,145,126
Due from banks registered in OECD countries	21,957,351	21,957,351	41,713,998	41,713,998
Balances due from banks, gross	**44,182,506**	**44,182,506**	**89,439,452**	**89,439,452**
ECL allowances	(50,135)	(50,135)	-	-
Balances due from banks, net	**44,132,371**	**44,132,371**	**89,439,452**	**89,439,452**

The table below discloses the balances due from banks by their type:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
On demand	22,485,598	22,485,598	62,752,051	62,752,051
Balances with maturity of three months or less	21,638,998	21,638,998	23,168,212	23,168,212
Other balances due from banks	57,910	57,910	3,519,189	3,519,189
Balances due from banks, gross	**44,182,506**	**44,182,506**	**89,439,452**	**89,439,452**
ECL allowances	(50,135)	(50,135)	-	-
Balances due from banks, net	**44,132,371**	**44,132,371**	**89,439,452**	**89,439,452**

12. Balances due from banks (cont'd)

The table below discloses an analysis of changes in gross carrying value and corresponding ECL allowance on amounts due from credit institutions during the year ended 31 December 2018 is as follows

Balances due from banks	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**89,439,452**	**-**	**-**	**89,439,452**
New assets originated or purchased	329,856,801	-	-	329,856,801
Assets repaid	(375 717 898)	-	-	(375 717 898)
Reclassification	(1,428,736)	-	-	(1,428,736)
Foreign exchange adjustments	2,032,887	-	-	2,032,887
Gross carrying value as at 31.12.2018	**44,182,506**	**-**	**-**	**44,182,506**

Balances due from banks	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**71,047**	**-**	**-**	**71,047**
New assets originated or purchased	943,812	-	-	943,812
Assets repaid	(748 327)	-	-	(748 327)
Reclassification*	(214,257)	-	-	(214,257)
Foreign exchange adjustments	(2,140)	-	-	(2,140)
ECL as at 31.12.2018	**50,135**	**-**	**-**	**50,135**

* Due to cancellation of a credit institution's activity licenses for ABLV Bank AS in July 2018, the Group and Bank's due to ABLV Bank in amount of 1,428,736 EUR were reclassified from due to credit institutions to loans and advances to customers as loans to legal entities.

The table below discloses the Group and Bank's balances due from banks by their ratings as at 31 December 2018 and 31 December 2017:

	31.12.2018		31.12.2017	
Rating	**Due from banks**		**Due from banks**	
	EUR	%	EUR	%
A1 to A3	817,694	1,85%	21,872,641	24,46%
Baa1 to Baa3	21,413,392	48,47%	25,034,600	27,99%
Ba1 to Ba3	11,323,182	25,63%	5,561,413	6,22%
B1 to B3	91,573	0,21%	1,923,410	2,15%
Below B3	10,478,067	23,71%	24,767,314	27,69%
	44,123,908	**99,87%**	**79,159,378**	**88,51%**
Without rating	58,598	0,13%	10,280,074	11,49%
ECL allowances	(50,135)	-	-	-
Balances due from banks, net	**44,132,371**	**100%**	**89,439,452**	**100,00%**

13. Loans and advances to customers

Analysis of loans by customer profile and type of loans:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Loans to legal entities	101,322,199	104,084,869	112,308,189	114,809,022
Loans to private individuals, except for mortgages	6,237,636	6,237,636	*10,788,782	*10,788,782
Mortgages	165,656	165,656	*218,879	*218,879
Total loans and advances to customers, gross	**107,725,491**	**110,488,161**	**123,304,831**	**125,805,664**
Allowances for loan impairment	(22,227,012)	(22,227,707)	(27,000,631)	(27,000,631)
Total loans and advances to customers, net	**85,498,479**	**88,260,454**	**96,304,200**	**98,805,033**

Notes to the financial statements *(cont'd)*

13. Loans and advances to customers *(cont'd)*

*In 2018 the amount of mortgages has been revised and amount of EUR 1 382 445 was reclassified to loans to private individuals, except for mortgages.

Category	31.12.2017	Reclassification	Restated 31.12.2017
Mortgages	9,406,337	(1,382,445)	218,879
Loan to private individuals, except for mortgages	1,590,305	1,382,445	10,788,782

The table below discloses an analysis of changes in gross carrying value and corresponding ECL allowance on amounts Group's loans and advances to customers during the year ended 31 December 2018 is as follows:

Loans to legal entities	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**58,226,142**	**20'258'440**	**33,823,607**	**112,308,189**
New assets originated or purchased	106,790,297	10,838,046	419'776	118,048,119
Assets repaid	(90'175,110)	(31,078,330)	(2'698'299)	(123,951,739)
Reclassification*	1,428,736	-	-	1,428,736
Assets sold	-	-	(9'952'684)	(9'952'684)
Transfers to Stage 1	906,377	(906,377)	-	-
Transfers to Stage 2	(20,961,305)	20,961,305	-	-
Transfers to Stage 3	(62'130)	(2'655'476)	2'717'606	-
Amounts written off	-	-	(172'219)	(172'219)
Foreign exchange adjustments	2'239'306	834'396	540'095	3'613'797
Gross carrying value as at 31.12.2018	**58,392,313**	**18'252'004**	**24,677,882**	**101,322,199**

Loans to legal entities	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**1,248,482**	**2,494,253**	**24,078,733**	**27,821,468**
New assets originated or purchased	1,922,318	4,985,556	1,860,747	8,768,621
Assets repaid	(2,228,461)	(5,155,523)	(3,084,213)	(10,468,197)
Reclassification*	214,257	-	-	214,257
Assets sold	-	-	(7,734,827)	(7,734,827)
Transfers to Stage 1	138,228	(138,228)	-	-
Transfers to Stage 2	(512,812)	512,812	-	-
Transfers to Stage 3	(2,195)	(457,851)	460,046	-
Amounts written off	-	-	(172,219)	(172,219)
Foreign exchange adjustments	45,118	77,205	466,118	588,441
ECL as at 31.12.2018	**824,935**	**2,318,224**	**15,874,385**	**19,017,544**

* Due to cancellation of a credit institution's activity licenses for ABLV Bank AS in July 2018, the Group due to ABLV Bank in 1,428,736 EUR reclassified from due to credit institutions to loans and advances to customers as loans to legal entities.

13. Loans and advances to customers *(cont'd)*

Loans to private individuals, except for mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**195,943**	**7,535,734**	**3,047,105**	**10,778,782**
New assets originated or purchased	420,032	775,806	564	1,196,402
Assets repaid	(429,009)	(3,015,739)	(15,389)	(3,460,137)
Assets sold	-	-	(2,294,372)	(2,294,372)
Transfers to Stage 1	12,254	(12,254)	-	-
Transfers to Stage 2	(149,332)	149,332	-	-
Transfers to Stage 3	(1,219)	(11)	1,230	-
Amounts written off	-	-	(21,796)	(21,796)
Foreign exchange adjustments	(2,946)	9,965	31,738	38,757
Gross carrying value as at 31.12.2018	**45,723**	**5,442,833**	**749,080**	**6,237,636**

Loans to private individuals, except for mortgages	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**9,598**	**1,688,840**	**2,935,527**	**4,633,965**
New assets originated or purchased	10,417	1,962,218	58,359	2,030,994
Assets repaid	(13,130)	(1,210,038)	(71,961)	(1,295,129)
Assets sold	-	-	(2,185,307)	(2,185,307)
Transfers to Stage 1	2,446	(2,446)	-	-
Transfers to Stage 2	(8,265)	8,265	-	-
Transfers to Stage 3	(7)	-	7	-
Amounts written off	-	-	(21,796)	(21,796)
Foreign exchange adjustments	99	1,027	34,252	35,378
ECL as at 31.12.2018	**1,158**	**2,447,866**	**749,081**	**3,198,105**

Mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**208,195**	**-**	**10,684**	**218,879**
New assets originated or purchased	11,678	2,950	-	14,628
Assets repaid	(56,110)	(17,751)	-	(73,861)
Transfers to Stage 1	115,092	(115,092)	-	-
Transfers to Stage 2	(128,429)	128,429	-	-
Foreign exchange adjustments	4,546	1,464	-	6,010
Gross carrying value as at 31.12.2018	**154,972**	**-**	**10,684**	**165,656**

Mortgages	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**2,135**	**-**	**10,684**	**12,819**
New assets originated or purchased	641	6,608	-	7,249
Assets repaid	(7,739)	(1,122)	-	(8,861)
Transfers to Stage 1	7,313	(7,313)	-	-
Transfers to Stage 2	(1,733)	1,733	-	-
Foreign exchange adjustments	62	94	-	156
ECL as at 31.12.2018	**679**	**-**	**10,684**	**11,363**

13. Loans and advances to customers *(cont'd)*

The table below discloses an analysis of changes in gross carrying value and corresponding ECL allowance on amounts Bank's loans and advances to customers during the year ended 31 December 2018 is as follows:

Loans to legal entities	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**60,726,975**	**20'258'440**	**33,823,607**	**114'809'022**
New assets originated or purchased	107,158,591	10,838,046	419,776	118,416,413
Assets repaid	(90,281,567)	(31,078,330)	(2'698'299)	(124,058,196)
Reclassification*	1,428,736	-	-	1,428,736
Assets sold	-	-	(9'952'684)	(9'952'684)
Transfers to Stage 1	906,377	(906,377)	-	-
Transfers to Stage 2	(20,961,305)	20,961,305	-	-
Transfers to Stage 3	(62'130)	(2'655'476)	2'717'606	-
Amounts written off	-	-	(172'220)	(172'220)
Foreign exchange adjustments	2'239'306	834'396	540'096	3'613'798
Gross carrying value as at 31.12.2018	**61,154,983**	**18'252'004**	**24,677,882**	**104'084'869**

Loans to legal entities	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**1,248,482**	**2,494,253**	**24,078,733**	**27,821,468**
New assets originated or purchased	1,936,042	4,985,556	1,860,747	8,782,345
Assets repaid	(2,241,490)	(5,155,523)	(3,084,213)	(10,481,226)
Reclassification*	214,257	-	-	214,257
Assets sold	-	-	(7,734,827)	(7,734,827)
Transfers to Stage 1	138,228	(138,228)	-	-
Transfers to Stage 2	(512,812)	512,812	-	-
Transfers to Stage 3	(2,195)	(457,851)	460,046	-
Amounts written off	-	-	(172,219)	(172,219)
Foreign exchange adjustments	45,118	77,205	466,118	588,441
ECL as at 31.12.2018	**825,630**	**2,318,224**	**15,874,385**	**19,018,239**

* Due to cancellation of a credit institution's activity licenses for ABLV Bank AS in July 2018, the Bank's due to ABLV Bank in 1,428,736 EUR reclassified from due to credit institutions to loans and advances to customers as loans to legal entities.

Loans to private individuals, except for mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**195,943**	**7,535,734**	**3,047,105**	**10,778,782**
New assets originated or purchased	420,032	775,806	564	1,196,402
Assets repaid	(429,009)	(3,015,739)	(15,389)	(3,460,137)
Assets sold	-	-	(2,294,372)	(2,294,372)
Transfers to Stage 1	12,254	(12,254)	-	-
Transfers to Stage 2	(149,332)	149,332	-	-
Transfers to Stage 3	(1,219)	(11)	1,230	-
Amounts written off	-	-	(21,796)	(21,796)
Foreign exchange adjustments	(2,946)	9,965	31,738	38,756
Gross carrying value as at 31.12.2018	**45,723**	**5,442,833**	**749,080**	**6,237,636**

Loans to private individuals, except for mortgages	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**9,598**	**1,688,840**	**2,935,527**	**4,633,965**
New assets originated or purchased	10,417	1,962,218	58,359	2,030,994
Assets repaid	(13,130)	(1,210,038)	(71,961)	(1,295,129)
Assets sold	-	-	(2,185,307)	(2,185,307)
Transfers to Stage 1	2,446	(2,446)	-	-
Transfers to Stage 2	(8,265)	8,265	-	-
Transfers to Stage 3	(7)	-	7	-
Amounts written off	-	-	(21,796)	(21,796)
Foreign exchange adjustments	99	1,027	34,252	35,378
ECL as at 31.12.2018	**1,158**	**2,447,866**	**749,081**	**3,198,105**

13. Loans and advances to customers *(cont'd)*

Mortgages	Stage 1	Stage 2	Stage 3	Total
Gross carrying value as at 01.01.2018	**208,195**	**-**	**10,684**	**218,879**
New assets originated or purchased	11,678	2,950	-	14,628
Assets repaid	(56,110)	(17,751)	-	(73,861)
Transfers to Stage 1	115,092	(115,092)	-	-
Transfers to Stage 2	(128,429)	128,429	-	-
Foreign exchange adjustments	4,546	1,464	-	6,010
Gross carrying value as at 31.12.2018	**154,972**	**-**	**10,684**	**165,656**

Mortgages	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**2,135**	**-**	**10,684**	**12,819**
New assets originated or purchased	641	6,608	-	7,249
Assets repaid	(7,739)	(1,122)	-	(8,861)
Transfers to Stage 1	7,313	(7,313)	-	-
Transfers to Stage 2	(1,733)	1,733	-	-
Foreign exchange adjustments	62	94	-	156
ECL as at 31.12.2018	**679**	**-**	**10,684**	**11,363**

The table below shows the loans by credit quality issued by the Group as at 31 December 2017:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Loans that are neither past due nor impaired				
- Standard loans	60,656,723	195,719	208,195	61,060,637
- Close-watch loans	-	-	-	**-**
- Substandard	-	-	-	**-**
Total neither past due nor impaired	**60,656,723**	**195,719**	**208,195**	**61,060,637**
Past due but not impaired				
- past due less than 30 days	9,443,052	-	-	9,443,052
- past due from 30 to 90 days	8,379,518	11	-	8,379,529
- past due from 91 to 180 days	-	*7,535,723	-	7,535,723
- past due 181 to 360 days	197,962	114	-	198,076
- past due over 360 days	55	110	-	165
Total past due but not impaired	**18,020,587**	**7,535,958**	**-**	**25,556,545**
Individually impaired loans (gross amount)				
- not past due	14,207,459	-	1,058,911	15,266,370
- past due less than 30 days	9,287	-	-	9,287
- past due from 30 to 90 days	174,857	-	-	174,857
- past due from 91 to 180 days	2,134,581	-	-	2,134,581
- past due 181 to 360 days	5,202,448	-	-	5,202,448
- past due over 360 days	11,902,247	1,674,660	323,199	13,900,106
Total individually impaired loans (gross)	**33,630,879**	**1,674,660**	**1 382 110**	**36,687,649**
Allowances for loan impairment	**(24,049,753)**	**(1,674,660)**	**(1 276 218)**	**(27,000,631)**
Loans and advances to customers, net	**88,258,436**	**7,731,677**	**314,087**	**96,304,200**

* At the end of 2017, the bank's decision-making bodies agreed on a new repayment schedule and on 18 January 2018 signed the corresponding amendments to the loan agreement. Therefore, the delay in the loan repayment is of a technical nature which does not affect the borrower's ability to settle its contractual liabilities to the Bank as they fall due.

13. Loans and advances to customers *(cont'd)*

The table below shows the loans by credit quality issued by the Bank as at 31 December 2017:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Loans that are neither past due nor impaired				
- Standard loans	63,157,556	195,719	208,195	63,561,470
- Close-watch loans	-	-	-	-
- Substandard	-	-	-	-
Total neither past due nor impaired	**63,157,556**	**195,719**	**208,195**	**63,561,470**
Past due but not impaired				
- past due less than 30 days	9,443,052	-	-	9,443,052
- past due from 30 to 90 days	8,379,518	11	-	8,379,529
- past due from 91 to 180 days	-	7,535,723	-	7,535,723
- past due 181 to 360 days	197,962	114	-	198,076
- past due over 360 days	55	110	-	165
Total past due but not impaired	**18,020,587**	**7,535,958**	**-**	**25,556,545**
Individually impaired loans (gross amount)				
- not past due	14,207,459	-	1,058,911	15,266,370
- past due less than 30 days	9,287	-	-	9,287
- past due from 30 to 90 days	174,857	-	-	174,857
- past due from 91 to 180 days	2,134,581	-	-	2,134,581
- past due 181 to 360 days	5,202,448	-	-	5,202,448
- past due over 360 days	11,902,247	1,674,660	323,199	13,900,106
Total individually impaired loans (gross)	**33,630,879**	**1,674,660**	**1 382 110**	**36,687,649**
Allowances for loan impairment	**(24,049,753)**	**(1,674,660)**	**(1 276 218)**	**(27,000,631)**
Loans and advances to customers, net	**90,759,269**	**7,731,677**	**314 087**	**98,805,033**

The table below discloses the changes in the Group's and Bank's allowances for loan impairment in 2017:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Allowances for loan impairment as at 1 January 2017	**31,939,011**	**1,631,518**	**1,437,457**	**35,007,986**
Increase in allowances for loan impairment for the year	(341,199)	16,740	(48)	(324,507)
Write-off of loans	(5,714,742)	(213)	-	(5,714,955)
Effect of currency fluctuations	(1,833,316)	26,615	(161,192)	(1,967,893)
Allowances for loan impairment as at 31 December 2017	**24,049,754**	**1,674,660**	**1,276,217**	**27,000,631**

13. Loans and advances to customers *(cont'd)*

Risk concentration in the loan portfolio by industry profile:

	31.12.2018 Group EUR	%	31.12.2018 Bank EUR	%	31.12.2017. Group EUR	%	31.12.2017. Bank EUR	%
Trade and commercial activities	37,535,022	34.84	37,535,022	33.97	47,320,329	38,38	47,320,329	37,61
Private individuals	6,403,292	5.94	6,403,292	5.80	10,996,642	8,92	10,996,642	8,74
Agriculture and food industry	4,066,677	3.78	4,066,677	3.68	5,206,663	4,22	5,206,663	4,14
Construction and operations with real estate	16,633,959	15.44	19,396,629	17.56	13,909,347	11,28	16,410,180	13,04
Transport and communications	32,039,854	29.74	32,039,854	29.00	29,793,285	24,16	29,793,285	23,68
Manufacturing	5,488,419	5.10	5,488,419	4.97	8,967,536	7,27	8,967,536	7,13
Tourism and hotel services, restaurant business	633,546	0.59	633,546	0.57	1,901,576	1,54	1,901,576	1,51
Financial services	4,004,905	3.72	4,004,905	3.62	4,241,432	3,44	4,241,432	3,37
Other	919,817	0.85	919,817	0.83	968,021	0,79	968,021	0,78
Total loans and advances to customers (before impairment allowances)	**107,725,491**	**100%**	**110,488,161**	**100%**	**123,304,831**	**100%**	**125,805,664**	**100%**

As at 31 December 2018, the total amount of loans issued to 10 largest Group's and Bank's customers was EUR 63,271,497 (2017: EUR 63,442,161), which comprises 57,27% of the total credit portfolio (2017: 50.43%).

As at 31 December 2018, the loans to 10 largest Group's and Bank's customers were secured by deposits amounting to EUR 2,704,395 (31 December 2017: EUR 7,591,813).

Notes to the financial statements *(cont'd)*

13. Loans and advances to customers *(cont'd)*

The table below presents the information on the secured loans issued by the Group as at 31 December 2017:

	Loans to legal entities EUR	Loans to private individuals, except for mortgages EUR	Mortgages EUR	Total EUR
Unsecured	5,275,722	1,841,041	323,199	7,439,962
Loans with sufficient collateral:				
- residential real estate	708,440	28,838	208,195	945,473
- other real estate	52,396,634	7,535,723	-	59,932,357
- cash deposits	1,925,760	2	-	1,925,762
- securities	611,899	-	-	611,899
- guarantees and other assets	34,903,580	733	-	34,904,313
Loans with insufficient collateral:				
- residential real estate	238,820	-	-	238,820
- other real estate	11,621,123	-	1,058,911	12,680,034
- cash deposits	3,173,332	-	-	3,173,332
- securities	-	-	-	-
- guarantees and other assets	1,452,879	-	-	1,452,879
Total loans and advances to customers (before impairment allowances)	**112,308,189**	**9,406,337**	**1,590,305**	**123,304,831**

The table below presents the information on the secured loans issued by the Bank as at 31 December 2017:

	Loans to legal entities EUR	Loans to private individuals, except for mortgages EUR	Mortgages EUR	Total EUR
Unsecured	5,275,722	1,841,041	323,199	7,439,962
Loans with sufficient collateral:				
- residential real estate	708,440	28,838	208,195	945,473
- other real estate	52,396,634	7,535,723	-	59,932,357
- cash deposits	4,426,593	2	-	4,426,595
- securities	611,899	-	-	611,899
- guarantees and other assets	34,903,580	733	-	34,904,313
Loans with insufficient collateral:				
- residential real estate	238,820	-	-	238,820
- other real estate	11,621,123	-	1,058,911	12,680,034
- cash deposits	3,173,332	-	-	3,173,332
- securities	-	-	-	-
- guarantees and other assets	1,452,879	-	-	1,452,879
Total loans and advances to customers (before impairment allowances)	**114,809,022**	**9,406,337**	**1,590,305**	**125,805,664**

13. Loans and advances to customers *(cont'd)*

The recoverable amount of collateral in respect of the Group's and Bank's loans past due but not impaired and loans individually impaired as at 31 December 2017 can be specified as follows:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Recoverable amount of collateral – loans past due but not impaired				
- Residential real estate	-	-	-	-
- Other real estate objects	9,495,855	7,535,723	-	17,031,578
- Cash deposits	-	-	-	-
- Other assets	8,522,913	-	-	8,522,913
Recoverable amount of collateral – individually impaired loans				
- Residential real estate	66,313	-	-	66,313
- Other real estate objects	18,675,410	-	774,606	19,450,017
- Cash deposits	-	-	-	-
- Other assets	4,377,223	-	-	4,377,223
Total	**41,137,714**	**7,535,723**	**774,606**	**49,448,043**

The financial effect of collateral is presented by disclosing separately impact (i) on assets with collateral equal or in excess of the carrying amount of assets ("Assets with collateral value exceeding the loan balance"), and (ii) on assets with collateral less than the carrying amount of assets ("Assets with insufficient collateral").

The values of collateral disclosed under the heading "Recoverable amount of collateral" represent the estimated recoverable amount which can be obtained from repossession and subsequent sale of collaterals and which has been applied in the assessment of the loan impairment. These values are lower than the fair values estimated by independent appraisers. The haircut applied to the fair values is associated to a large extent with the uncertainty described in Note 2 "Operating Environment of the Group and the Bank".

The above along with other uncertainties, may impact the expenses for foreclosure and sale of collateral as well as the price and timing of the sale of collateral.

The analysis of the Group's collateral as at 31 December 2018 is as follows:

	Assets with collateral value exceeding the loan balance		Assets with insufficient collateral	
	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral
	EUR	EUR	EUR	EUR
Loans to legal entities	68'323'101	138'073'570	32'854'170	10'267'736
Loans to individuals – consumer loans	5'452'395	12'413'009	471'668	-
Mortgages	154'973	583'349	323'046	-
Total	**73'930'469**	**151'069'928**	**33'648'884**	**10'267'736**

13. Loans and advances to customers *(cont'd)*

The analysis of the Bank's collateral as at 31 December 2018 is as follows:

	Assets with collateral value exceeding the loan balance		Assets with insufficient collateral	
	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral
	EUR	EUR	EUR	EUR
Loans to legal entities	68'323'101	138'073'570	35'616'766	12'935'799
Loans to individuals – consumer loans	5'452'395	12'413'009	471'668	-
Mortgages	154'973	583'349	323'046	-
Total	**73'930'469**	**151'069'928**	**36'411'480**	**12'935'799**

The analysis of the Group's collateral as at 31 December 2017 is as follows:

	Assets with collateral value exceeding the loan balance		Assets with insufficient collateral	
	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral
	EUR	EUR	EUR	EUR
Loans to legal entities	90,546,313	192,673,157	21,761,876	11,211,805
Loans to individuals – consumer loans	7,565,296	13,385,760	1,841,041	-
Mortgages	208,195	559,672	1,382,110	774,606
Total	**98,319,804**	**206,618,589**	**24,985,027**	**11,986,411**

The analysis of the Bank's collateral as at 31 December 2017 is as follows:

	Assets with collateral value exceeding the loan balance		Assets with insufficient collateral	
	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral	Carrying amount of asset (before impairment allowances)	Recoverable amount of collateral
	EUR	EUR	EUR	EUR
Loans to legal entities	93,047,146	195,447,601	21,761,876	11,211,805
Loans to individuals – consumer loans	7,565,296	13,385,760	1,841,041	-
Mortgages	208,195	559,672	1,382,110	774,606
Total	**100,820,637**	**209,393,033**	**24,985,027**	**11,986,411**

14. Financial assets at fair value through profit or loss

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Latvian government bonds	1,273,368	1,273,368	1,505,882	1,505,882
OECD government bonds	21,153,385	21,153,385	54,316,443	54,316,443
OECD corporate bonds	2,290,225	2,290,225	3,980,143	3,980,143
Non-OECD corporate bonds	524,700	524,700	540,411	540,411
Unquoted shares	7,808	7,808	7,455	7,455
	25,249,486	**25,249,486**	**60,350,334**	**60,350,334**

The analysis of the Group and Bank's securities by issuers' ratings:

Rating	31.12.2018 Securities EUR	%	31.12.2017 Securities EUR	%
Aaa to Aa3	12,903,680	51,10%	46,157,114	76,48%
A1 to A3	11,331,446	44,88%	12,136,715	20,11%
Baa1 to Baa3	1,006,552	3,99%	2,012,915	3,34%
Ba1 to Ba3	-	-	16,052	0,03%
B1 to B3	-	-	20,083	0,03%
Below B3	7,808	0,03%	7,455	0,01%
	25,249,486	**100%**	**60,350,334**	**100%**
Without rating	-	-	-	-
	25,249,486	**100%**	**60,350,334**	**100%**

Notes to the financial statements *(cont'd)*

15. Investment in subsidiary

The table below discloses the Bank's investment in its subsidiary as at 31 December 2018.

Company	Address	Share capital	Bank's interest	Equity	Assets as at 31.12.2018	(Loss) for the reporting year
Grunewald Residence SIA	Jura Alunāna Street 2, Riga, LV-1010	6,100,000	92,42%	6,424,020	9,211,287	(74,055)

The table below discloses the Bank's investment in its subsidiary as at 31 December 2017.

Company	Address	Share capital	Bank's interest	Equity	Assets as at 31.12.2018	(Loss) for the reporting year
Grunewald Residence SIA	Jura Alunāna Street 2, Riga, LV-1010	6,600,000	100%	6,468,075	9,009,995	(81,584)

At the end of 2017, a real estate – a land plot with buildings in an exclusive district of Berlin, Germany – was acquired by the subsidiary within a framework of the debt recovery procedure against a Bank's borrower. The acquisition was carried out with a view to developing and selling the property. The real estate is encumbered with rent agreements for the termination of which and for providing legal assistance in respect of the real estate in general, the subsidiary has hired one of the leading law firms in Berlin. The providers of legal assistance believe in a positive outcome concerning the possibility to terminate the rent. In 2018 first court proceeding were held and this process will continue in 2019. At the same time, the subsidiary has commissioned one of the leading architectural practices in Berlin a design for the real estate development, project documentation was delivered as agreed, building permit was issued on June 01, 2018 .

According to the estimates of an independent valuer, the value of the real estate as at the end of the year 2018 is EUR 9.0 million (see Note 19 on the estimates used in the valuation). If the real estate had not been encumbered with rent agreements and without any measures taken for its improvement, its value would have been EUR 20.4 million (according to the valuation obtained in the beginning of 2018).

Given the upward tendencies in the real estate market in Berlin, it is expected that the value of the real estate owned by the subsidiary will grow. On December 19, 2018, the 500,000 of company's shares sold to third party, as a result total direct Bank's investment into this subsidiary, as at December 31, 2018 was 92.42%..

16. Intangible assets

Changes in the Group and Bank's intangible assets in 2018 and 2017 can be specified as follows:

	Software 2018 EUR	Pre-payments 2018 EUR	Total software 2018 EUR	Software 2017 EUR	Pre-payments 2017 EUR	Total software 2017 EUR
Cost						
At the beginning of the year	2,100,907	27,323	2,128,230	1,717,001	229,766	1,946,767
Reclassified				-	(229,766)	(229,766)
Additions	48,736	42,811	91,547	384,108	27,323	411,431
Disposals	-			(202)	-	(202)
At the end of the year	**2,149,643**	**70,134**	**2,219,777**	**2,100,907**	**27,323**	**2,128,230**
Amortization						
Accumulated amortization at the beginning of the year	1,555,082	-	1,555,082	1,421,772	-	1,421,772
Charge for the year	161,809	-	161,809	133,512	-	133,512
On disposals	-	-	-	(202)	-	(202)
Accumulated amortization at the end of the year	**1,716,891**	**-**	**1,716,891**	**1,555,082**	**-**	**1,555,082**
Net carrying amount at the beginning of the year	**545,825**	**27,323**	**573,148**	**295,229**	**229,766**	**524,995**
Net carrying amount at the end of the year	**432,752**	**70,134**	**502,886**	**545,825**	**27,323**	**573,148**

As at 31 December 2018, a number of assets that have been fully amortized are still in active use. The total original cost value of these assets as at the end of the year was EUR 1,375,886 (31 December 2017: EUR 1,330,043).

Intangible assets are amortized over their estimated useful lives, not exceeding 5 years, on a straight-line basis and disclosed under the amortization and depreciation caption of the statement of comprehensive income.

Notes to the financial statements *(cont'd)*

17. Property, plant and equipment

Changes in the Group's and Bank's property and equipment in 2018 can be specified as follows:

	Land and building EUR	Transport vehicles EUR	Computers EUR	Office equipment EUR	Other assets EUR	Pre-payment EUR	Total EUR
Cost							
As at 31.12.2017	**13,335,313**	**89,012**	**1,195,212**	**602,596**	**100,927**	**9,548**	**15,332,608**
Additions	-	-	6,208	1,972	-	1,973	10,153
Disposals	-	(23,833)	(112,659)	(322)	-	-	(136,814)
Reclassified	(313)	-	-	313	-	-	-
Revaluation	-	-	-	-	-	-	-
As at 31.12.2018	**13,335,000**	**65,179**	**1,088,761**	**604,559**	**100,927**	**11,521**	**15,205,947**
Depreciation							
As at 31.12.2017	**-**	**73,097**	**835,055**	**547,401**	**55,048**	**-**	**1,510,601**
On disposals	-	(23,833)	(112,315)	(322)	-	-	(136,470)
Revaluation	-	-	-	-	-	-	-
Charge for 2018	150,899	11,782	182,479	19,845	6,116	-	371,121
As at 31.12.2018	**150,899**	**61,046**	**905,219**	**566,924**	**61,164**	**-**	**1,745,252**
Net carrying amount as at 31.12.2017	**13,335,313**	**15,915**	**360,157**	**55,195**	**45,879**	**9,548**	**13,822,007**
Net carrying amount as at 31.12.2018	**13,184,101**	**4,133**	**183,542**	**37,635**	**39,763**	**11,521**	**13,460,695**

As at 31 December 2018, a number of assets that have been fully amortized are still in active use. The total original cost value of these assets as at the end of the year was EUR 1,123,567 (31 December 2017: EUR 1,258,363).

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset applying the depreciation rates established by the Management and disclosed under the amortization and depreciation caption of the statement of comprehensive income.

At the end of the year 2018, the Bank performed the revaluation of the building on the basis of a valuation carried out by an independent certified valuator in accordance with international standards. The fair value of the building was determined using the income approach method. The expected 2-year cash flow was discounted applying a discount rate of 7%; the reversion capitalization rate was 6%. The forecasts were based on the rental income. As a result of the revaluation, the Bank's building value was set at EUR 13,410 million. EUR.

The sensitivity analysis reveals that decrease or increase of the discount rate by 1% would increase the value of the Bank's building by EUR 250,000 or decrease by EUR 240,000.

17. Property, plant and equipment *(cont'd)*

Changes in the Group's and Bank's property and equipment in 2017 can be specified as follows:

	Land and building EUR	Transport vehicles EUR	Computers EUR	Office equipment EUR	Other assets EUR	Pre-payment EUR	Total EUR
Cost							
As at 31.12.2016	**14,748,664**	**89,012**	**791,518**	**594,592**	**100,927**	**164,763**	**16,489,476**
Additions	-	-	240,569	11,065	-	9,548	261,182
Disposals	-	-	(1,325)	(3,061)	-		(4,386)
Reclassified	313	-	164,450	-		(164,763)	-
Revaluation	(1,413,664)	-	-	-	-	-	(1,413,664)
As at 31.12.2017	**13,335,313**	**89,012**	**1,195,212**	**602,596**	**100,927**	**9,548**	**15,332,608**
Depreciation							
As at 31.12.2016	**298,620**	**60,061**	**685,814**	**527,653**	**48,930**	**-**	**1,621,078**
On disposals	-	-	(1,325)	(3,051)	-	-	(4,376)
Revaluation	(477,792)	-	-	-	-	-	(477,792)
Charge for 2017	179,172	13,036	150,566	22,799	6,118	-	371,691
As at 31.12.2017	**-**	**73,097**	**835,055**	**547,401**	**55,048**	**-**	**1,510,601**
Net carrying amount as at 31.12.2016	**14,450,044**	**28,951**	**105,704**	**66,939**	**51,997**	**164,763**	**14,868,398**
Net carrying amount as at 31.12.2017	**13,335,313**	**15,915**	**360,157**	**55,195**	**45,879**	**9,548**	**13,822,007**

At the end of the year 2017, the Bank performed the revaluation of the building on the basis of a valuation carried out by an independent certified valuator in accordance with international standards. The fair value of the building was determined using the income approach method. The expected 5-year cash flow was discounted applying a discount rate of 7%; the reversion capitalization rate was 6%. The forecasts were based on the rental income. As a result of the revaluation, the Bank recognized an impairment of EUR 935,872.

The sensitivity analysis reveals that decrease or increase of the discount rate by 1% would increase the value of the Bank's building by EUR 572,000 or decrease by EUR 542,000.

18. Equity instruments at fair value through other comprehensive income

Equity instruments at fair value through other comprehensive income represent the VISA Inc preference shares obtained by the Bank in the context of the sale of shares of VISA Europe Limited to VISA Inc.

19. Other assets

Other assets in breakdown between financial assets and non-financial assets can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Financial assets, incl.:	5,885,247	5,869,670	3,878,758	3,280,184
– Security deposits	1,259,501	1,259,501	1,201,604	1,201,604
– Accounts receivable	256,613	246,036	370,537	255,395
– Interbank settlements in progress	102,865	102,865	1,008,661	1,008,661
– Other financial assets	4,266,268	4,261,268	1,297,956	814,524
Non-financial assets	12,579,140	3,390,613	11,516,593	3,462,286
– repossessed collaterals	11,354,969	2,166,442	10,328,063	2,273,756
– Investment gold	1,224,171	1,224,171	1,188,530	1,188,530
Total other assets, gross	**18,464,387**	**9,260,283**	**15,395,351**	**6,742,470**
Impairment allowances for financial assets	(91,987)	(91,987)	(114,188)	(114,188)
Total other assets, net:	**18,372,400**	**9,168,296**	**15,281,163**	**6,628,282**

Accounts receivable and other financial assets represent balances due from customers and business partners amounting to EUR 91,987 (2017: EUR 114,188), which have been fully provided for.

The analysis of the changes in the ECLs associated with other financial assets for the year ended 31 December 2018 is as follows:

	Stage 1	Stage 2	Stage 3	Total
ECL as at 1 January 2018	**361**	**-**	**17,285**	**17,646**
Transfers to Stage 1	-	-	-	**-**
Transfers to Stage 2	-	-	-	**-**
Transfers to Stage 3	(187)	-	187	-
ECL charge	5,491	-	78,247	83,738
Amounts written off	(38)	-	(9,359)	(9,397)
Foreign exchange adjustments	-	-	-	-
As at 31 December 2018	**5,627**	**-**	**86,360**	**91,987**

Changes in the allowances for impairment of other financial assets of the Group and the Bank in 2017 can be specified as follows:

	Receivables EUR	Balanced due from customers EUR	Total EUR
Allowances for impairment of other financial assets as at 1 January 2017	**-**	**94,480**	**94,480**
Increase in allowances for impairment of other financial assets	27,285	130,581	157,866
Write-offs of other financial assets	(10,000)	(128,158)	(138,158)
Allowances for impairment of other financial assets as at 31 December 2017	**17,285**	**96,903**	**114,188**

19. Other assets *(cont'd)*

In non-financial assets the Group and Bank include assets obtained through repossessing collaterals which had served as security for loans and are intended for sale. The repossessed assets include private property and land plots in Latvia and Ukraine and for the Group – also in Germany (see Note 15). Non-financial assets are stated at fair value determined according to the valuation carried out by an independent certified valuer in accordance with international standards.

The table below summarizes the methods used by the Group and Bank in determining the fair value of non-financial assets.

No	Property	Municipality	City/ pagasts	Carrying value EUR	Methods used in fair value measurement
1	Land	Riga	Riga	22,000	Market (comparables) approach
2	Apartment	Riga	Riga	174,300	Market (comparables) approach
3	Multi-apartment building	Riga	Riga	507,094	Income approach
4	Office premises	Odes	Odes	1,000,584	Market (comparables) approach
5	Warehouse premises	Kharkiv	Vasyshcheve	172,678	Market (comparables) approach
6	Warehouse and production premises	Kiev	Fastov	289,786	Market (comparables) approach
Total Bank's repossessed assets				2,166,442	
7	Land	Berlin	Berlin	9,188,527	Income approach
Total Group's repossessed assets				11,354,969	

In the reporting year, profit of non-financial assets of EUR 370,276 was recognized (2017: impairment EUR 1,031,940) and disclosed in the statement of comprehensive income under other expense.

20. Cash and cash equivalents

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Cash and balances with the Bank of Latvia (Note 11)	95,098,162	95,098,162	90,638,213	90,638,213
Balances due form other banks with original maturity of 3 months or less	44,080,337	44,080,337	85,920,263	85,920,263
Total	**139,178,499**	**139,178,499**	**176,558,476**	**176,558,476**

21. Deposits from customers

(a) Analysis of deposits by customer profile

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Legal entities				
– - current/ settlement accounts	162,160,399	162,167582	229,487,569	229,835,683
– - term deposits	10,042,703	10,042,703	27,435,077	27,435,077
Private individuals				
– - current/ settlement accounts	42,653,555	42,653,555	33,520,614	33,520,614
– - term deposits	2,973,786	2,973,786	6,039,189	6,039,189
Total deposits from customers:	**217,830,443**	**217,837,626**	**296,482,449**	**296,830,563**
Sector:				
Private companies	138,756,333	138,763,516	255,621,873	255,969,987
Private individuals	45,627,341	45,627,341	39,559,803	39,559,803
Financial institutions	33,213,991	33,213,991	1,283,020	1,283,020
Non-profit institutions	199,664	199,664	8,120	8,120
Institutions of financial institutions and money lenders	33,114	33,114	-	-
Latvian government	-	-	9,633	9,633
Total deposits from customers:	**217,830,443**	**217,837,626**	**296,482,449**	**296,830,563**

(b) Analysis of deposits by place of residence

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Residents	50,907,699	50,914,881	17,437,441	17,785,555
Non-residents	166,922,744	166,922,744	279,045,008	279,045,008
Total deposits from customers:	**217,830,443**	**217,837,625**	**296,482,449**	**296,830,563**

The average interest rate on term deposits in 2018 was 3.72% (2017: 3.19%) and the average interest rate on demand deposits was 0.00% (2017: 0.00%). All deposits bear a fixed interest rate.

Deposits from customers by industry can be specified as follows:

	31.12.2018 Group EUR	%	31.12.2018 Bank EUR	%	31.12.2017 Group EUR	%	31.12.2017 Bank EUR	%
Manufacturing	334,657	0,15	334,657	0,15	1,362,152	0,46	1,362,152	0,46
Construction and real estate	7,762,032	3,57	7,769,215	3,57	9,986,205	3,37	10,334,319	3,48
Trade and commercial activities	88,082,947	40,44	88,082,947	40,44	159,712,515	53,87	159,712,515	53,80
Financial and insurance services	58,017,419	26,63	58,017,419	26,63	35,225,496	11,88	35,225,496	11,87
Transport and communications	16,085,851	7,38	16,085,851	7,38	44,850,221	15,13	44,850,221	15,11
Agriculture and food industries	39,656	0,02	39,656	0,02	81,843	0,03	81,843	0,03
Private individuals	45,627,341	20,95	45,627,341	20,95	39,559,803	13,34	39,559,803	13,33
Other	1,880,540	0,86	1,880,540	0,86	5,704,214	1,93	5,704,214	1,92
Total deposits from customers	**217,830,443**	**100%**	**217,837,626**	**100%**	**296,482,449**	**100%**	**296,830,563**	**100%**

The total amount of deposits attributable to 20 largest depositors as at 31 December 2018 was EUR 118,383,493 (2017: EUR 133,716,620), comprising 54,34% of the Bank's total portfolio (2017: 45,05%).

22. Debt securities

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Debt securities	17,558,810	17,558,810	16,763,810	16,763,810
	17,558,810	**17,558,810**	**16,763,810**	**16,763,810**

During 2016, the Bank issued debt securities in several tranches. The debt securities are offered through over-the-counter (OTC) trading and are not quoted on an open market.

The debt securities issued represent the following issues:

Subordinated bond series RIB SUBUSD-01/2016 issue totaling USD 2,200,000. The redemption date - 26 April 2021, the coupon rate - 4.50%, a coupon payment twice a year on 26 October and 26 April. Balance at 31 December 2018 amounted to EUR 1,937,009 (31 December 2017: EUR 1,849,308);

Subordinated bond series RIB SUBUSD-03/2016 issue totaling USD 14,300,000. The redemption date – 22 June 2021, the coupon rate – 4.50%, a coupon payment twice a year on 22 December and 22 June. Balance at 31 December 2018 amounted to EUR 12,503,133 (31 December 2017: EUR 11,937,036).

Subordinated bond series RIB SUBUSD-04/2016 issue totaling USD 3,500,000. The redemption date – 19 July 2021, the coupon rate – 4.50%, a coupon payment 2 times a year on 19 January and 19 July. Balance at 31 December 2018 amounted to EUR 3,118,668 (31 December 2017: EUR 2,977,466.

23. Other financial liabilities

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Liability suspense account*	6,247	6,247	55,702	55,702
Settlements on behalf of a closed bank	16,585	16,585	16,585	16,585
Cash in transit	860	860	5,334	5,334
Accounts payable	140,215	115,618	423,900	421,813
Impairment allowance for off-balance sheet liabilities	112,053	112,054	-	-
Dividend payment	2,656,244	2,656,244	-	-
	2,932,204	**2,907,608**	**501,521**	**499,434**

* The liability suspense account as at 31 December 2018 and 31 December 2017 includes the amounts erroneously transferred to the Bank, which were returned to the senders at the beginning of 2019 and 2018 respectively.

24. Accrued expense

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Vacation pay reserve	336,010	336,010	358,648	358,648
Accrual for the guarantee fund and FCMC financing	60,544	60,544	136,635	136,635
State statutory social insurance contributions	247,895	247,895	284,505	284,505
Other accrued expense	288,835	288,835	109,181	109,181
	933,284	**933,284**	**888,969**	**888,969**

25. Derivative financial instruments

The Group and the Bank use the following derivative financial instruments: currency forwards – agreements on currency acquisition in the future, currency swaps – commitments to exchange one set of cash flow for another. The Group and Bank's credit risk represents the potential cost to replace the forward contracts if the counterparties fail to perform their obligations. To control the level of credit risk taken, the Group and the Bank assess counterparty risk using the same techniques as for its lending activities.

The notional amounts of financial instruments provide a basis for comparison with instruments recognized on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments, therefore, they cannot be used for determining the level of the Group and Bank's exposure to credit risk or market risk. The derivative instruments become favorable or unfavorable as a result of fluctuations in market interest rates or foreign exchange rates.

The Group and Bank's notional amounts and fair values of derivative instruments held for trading are set out in table below.

	31.12.2018			31.12.2017		
	Notional	Fair value		Notional	Fair value	
	amount	Assets	Liabilities	amount	Assets	Liabilities
	EUR	EUR	EUR	EUR	EUR	EUR
Currency swaps	-	-	-	56,074,212	64,031	(652,280)
Currency forwards	-	-	-	612,368	724	(38)
Options	-	-	-	17,400	1,001	-
Total	**-**	**-**	**-**	**56,703,980**	**65,756**	**(652,318)**

The Group and Bank's notional amounts of derivative instruments by counterparty credit rating are set out in the table below:

	31.12.2018			31.12.2017		
	Notional	Fair value		Notional	Fair value	
	amount	Assets	Liabilities	amount	Assets	Liabilities
	EUR	EUR	EUR	EUR	EUR	EUR
Aaa to Aa3	-	-	-	-	-	-
A1 to A3	-	-	-	-	-	-
B1 to B3	-	-	-	6,077,821	9,271	(10,809)
Caa1 and below	-	-	-			
Without rating	-	-	-	50,626,159	56,485	(641,509)
Total	**-**	**-**		**56,703,980**	**65,756**	**(652,318)**

26. Share capital

The Bank's issued and fully paid share capital as at 31 December 2018 was EUR 32,334,756 (31 December 2017: EUR 32,334,762). The nominal value of one share was EUR 1.00 (31 December 2017: EUR 1.00). All shares are ordinary registered shares with voting rights. One share is one vote.

On 27 April 2016, the denomination of the share capital from the lats to the euro was registered. As a result of the denomination, a difference of EUR 6 was included in equity under reserves.

The shareholders of the Bank as at 31 December 2018 and 31 December 2017:

	31.12.2018 EUR	%	31.12.2017 EUR	%
SIA SKY Investment Holding	12,094,410	37,40	12,094,410	37,40
Juriy Rodin	6,466,198	20,00	6,466,198	20,00
AB Pivdenny	4,449,558	13,76	4,449,558	13,76
Mark Bekker	3,418,808	10,57	3,418,808	10,57
Other shareholders (with less than 10% of shares)	5,905,782	18,27	5,905,782	18,27
Total share capital paid	**32,334,756**	**100%**	**32,334,756**	**100%**

27. Off-balance items and encumbered assets

Contingent liabilities

Contingent liabilities can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Guarantees	6,934,513	6,934,513	8,931,032	8,931,032
	6,934,513	**6,934,513**	**8,931,032**	**8,931,032**

The Group and the Bank have issued guarantees amounting to EUR 6,934,513 (31 December 2017: EUR 8,931,032). These guarantees are secured by cash or loans which are blocked or reserved at the Group and the Bank and secure the Group and Bank's balances due from customers if the guarantee conditions are met.

Loan commitments

The outstanding loan commitments can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Loan commitments	2,164,429	2,168,986	9,602,234	9,602,234
Undrawn credit lines	9,383,274	9,383,274	12,143,597	12,143,597
Total loan commitments	**11,547,703**	**11,552,260**	**21,745,831**	**21,745,831**

The total outstanding contractual amount of undrawn credit lines and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being actually funded.

27. Off-balance sheet items and encumbered assets *(cont'd)*

The loan commitments are denominated in the following currencies:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
USD	144,180	144,180	6,645,685	6,645,685
EUR	2,020,249	2,024,806	2,956,549	2,956,549
Total loan commitments	**2,164,429**	**2,168,986**	**9,602,234**	**9,602,234**

The undrawn credit lines are denominated in the following currencies:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
USD	3,640,972	3,640,972	8,435,617	8,435,617
EUR	5,742,302	5,742,302	3,707,980	3,707,980
Total undrawn credit lines	**9,383,274**	**9,383,274**	**12,143,597**	**12,143,597**

The analysis of the changes in allowance for ECLs in the year ended 31 December 2018 can be specified as follows:

Loan commitments	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**259,874**	**20,425**	**-**	**280,299**
Increase	692,117	835,643	-	1,527,760
Decrease	(1,352,977)	(352,815)	-	(1,705,792)
Transfers to Stage 1	(27,723)	27,723	-	-
Transfers to Stage 2	486,265	(486,265)	-	-
Foreign exchange adjustments	7,512	1,528	-	9,040
ECL as at 31.12.2018	**65,068**	**46,239**	**-**	**111,307**

Guarantees	Stage 1	Stage 2	Stage 3	Total
ECL as at 01.01.2018	**28,830**	**-**	**-**	**28,830**
Increase	1,194	-	-	1,194
Decrease	(29,276)	-	-	(29,276)
ECL as at 31.12.2018	**748**	**-**	**-**	**748**

Where the Bank is the lessee, the future lease payments under concluded operating lease agreements are as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Up to 1 year	34,492	34,492	48,065	48,065
1 to 5 years	81,142	81,142	87,644	87,644
Over 5 years	-	-	-	-
Total operating lease liabilities	**115,634**	**115,634**	**135,710**	**135,710**

27. Off-balance sheet items and encumbered assets *(cont'd)*

Encumbered assets

The pledged and restricted assets can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Balances due from banks	6,784,766	6,784,766	17,026,611	17,026,611
Other assets	4,436,378	4,436,378	1,514,778	1,514,778
Total	**11,221,144**	**11,221,144**	**18,541,389**	**18,541,389**

All encumbered assets serve as security for the Group and Bank's financial liabilities as at 31 December 2018 and31 December 2017. The carrying amount of encumbered assets approximate their fair value both as at 31 December 2018 and as at 31 December 2017.

The encumbered assets of the Group and the Bank as at 31 December 2018 consisted of:

- Security deposits of EUR 4,436,378 for potential claims from Visa Inc, MasterCard Europe SPRL and Interactive Brokers LLC. The agreements with these organization provide for ensuring a sufficient amount of resources available in the deposit accounts with Lloyds TSB Bank plc (MasterCard Europe Sprl), U.S Bank (Visa Inc) respectively, which could cover all expenses related to the participation of the Bank in these organizations. The total amount of these encumbered assets is included under other assets.
- Security deposits of EUR 6,726,856 for the guarantees issued by the Group and the Bank. Total amount of these encumbered assets is included under the balances due from other banks.
- Security deposits of EUR 57,910 for carrying out transactions in securities and derivative financial instruments. The total amount of these encumbered assets is included under the balances due from other banks.

The encumbered assets of the Group and the Bank as at 31 December 2017 consisted of:

- Security deposits of EUR 1,514,778 for potential claims from Visa Inc, MasterCard Europe SPRL and Interactive Brokers LLC. The agreements with these organization provide for ensuring a sufficient amount of resources available in the deposit accounts with Lloyds TSB Bank plc (MasterCard Europe Sprl), U.S Bank (Visa Inc) respectively, which could cover all expenses related to the participation of the Bank in these organizations. The total amount of these encumbered assets is included under other assets.
- Security deposits of EUR 7,881,746 for the guarantees issued by the Group and the Bank. Total amount of these encumbered assets is included under the balances due from other banks.
- Security deposits of EUR 9,144,865 for carrying out transactions in securities and derivative financial instruments. The total amount of these encumbered assets is included under the balances due from other banks.

28. Capital adequacy

The Group's capital adequacy ratio according to the requirements of the Financial and Capital Market Commission is calculated as follows:

Description	31.12.2018 EUR	31.12.2017 EUR
Total own funds	**50,293,100**	**56,479,236**
– Tier 1 capital	37,639,741	38,611,886
– Common equity Tier 1 capital	37,639,741	38,611,886
– Tier 2 capital	12,653,359	17,867,350
Total risk exposure amount	**186,580,861**	**189,887,472**
– Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	153,807,198	154,754,958
– Total risk exposure amount for position, foreign exchange and commodities risks	4,158,663	7,046,938
– Total risk exposure amount for operational risk	28,615,000	27,969,088
– Total exposure amounts for credit valuation adjustment	-	116,488
Capital adequacy ratios		
– Common equity Tier 1 Capital ratio	20,17%	20,33%
– Surplus (+) / Deficit (-) of Common equity Tier 1 capital (4.5%)	29,243,602	30,066,950
– Tier 1 Capital ratio	20,17%	20,33%
– Surplus (+) / Deficit (-) of Tier 1 capital (6%)	26,444,889	27,218,638
– Total capital ratio	26,96%	29,74%
– Surplus (+) / Deficit (-) of total capital (8%)	35,366,631	41,288,238
– Capital retention reserve (%)	2.5%	2,5%
– Capital retention reserve	4,664,522	4,747,187

The Bank's capital adequacy ratio according to the requirements of the Financial and Capital Market Commission is calculated as follows:

Description	31.12.2018 EUR	31.12.2017 EUR
Total own funds	**49,962,284**	**56,581,161**
– Tier 1 capital	37,308,925	38,713,811
– Common equity Tier 1 capital	37,308,925	38,713,811
– Tier 2 capital	12,653,359	17,867,350
Total risk exposure amount	**183,617,538**	**187,834,627**
– Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	150,844,962	152,702,076
– Total risk exposure amount for position, foreign exchange and commodities risks	4,158,663	7,046,938
– Total risk exposure amount for operational risk	28,613,913	27,969,125
– Total exposure amounts for credit valuation adjustment	-	116,488
Capital adequacy ratios		
– Common equity Tier 1 Capital ratio	20,32%	20,61%
– Surplus (+) / Deficit (-) of Common equity Tier 1 capital (4.5%)	29,046,136	30,261,253
– Tier 1 Capital ratio	20,32%	20,61%
– Surplus (+) / Deficit (-) of Tier 1 capital (6%)	26,29,1873	27,443,733
– Total capital ratio	27,21%	30,12%
– Surplus (+) / Deficit (-) of total capital (8%)	35,272,881	41,554,391
– Capital retention reserve (%)	2.5%	2,5%
– Capital retention reserve	4,590,438	4,695,866

29. Analysis of assets and liabilities by currency profile

The table below provides the analysis of the Group's assets, liabilities and shareholders' equity as at 31 December 2018 by currency profile:

	USD EUR	EUR EUR	Other EUR	Total EUR
Assets				
Cash and deposits with the Bank of Latvia	401,845	94,686,900	-	95,088,745
Balances due from banks	41,870,087	1,913,850	348,434	44,132,371
Loans and advances to customers	56,912,505	28,572,551	13,423	85,498,479
Financial assets at fair value through profit or loss	23,976,119	1,273,367	-	25,249,486
Equity instruments at fair value through other comprehensive income	-	284,083	-	284,083
Intangible assets	16,993	485,893	-	502,886
Property and equipment	-	13,460,695	-	13,460,695
Corporate income tax	-	278,648	-	278,648
Prepaid expenses	14,314	205,557	1,179	221,050
Other assets	2,348,697	12,474,482	3,549,221	18,372,400
Total assets	**125,540,560**	**153,636,026**	**3,912,257**	**283,088,843**
Liabilities and equity				
Deposits from customers	96,622,172	118,599,846	2,608,425	217,830,443
Debt securities	17,558,810	-	-	17,558,810
Deferred income and accrued expense	1,284	911,318	20,682	933,284
Other liabilities	150,831	2,779,492	1,881	2,932,204
Subordinated loans	11,207,357	-	-	11,207,357
Equity	-	32,626,745	-	32,626,745
Total liabilities and equity	**125,540,454**	**154,917,401**	**2,630,988**	**283,088,843**
Net long / (short) position for statement of financial position items	106	(1,281,375)	1,281,269	-
Off-balance sheet claims arising from foreign exchange contracts	-	-	-	-
Off-balance sheet liabilities arising from foreign exchange contracts	-	-	-	-
Net long / (short) position on foreign exchange	-	-	-	-
Net long / (short) position	**106**	**(1,281,375)**	**1,281,269**	**-**
As at 31 December 2017				
Total assets	**197,277,898**	**162,147,192**	**7,538,390**	**366,963,480**
Total liabilities and equity	**242,288,071**	**117,855,577**	**6,819,832**	**366,963,480**
Net long / (short) position for statement of financial position items	**(45,010,173)**	**44,291,615**	**718,558**	**-**
Off-balance sheet items arising from foreign exchange				
Off-balance sheet claims arising from foreign exchange contracts	50,632,394	5,000,000	468,497	56,100,891
Off-balance sheet liabilities arising from foreign exchange contracts	5,403,287	50,450,000	768,083	56,621,370
Net long / (short) position on foreign exchange	45,229,107	(45,450,000)	(299,586)	(520,479)
Net long / (short) position	**218,934**	**(1,158,385)**	**418,972**	**(520,479)**

29. Analysis of assets and liabilities by currency profile *(cont'd)*

The table below provides the analysis of the Bank's assets, liabilities and shareholders' equity as well as off-balance sheet items arising from currency swaps as at 31 December 2018 by currency profile:

	USD EUR	EUR EUR	Other EUR	Total EUR
Assets				
Cash and deposits with the Bank of Latvia	401,845	94,686,900	-	95,088,745
Balances due from banks	41,870,087	1,913,850	348,434	44,132,371
Loans and advances to customers	56,912,505	31,334,526	13,423	88,260,454
Financial assets at fair value through profit or loss	23,976,119	1,273,367	-	25,249,486
Investment in subsidiary	-	6,100,000	-	6,100,000
Equity instruments at fair value through other comprehensive income	-	284,083	-	284,083
Intangible assets	16,993	485,893	-	502,886
Property and equipment	-	13,460,695	-	13,460,695
Corporate income tax	-	278,648	-	278,648
Prepaid expenses	14,314	205,557	1,179	221,050
Other assets	2,348,697	3,270,378	3,549,221	9,168,296
Total assets	**125,540,560**	**153,293,897**	**3,912,257**	**282,746,714**
Liabilities and equity				
Deposits from customers	96,622,172	118,607,029	2,608,425	217,837,626
Debt securities	17,558,810	-	-	17,558,810
Deferred income and accrued expense	1,284	911,318	20,682	933,284
Other liabilities	150,831	2,754,896	1,881	2,907,608
Subordinated loans	11,207,357	-	-	11,207,357
Equity	-	32,302,029	-	32,302,029
Total liabilities and equity	**125,540,454**	**154,575,272**	**2,630,988**	**282,746,714**
Net long / (short) position for statement of financial position items	106	(1,281,375)	1,281,269	-
Off-balance sheet claims arising from foreign exchange contracts	-	-	-	-
Off-balance sheet liabilities arising from foreign exchange contracts	-	-	-	-
Net long / (short) position on foreign exchange	-	-	-	-
Net long / (short) position	**106**	**(1,281,375)**	**1,281,269**	**-**
As at 31 December 2017				
Total assets	**197,277,898**	**162,595,144**	**7,538,390**	**367,411,432**
Total liabilities and equity	**242,288,071**	**118,303,529**	**6,819,832**	**367,411,432**
Net long / (short) position for statement of financial position items	**(45,010,173)**	**44,291,615**	**718,558**	**-**
Off-balance sheet items arising from foreign exchange				
Off-balance sheet claims arising from foreign exchange contracts	50,632,394	5,000,000	468,497	56,100,891
Off-balance sheet liabilities arising from foreign exchange contracts	5,403,287	50,450,000	768,083	56,621,370
Net long / (short) position on foreign exchange	45,229,107	(45,450,000)	(299,586)	(520,479)
Net long / (short) position	**218,934**	**(1,158,385)**	**418,972**	**(520,479)**

30. Analysis of assets and liabilities by maturity profile

The table below provides the analysis of the Group's assets and liabilities by contractual maturity as at 31 December 2018.

	Past due EUR	Within 1 month EUR	1 – 3 months EUR	3 – 6 months EUR	6 –12 months EUR	1–5 years EUR	Over 5 years and undated EUR	Total EUR
Assets								
Cash and balances with the Bank of Latvia	-	95,088,745	-	-	-	-	-	95,088,745
Balances due from banks	-	37,402,262	913,401	4,766,708	-	1,050,000	-	44,132,371
Loans and advances to customers	4,816,304	8,071,017	3,627,137	4,579,166	37,151,556	7,673,145	19,580,154	85,498,479
Financial assets at fair value through profit or loss	-	8,549,820	5,462,125	661,999	8,598,483	1,969,251	7,808	25,249,486
Equity instruments at fair value through other comprehensive income	-	-	-	-	-	-	284,083	284,083
Intangible assets	-	-	-	-	-	-	502,886	502,886
Property and equipment	-	-	-	-	-	-	13,460,695	13,460,695
Prepaid expense	-	-	-	-	221,050	-	-	221,050
Corporate income tax	-	-	-	-	278,648	-	-	278,648
Other assets	-	4,319,863	-	146,691	2,233,773	-	11,672,073	18,372,400
Total assets	**4,816,304**	**153,431,707**	**10,002,663**	**10,154,564**	**48,483,510**	**10,692,396**	**45,507,699**	**283,088,843**
Liabilities and equity								
Deposits from customers	-	205,555,285	1,106,956	4,942,900	1,425,031	4,731,154	69,117	217,830,443
Debt securities	-	61,899	-	29,662	-	17,467,249	-	17,558,810
Deferred income and accrued expense	-	-	933,284	-	-	-	-	933,284
Other liabilities	-	2,906,129	-	-	9,490	-	16,585	2,932,204
Subordinated loans	-	5,611	-	873,362	1,746,725	8,581,659	-	11,207,357
Share capital and reserves	-	-	-	-	-	-	32,626,745	32,626,745
Total liabilities and equity	-	**208,528,924**	**2,040,240**	**5,845,924**	**3,181,246**	**30,780,062**	**32,712,447**	**283,088,843**
Off-balance sheet liabilities	-	19,735	1,834,552	8,948,516	2,893,144	4,717,152	69,117	18,482,216
Liquidity	**4,816,304**	**(55,116,952)**	**6,127,871**	**(4,639,876)**	**42,409,120**	**(24,804,818)**	**12,726,135**	**(18,482,216)**

As at 31 December 2017

	Past due EUR	Within 1 month EUR	1 – 3 months EUR	3 – 6 months EUR	6 –12 months EUR	1–5 years EUR	Over 5 years and undated EUR	Total EUR
Total assets	**5,250,394**	**181,152,025**	**40,387,367**	**19,652,775**	**48,231,367**	**54,717,621**	**17,571,931**	**366,963,480**
Total liabilities and equity	**-**	**265,837,544**	**11,994,462**	**2,098,477**	**12,709,031**	**35,023,845**	**39,300,121**	**366,963,480**
Off-balance sheet liabilities	-	1,011,019	4,879,487	6,863,686	4,591,178	10,668,671	2,662,822	30,676,863
Liquidity	**5,250,394**	**(85,696,538)**	**23,513,418**	**10,690,612**	**30,931,158**	**9,025,105**	**(24,391,012)**	**(30,676,863)**

30. Analysis of assets and liabilities by maturity profile *(cont'd)*

The table below provides the analysis of the Bank's assets and liabilities by contractual maturity as at 31 December 2018.

	Past due EUR	Within 1 month EUR	1 – 3 months EUR	3 – 6 months EUR	6 –12 months EUR	1–5 years EUR	Over 5 years and undated EUR	Total EUR
Assets								
Cash and balances with the Bank of Latvia	-	95,088,745	-	-	-	-	-	95,088,745
Balances due from banks	-	37,402,262	913,401	4,766,708	-	1,050,000	-	44,132,371
Loans and advances to customers	4,816,304	8,071,017	3,627,137	4,579,166	37,151,556	10,435,120	19,580,154	88,260,454
Financial assets at fair value through profit or loss	-	8,549,820	5,462,125	661,999	8,598,483	1,969,251	7,808	25,249,486
Investment in subsidiary	-	-	-	-	-	-	6,100,000	6,100,000
Equity instruments at fair value through other comprehensive income	-	-	-	-	-	-	284,083	284,083
Intangible assets	-	-	-	-	-	-	502,886	502,886
Property and equipment	-	-	-	-	-	-	13,460,695	13,460,695
Prepaid expense	-	-	-	-	221,050	-	-	221,050
Corporate income tax	-	-	-	-	278,648	-	-	278,648
Other assets	-	4,304,286	-	146,691	2,233,773	-	2,483,546	9,168,296
Total assets	**4,816,304**	**153,416,130**	**10,002,663**	**10,154,564**	**48,483,510**	**13,454,371**	**42,419,172**	**282,746,714**
Liabilities and equity								
Deposits from customers	-	205,562,468	1,106,956	4,942,900	1,425,031	4,731,154	69,117	217,837,626
Debt securities	-	61,899	-	29,662	-	17,467,249	-	17,558,810
Deferred income and accrued expense	-	-	933,284	-	-	-	-	933,284
Other liabilities	-	2,881,533	-	-	9,490	-	16,585	2,907,608
Subordinated loans	-	5,611	-	873,362	1,746,725	8,581,659	-	11,207,357
Share capital and reserves	-	-	-	-	-	-	32,302,029	32,302,029
Total liabilities and equity	**-**	**208,511,511**	**2,040,240**	**5,845,924**	**3,181,246**	**30,780,062**	**32,387,731**	**282,746,714**
Off-balance sheet liabilities	**-**	19,735	1,834,552	8,948,516	2,893,144	4,721,709	69,117	18,486,773
Liquidity	**4,816,304**	**(55,115,116)**	**6,127,871**	**(4,639,876)**	**42,409,120**	**(22,047,400)**	**9,962,324**	**(18,486,773)**

As at 31 December 2017

	Past due EUR	Within 1 month EUR	1 – 3 months EUR	3 – 6 months EUR	6 –12 months EUR	1–5 years EUR	Over 5 years and undated EUR	Total EUR
Total assets	**5,250,394**	**181,149,284**	**40,387,367**	**19,652,775**	**47,636,367**	**49,163,314**	**24,171,931**	**367,411,432**
Total liabilities and equity	**-**	**266,183,571**	**11,994,462**	**2,098,477**	**12,709,031**	**35,023,845**	**39,402,046**	**367,411,432**
Off-balance sheet liabilities	-	1,011,019	4,879,487	6,863,686	4,591,178	10,668,671	2,662,822	30,676,863
Liquidity	**5,250,394**	**(86,045,306)**	**23,513,418**	**10,690,612**	**30,336,158**	**3,470,798**	**(17,892,937)**	**(30,676,863)**

Notes to the financial statements *(cont'd)*

30. Analysis of assets and liabilities by maturity profile *(cont'd)*

The Management of the Group and the Bank believes that short-term liquidity is not endangered. The Bank's liquidity ratio calculated according to the FCMC requirements was 69,29% as at 31 December 2018 (31 December 2017: 73.46%). In accordance with the FCMC requirements, the Bank has to ensure a sufficient amount of liquid assets to settle its liabilities, but not less than 60% of the total amount of its current liabilities.

Deposits serving as security for customer liabilities are disclosed according to the maturity of the underlying liability.

The table below presents the Group's contractual undiscounted cash flows of the financial liabilities as at 31 December 2018:

	Past due	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Debt securities	-	123,799	-	59,324	-	17,467,249	-	17,650,372
Deposits from customers	-	205,562,678	1,108,575	4,947,913	1,439,371	4,818,954	-	217,877,491
Other liabilities	-	2,907,608	-	-	-	-	-	2,907608
Subordinated loans	-	83,107	147,986	1,097,832	2,128,721	9,405,454	-	12,863,100
Total liabilities	**-**	**208,677,192**	**1,256,561**	**6,105,069**	**3,568,092**	**31,691,657**	**-**	**251,298,571**
Off-balance sheet liabilities	-	19,735	1,834,552	8,948,516	2,893,144	4,717,152	69,117	18,482,216

The table below presents the Bank's contractual undiscounted cash flows of the financial liabilities as at 31 December 2018:

	Past due	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Debt securities	-	123,799	-	59,324	-	17,467,249	-	17,650,372
Deposits from customers	-	205,569,861	1,108,575	4,947,913	1,439,371	4,818,954	-	217,884,674
Other liabilities	-	2,907,608	-	-	-	-	-	2,907608
Subordinated loans	-	83,107	147,986	1,097,832	2,128,721	9,405,454	-	12,863,100
Total liabilities	**-**	**208,684,375**	**1,256,561**	**6,105,069**	**3,568,092**	**31,691,657**	**-**	**251,305,754**
Off-balance sheet liabilities	**-**	19,735	1,834,552	8,948,516	2,893,144	4,721,709	69,117	18,486,773

The table below presents the Group's contractual undiscounted cash flows of the financial liabilities as at 31 December 2017:

	Past due	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Debt securities	-	118,194	-	56,637	-	16,676,395	-	16,851,227
Deposits from customers	-	264,183,567	12,109,806	2,155,464	10,921,449	8,234,814	69,117	297,674,216
Other liabilities	-	501,521	-	-	-	-	-	501,521
Subordinated loans	-	89,398	160,742	247,058	2,159,265	12,275,349	-	14,931,811
Total liabilities	**-**	**264,892,680**	**12,270,547**	**2,459,159**	**13,080,714**	**37,186,558**	**69,117**	**329,958,775**
Off-balance sheet liabilities	**-**	1,011,019	4,879,487	6,863,686	4,591,178	10,668,671	2,662,822	30,676,863

30. Analysis of assets and liabilities by maturity profile *(cont'd)*

The table below presents the Bank's contractual undiscounted cash flows of the financial liabilities as at 31 December 2017:

	Past due EUR	Within 1 month EUR	1 – 3 months EUR	3 – 6 months EUR	6 –12 months EUR	1–5 years EUR	Over 5 years and undated EUR	Total EUR
Debt securities	-	118,194	-	56,637	-	16,676,395	-	16,851,227
Deposits from customers	-	264,531,682	12,109,806	2,155,464	10,921,449	8,234,814	69,117	298,022,331
Other liabilities	-	499,434	-	-	-	-	-	499,434
Subordinated loans	-	89,398	160,742	247,058	2,159,265	12,275,349	-	14,931,811
Total liabilities	**-**	**265,238,708**	**12,270,548**	**2,459,159**	**13,080,714**	**37,186,558**	**69,117**	**330,304,804**
Off-balance sheet liabilities	-	1,011,019	4,879,487	6,863,686	4,591,178	10,668,671	2,662,822	30,676,863

The table below presents the Group and Bank's contractual undiscounted cash flows of the derivative financial instruments as at 31 December 2017:

	Within 1 month EUR	1 - 3 months EUR	Over 3 months EUR	Total EUR
Derivatives offset on a gross basis				
Foreign exchange derivatives:				
Inflow	56,118,292	-	-	**56,118,292**
Outflow	56,621,369	-	-	**56,621,369**

31. Analysis of maturities of assets and liabilities based on interest rate changes

The Group's assets and liabilities categorized by the earlier of contractual repricing or maturity dates as at as at 31 December 2018:

	Within one month EUR	1–3 months EUR	3–6 months EUR	6–12 months EUR	1–5 years EUR	Over 5 years EUR	Items not sensitive to the interest risk EUR	Total EUR
Assets								
Cash and balances with the Bank of Latvia	94,163,606	-	-	-	-	-	925,139	95,088,745
Balances due from banks	37,270,708	32,676	-	-	-	-	6,828,987	44,132,371
Loans and advances to customers	14,617,840	9,961,541	4,011,320	33,002,691	22,405,840	28,488	1,470,759	85,498,479
Financial assets at fair value through profit or loss	8,549,820	5,462,125	661,999	8,598,483	1,969,251	-	7,808	25,249,486
Equity instruments at fair value through other comprehensive income	-	-	-	-	-	-	284,083	284,083
Other assets	-	-	-	-	-	-	5,885,247	5,885,247
Total assets	**154,601,974**	**15,456,342**	**4,673,319**	**41,601,174**	**24,375,091**	**28,488**	**15,402,023**	**256,138,411**
Liabilities and equity								
Deposits from customers	622,762	223,668	162,503	1,420,885	1,003,994	-	214,396,631	217,830,443
Debt securities	-	-	-	-	17,467,249	-	91,561	17,558,810
Other liabilities	-	-	-	-	-	-	3,865,488	3,865,488
Subordinated loans	-	-	873,362	1,746,725	8,581,659	-	5,611	11,207,357
Total liabilities	622,762	223,668	1,035,865	3,167,610	27,052,902	-	218,359,291	250,462,098
Equity							32,626,745	32,626,745
Total liabilities and equity	**622,762**	**223,668**	**1,035,865**	**3,167,610**	**27,052,902**	**-**	**250,986,036**	**283,088,843**
Sensitivity of statement of financial position items to interest rate risk	153,979,212	15,232,674	3,637,454	38,433,564	(2,677,811)	28,488	(235,584,013)	(26,950,432)
As at 31 December 2017								
Total assets	**177,674,769**	**39,382,362**	**19,440,603**	**37,846,956**	**42,350,944**	**30,031**	**50,237,815**	**366,963,480**
Total liabilities and equity	**2,185,856**	**3,813,452**	**585,376**	**7,881,936**	**27,688,420**	**-**	**324,808,440**	**366,963,480**
Sensitivity of statement of financial position items to interest rate risk	175,488,913	35,568,910	18,855,227	29,965,020	14,662,524	30,031	(274,570,625)	-

31. Analysis of maturities of assets and liabilities based on interest rate changes *(cont'd)*

The Bank's assets and liabilities categorized by the earlier of contractual repricing or maturity dates as at as at 31 December 2018:

	Within one month EUR	1–3 months EUR	3–6 months EUR	6–12 months EUR	1–5 years EUR	Over 5 years EUR	Items not sensitive to the interest risk EUR	Total EUR
Assets								
Cash and balances with the Bank of Latvia	94,163,606	-	-	-	-	-	925,139	95,088,745
Balances due from banks	37,270,708	32,676	-	-	-	-	6,828,987	44,132,371
Loans and advances to customers	14,617,840	12,723,516	4,011,320	33,002,691	22,405,840	28,488	1,470,759	88,260,454
Financial assets at fair value through profit or loss	8,549,820	5,462,125	661,999	8,598,483	1,969,251	-	7,808	25,249,486
Equity instruments at fair value through other comprehensive income	-	-	-	-	-	-	284,083	284,083
Other assets	-	-	-	-	-	-	5,869,670	5,869,670
Total assets	**154,601,974**	**18,218,317**	**4,673,319**	**41,601,174**	**24,375,091**	**28,488**	**15,386,446**	**258,884,809**
Liabilities and equity								
Deposits from customers*	622,762	223,668	162,503	1,420,885	1,003,994	-	214,403,814	217,837,626
Debt securities	-	-	-	-	17,467,249	-	91,561	17,558,810
Other liabilities	-	-	-	-	-	-	3,840,892	3,840,892
Subordinated loans	-	-	873,362	1,746,725	8,581,659	-	5,611	11,207,357
Total liabilities	622,762	223,668	1,035,865	3,167,610	27,052,902	-	218,341,878	250,444,685
Equity	-	-	-	-	-	-	32,302,029	32,302,029
Total liabilities and equity	**622,762**	**223,668**	**1,035,865**	**3,167,610**	**27,052,902**	**-**	**250,643,907**	**282,746,714**
Sensitivity of statement of financial position items to interest rate risk	153,979,212	17,994,649	3,637,454	38,433,564	(2,677,811)	28,488	(235,257,461)	(23,861,905)
As at 31 December								
Total assets	**177,674,769**	**41,882,362**	**19,440,603**	**37,846,956**	**42,350,944**	**30,031**	**48,185,767**	**367,411,432**
Total liabilities and equity	**2,185,856**	**3,813,452**	**585,376**	**7,881,936**	**27,688,420**	**-**	**325,256,392**	**367,411,432**
Sensitivity of statement of financial position items to interest rate risk	175,488,913	38,068,910	18,855,227	29,965,020	14,662,524	30,031	(277,070,625)	-

* The deposits from customers which are not sensitive to interest rate risk include guarantee deposits totaling EUR 9,586,580 (2017: EUR 18,141,170).

32. Related party disclosures

Parties are considered to be related if one party has the ability to control the other party, are under common control or one exercises significant influence over the other party in making financial or operational decisions. Related parties are defined as shareholders, members of the Council and the Board, key management personnel of the Group and the Bank, their close relatives and companies in which they have a controlling interest as well as companies, where they have significant influence.

The parent company of the Group and the Bank is AB Pivdenny bank as it controls the operations of the Group and the Bank. The ultimate beneficiary of the Bank is Juriy Rodin.

Transactions with related parties as at 31 December 2018 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Total loans and advances to customers (contractual interest rate: 4-12%)	-	1,812,479	2,762,595	-
Correspondent account	10,058,882	-	-	-
Deposits from customers (contractual interest rate: 0.0%)	-	12,130,307	7,183	1,065,584
Subordinated loans (contractual interest rate: 7.0-8.5%)	-	8,292,127	-	-
Dividend payable	-	743,434	-	1,912,810

Income and expense from transactions with related parties in 2018 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Interest income	737,320	100,379	106,800	210
Interest expense	-	650,778	-	-
Impairment allowances	456	(132,346)	694	182
Fee and commission income	-	15,501	186	1,665
Fee and commission expense	15,812	-	-	-
Administrative and other operating expense	18,149	-	600	-

Off-balance sheet liabilities towards related parties as at 31 December 2018 can be specified as follows:

	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Undrawn credit lines	-	4,557	8,900
Assets under management	1,319	-	1,147

Loans issued to and repaid by related parties in 2018 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Issued to related parties	25,720,960	-	261,443	57,319
Repaid by related parties	36,846,937	440,558	-	57,319

Transactions with the Bank's parent company include the total amount of the current loans issued and repaid in 2018.

32. Related party disclosures *(cont'd)*

Transactions with related parties as at 31 December 2017 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Total loans and advances to customers (contractual interest rate: 0-12%)	10,706,000	2,164,130	2,500,833	-
Correspondent account	13,875,078	-	-	-
Investment in subsidiary	-	-	6,600,000	-
Deposits from customers (contractual interest rate: 0.0%)	-	1,438,164	348,114	1,651,480
Subordinated loans (contractual interest rate: 7.0-8.5%)	-	7,916,689	-	-

Income and expense from transactions with related parties in 2017 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Interest income	1,036,369	129,644	26,389	590
Interest expense	(80,194)	(549,056)	-	-
Impairment allowances	-	192,178	-	-
Fee and commission income	-	35,464	121	7,379
Fee and commission expense	(68,636)	-	-	-
Administrative and other operating expense	(108,603)*	-	600	-

* incl. a receivable of EUR 90,771 written off.

Off-balance sheet liabilities towards related parties as at 31 December 2017 can be specified as follows:

	Entities owned by the Bank's shareholders	Other related parties
Undrawn credit lines	-	6,134
Assets under management	5,313,027	743,136

Loans issued to and repaid by related parties in 2017 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Issued to related parties	145,355,397	-	2,500,000	51,742
Repaid by related parties	144,684,566	511,529	-	58,726

Transactions with the Bank's parent company include the total amount of the current loans issued and repaid in 2018.

32. Related party disclosures *(cont'd)*

Remuneration to the Board and Council of the Bank can be specified as follows:

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Short-term benefits:				
- Salaries	610,220	610,220	661,449	652,743
- State statutory social insurance contributions	155,951	155,951	173,270	171,216
Total	**766,171**	**766,171**	**834,719**	**823,959**

33. Fair values of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is quoted prices in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The Group and the Bank disclose information on fair values of assets and liabilities in such a way as to enable its comparison with their carrying amounts.

When determining fair values of assets and liabilities, the Group and the Bank use three hierarchical measurement levels of fair value:

Level 1 – Quoted prices in an active market;

Level 2 – Valuation techniques for which the input that is significant to the fair value measurement is observable in the market;

Level 3 – Other valuation techniques for which the input that is significant to the fair value measurement is unobservable.

Instruments within **Level 1** include financial instruments traded on the stock exchange.

Fair value for such financial instruments as financial assets at fair value through profit and loss is mainly determined based on publicly available quoted prices (bid price obtained from the Bloomberg system).

Instruments within **Level 2** include assets, for which no active market exists, such as over-the-counter (OCT) derivative financial instruments and currency swaps as well as balances on demand with the Bank of Latvia, amounts due from banks, financial assets at fair value through profit and loss, amounts due to banks and deposits from customers as well as other financial assets and liabilities.

The fair value of derivative financial instruments is based on discounted cash flow models with all parameters used (foreign currency exchange rate, interest rate) being observable in the market.

The fair value of cash and demand deposits with the Bank of Latvia is based on the estimated present value of discounted future cash flows. The discount rate applied is based on the interest rates prevailing in the market at the end of the year.

The fair value of balances due from banks is based on the estimated present value of discounted future cash flows. The discount rate applied is based on the interest rates prevailing in the market at the end of the year.

The fair value of deposits from customers is based on the estimated present value of discounted future cash flows. The discount rate applied is based on the interest rates prevailing in the market at the end of the year.

33. Fair values of financial assets and liabilities *(cont'd)*

The estimated fair value of other financial assets and liabilities is based on the estimated present value of discounted future cash flows. The discount rate applied is based on the interest rates prevailing in the market at the end of the year.

Level 3 instruments are available-for-sale financial assets as well as loans and subordinated debt.

In the reporting year, the fair value of available-for-sale financial instruments was based on an indicative price offer received from a potential buyer and which is considered to be the best estimate of the fair value.

The fair value of loans is based on the estimated present value of discounted future cash flows. Discount rate applied in the calculation is based on the interest rates prevailing in the market at the end of the year as adjusted for credit risk.

The fair value of the subordinated loan is based on the estimated present value of discounted future cash flows. Discount rate applied in the calculation is based on the interest rate applied to the last transaction adjusted for the decline in the market rates observed in the respective period.

The fair value of debt securities is based on estimated present value of discounted future cash flows. Discount rate applied in the calculation is based on the interest rate applied to last transaction adjusted for the decline in the market rates observed in the respective period.

The carrying amounts of the Group's assets measured at amortized cost and their fair values can be specifies as follows:

	31.12.2018		31.12.2017	
	Carrying amount EUR	Fair value EUR	Carrying amount EUR	Fair value EUR
Assets measured at amortized cost				
Cash and balances with the Bank of Latvia	95,088,745	95,088,745	90,638,213	90,638,213
Balances due from banks	44,132,371	44,132,371	89,439,452	89,439,452
Loans to legal entities	82,304,655	89,094,220	88,258,436	96,470,638
Loans to private individuals, except for mortgages	3,039,727	3,387,513	7,731,677	8,556,368
Mortgages	154,097	182,449	314,087	407,072
Other financial assets	5,885,247	5,885,247	3,878,758	3,878,758
Total assets measured at amortized cost	**230,604,842**	**237,770,545**	**280,260,623**	**289,390,501**
Liabilities measured at amortized cost				
Deposits from customers	217,830,443	219,245,093	296,482,449	296,899,574
Debt securities	17,558,810	17,558,810	16,763,810	16,763,810
Subordinated loans	11,207,357	11,353,625	12,367,892	12,511,188
Other financial liabilities	2,932,204	2,932,204	501,521	501,521
Total liabilities measured at amortized cost	**249,528,814**	**251,089,732**	**326,115,672**	**326,676,093**

33. Fair values of financial assets and liabilities *(cont'd)*

The carrying amounts of the Bank's assets measured at amortized cost and their fair values can be specifies as follows:

	31.12.2018		31.12.2017	
	Carrying amount EUR	Fair value EUR	Carrying amount EUR	Fair value EUR
Assets measured at amortized cost				
Cash and balances with the Bank of Latvia	95,088,745	95,088,745	90,638,213	90,638,213
Balances due from banks	44,132,371	44,132,371	89,439,452	89,439,452
Loans to legal entities	85,066,630	91,972,181	90,759,269	99,072,521
Loans to private individuals, except for mortgages	3,039,727	3,387,513	7,731,677	8,556,368
Mortgages	154,097	182,449	314,087	407,072
Other financial assets	5,869,670	5,869,670	3,280,184	3,280,184
Total assets measured at amortized cost	**233,351,240**	**240,632,929**	**282,162,882**	**291,393,810**
Liabilities measured at amortized cost				
Deposits from customers	217,837,626	219,252,277	296,830,563	297,247,688
Debt securities	17,558,810	17,558,810	16,763,810	16,763,810
Subordinated loans	11,207,357	11,353,625	12,367,892	12,511,188
Other financial liabilities	2,907,608	2,907,608	499,434	499,434
Total liabilities measured at amortized cost	**249,511,401**	**251,072,320**	**326,461,699**	**327,022,120**

33. Fair values of financial assets and liabilities *(cont'd)*

The Group's assets by fair value hierarchy levels (at carrying amounts) can be specified as follows:

	31.12.2018			31.12.2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	EUR	EUR	EUR	EUR	EUR	EUR
Assets measured at fair value						
Derivative financial instruments	-	-	-	-	65,756	-
Available-for-sale financial assets	-	-	284,083	-	-	234,942
Financial assets at fair value through profit or loss	23,976,121	1,273,367	-	58,265,632	2,084,702	-
Total assets measured at fair value	**23,976,121**	**1,273,367**	**284,083**	**58,265,632**	**2,150,458**	**234,942**
Assets for which fair value is disclosed						
Cash and balances with the Bank of Latvia	-	95,088,745	-	-	90,638,213	-
Balances due from banks	-	44,132,371	-	-	89,439,452	-
Loans and advances to customers	-	-	85,498,479	-	-	96,304,200
Other financial assets	-	5,885,247	-	-	3,878,758	-
Total assets for which fair value is disclosed	**-**	**145,106,363**	**85,498,479**	**-**	**183,956,423**	**96,304,200**

	31.12.2018			31.12.2017		
Liabilities measured at fair value						
Derivative financial instruments	-	-	-	-	652,318	-
Total liabilities measured at fair value	**-**	**-**	**-**	**-**	**652,318**	**-**
Liabilities for which fair value is disclosed						
Deposits from customers	-	217,830,443	-	-	296,482,449	-
Debt securities	-	-	17,558,810	**-**	-	16,763,810
Subordinated loans	-	-	11,207,357	**-**	-	12,367,892
Other financial liabilities	-	2,932,204	-	**-**	501,521	-
Total liabilities for which fair value is disclosed	**-**	**220,762,647**	**28,766,167**	**-**	**296,983,970**	**29,131,702**

33. Fair values of financial assets and liabilities *(cont'd)*

The Bank's assets by fair value hierarchy levels (at carrying amounts) can be specified as follows:

	31.12.2018.			31.12.2017.		
	Level 1 EUR	Level 2 EUR	Level 3 EUR	Level 1 EUR	Level 2 EUR	Level 3 EUR
Assets measured at fair value						
Derivative financial instruments	-	-	-	-	65,756	-
Available-for-sale financial assets	-	-	284,083	-	-	234,942
Financial assets at fair value through profit or loss	23,976,121	1,273,367	-	58,265,632	2,084,702	-
Total assets measured at fair value	**23,976,121**	**1,273,367**	**284,083**	**58,265,632**	**2,150,458**	**234,942**
Assets for which fair value is disclosed						
Cash and balances with the Bank of Latvia	-	95,088,745	-	-	90,638,213	-
Balances due from banks	-	44,132,371	-	-	89,439,452	-
Loans and advances to customers	-	-	88,260,454	-	-	98,805,033
Other financial assets	-	5,869,670	-	-	3,280,184	-
Total assets for which fair value is disclosed	**-**	**145,090,786**	**88,260,454**	**-**	**183,357,849**	**98,805,033**
Liabilities measured at fair value						
Derivative financial instruments	-	-	-	-	652,318	-
Total liabilities measured at fair value	**-**	**-**	**-**	**-**	**652,318**	**-**
Liabilities for which fair value is disclosed						
Deposits from customers	-	217,837,626	-	-	296,830,563	-
Debt securities	-	-	17,558,810	-	-	16,763,810
Subordinated loans	-	-	11,207,357	-	-	12,367,892
Other financial liabilities	-	2,907,608	-	-	499,434	-
Total liabilities for which fair value is disclosed	**-**	**220,745,234**	**28,766,167**	**-**	**297,329,997**	**29,131,702**

Notes to the financial statements *(cont'd)*

34. Subordinated loans

Subordinated loans as at 31 December of 2018 and 31 December 2017 can be specified as follows:

	31.12.2018 Group EUR	%	31.12.2018 Bank EUR	%	31.12.2017 Group EUR	%	31.12.2017 Bank EUR	%
Fortum Trade Services LTD (maturity 2019-2021)	7,855,348	7,00-8,50	7,855,348	7,00-8,50	7,499,686	7,00-8,50	7,499,686	7,00-8,50
Heshvan Limited (maturity 2020-2021)	2,064,228	8,00-8,50	2,064,228	8,00-8,50	1,970,767	8,00-8,50	1,970,767	8,00-8,50
Crownfield Nordic Limited Partnership (atmaksa 2018.gads)	-	-	-	-	1,667,964	7,00	1,667,964	7,00
Milandale Limited (maturity 2021)	436,778	8,00	436,778	8,00	417,003	8,00	417,003	8,00
Maxiplan L.P (maturity 2020)	370,563	8,50	370,563	8,50	353,785	8,50	353,785	8,50
Igors Chudenkov (maturity 2020)	366,899	8,50	366,899	8,50	350,287	8,50	350,287	8,50
Andrejs Volodin (2020)	113,541	8,50	113,541	8,50	108,400	8,50	108,400	8,50
Total subordinated loans	**11,207,357**		**11,207,357**		**12,367,892**		**12,367,892**	

35. Assets under management

Assets under management are securities and other customer assets acquired under trust agreements.

	31.12.2018 Group EUR	31.12.2018 Bank EUR	31.12.2017 Group EUR	31.12.2017 Bank EUR
Legal entities:				
- non-residents	68,836,200	68,836,200	86,632,296	86,632,296
Private individuals:				
- residents	216,624	216,624	199,006	199,006
- non-residents	457,519	457,519	1,413,511	1,413,511
Total	**69,510,343**	**69,510,343**	**88,244,813**	**88,244,813**

36. Return on equity and return on assets

	31.12.2018 Group	31.12.2018 Bank	31.12.2017 Group	31.12.2017 Bank
Return on equity (ROE) (%)	15.52%	15.66%	6,55%	6,74%
Return on assets (ROA) (%)	1.78%	1.80%	0,66%	0,65%

Both ratios are calculated according to the FCMC regulations on the basis of annual averages month by month. ROE is calculated as annualized net profit for the reporting period divided by the average of total equity. Return on average assets (ROA) is calculated as annualized net profit for the reporting period divided by the average of total assets.

37. Going concern

In 2018, a series of events considerably affected functioning of the banking sector in Latvia making banks reconsider their business models.

In February 2018, the Financial Crimes Enforcement Network (FinCEN) of the US Department of the Treasury published a draft report on restricting access to US financial system for one of the major banks in Latvia (on the basis of Article 311 of the US PATRIOT ACT). In May 2018, amendments to the AML/CTF Law came into force restricting the service provision to part of the shell companies. In August 2018, the *Moneyval* report on the valuation of Latvian financial system was published outlining its shortcomings.

The above events led to increased attention to Latvian financial system. In the spring and summer of 2018, a number of international partners of Latvian banks limited their activities in the region. Although the effect of these events on the overall functioning of the banking system was not critical, they triggered active transformation of the business models of "non-resident" banks. Latvian banks also assessed their risk appetite level in servicing the "not-resident" customer portfolio and took appropriate risk mitigation measures.

The above mentioned conditions give rise to a material uncertainty which may cast significant doubt on the Group and Bank's ability to continue as a going concern and, therefore, on their ability to realize their assets and discharge their liabilities in the normal course of business. However, taking into account that the Group and the Bank has developed the new 2018-2021 Development Strategy of the Bank whose realization was already begun in the second half of 2018 and continuing in 2019, the management of the Group and the Bank does not expect that the developments in Latvian banking system and the revised AML/CTF Law could have an adverse effect on the Group and Bank's business model and ability to continue as a going concern.

In the spring and summer of 2018, the Group and the Bank closely followed further developments and analyzed their impact on the Bank's ability to continue as a going concern. In June 2018, the Supervisory Council of the Bank approved the new 2018-2021 Development Strategy of the Bank. The Strategy envisages the continuation of banking business in Latvian and EU markets as well as transforming the Bank in accordance with the plan and in line with the new operational format.

The events of 2018 required considerable efforts by the Bank to define its role in the new conditions of the banking market under transformation. Entering new market segments requires the Bank to review its standard products and business approaches as well as to introduce new products/services focused on new non-resident customer groups. The work will continue in 2019, it is expected that in 2019 the Bank will finalize the transformation of its business model and begin to increase business volumes in new customer segments.

The activities in the second half of the previous year were directed at achieving the targets set in the new strategy, i.e., ensuring customer risk acceptable to the Bank, optimization of administrative expenses while maintaining high compliance with laws and regulations as well as preparation for active participation in the domestic and EU markets. In 2018, meeting the requirements laid down in the revised AML/CTF Law and new ML/TF risk management strategy, the Bank considerably reduced its non-resident customer base – overall 2,520 customer accounts were closed in 2018. Starting from the 2nd quarter, the Bank expects a gradual increase in the number of customers mainly through winning customers in the domestic and EU markets.

37. Going concern (cont'd)

In 2018, deposits from customers decreased by EUR 78.9 million and at the end of 2018 totaled EUR 217.7 million by EUR 51.6 million exceeding the Bank's management projections made during the development and approval phases of the Bank's development strategy in May – June 2018. Such a fall in deposits resulted in a slight decrease in the interest income (by 9.1%), relating mainly to the deployment of free-cash.

In 2019, the Bank intends to improve the uptake of its new strategy focused on the domestic and EU markets which will result in a considerable increase in the Bank's loan portfolio and income relating to the domestic market. The Bank has established that Latvian SME will be the target segment for domestic lending to whom a full range of long-term and short-term funding opportunities will be offered. As its main competitive advantages the Bank sees highly qualified, competent and experienced staff as well as fast and flexible decision making on lending. To ensure a faster realization of the new strategy, in the first half of 2019 considerable support measures will be taken for positioning the Bank's brand on Latvian market.

In 2019, the Bank does not expect a considerable change in deposits from customers (settlement accounts and deposits); they will remain within the indicative limit of EUR 200 million. The activities of the Bank's marketing and sales group in 2019 will result in increasing the share of Latvian loan portfolio in the Bank's total loan portfolio with the share of the CIS-related loan portfolio gradually decreasing. The share of net interest income is projected to increase to 52.2% of the Bank's total net income by the end of 2019. The projected decrease in the share of net fee and commission income is from 38.4% in 2018 to 35.6% of the Bank's total net income in 2019.

In line with the strategy for the year 2018, the Bank has received the FCMC approval and finalized the preparation for attracting deposits from customers through deposit platforms. On 2 January 2019 the Bank received the first deposits from German residents (private individuals). As at 15 February 2019, deposits amounting to EUR 8.08 million euro with a maturity between 3 to 24 months were attracted. In 2018, an audit of the Bank's existing customer base was carried out to verify the compliance of the existing customer deposits with the new requirements of the AML/CTF Law. In assessing the stability of the existing deposits, attracting funding through the above mentioned German deposit platforms is expected to serve as an additional instrument for liquidity management under the Bank's strategy for 2019.

In 2019, the Bank plans to finalize several projects commenced in 2018 as well as new projects of strategic importance for the transformation of the Bank's business model, namely: implementation of an advanced Mobile Banking application; development of new corporate banking products; publishing of a new website; finishing the change of the Bank's logo and creation of a new visual identity as well as ongoing development of the Bank's image and strategic communication on the domestic market. The Bank's management strongly believes that the implementation of the above projects will enhance the Bank's visibility both in Latvia and EU. In the first six months, the Bank expects to draw up and approve a strategy for the development of technologies and the digital transformation of the Bank's products. In the 3rd quarter of 2019, the Bank plans to review, get approved by the Supervisory Council and submit to the FCMC the new 2019-2022 Development Strategy of the Bank which would include a specified development scenario for the next three years taking into account both the results of the transformation of the Bank carried out in 2018 and 2019 and the vision of the Bank's management about possibilities for further development on Latvian and EU markets.

37. Going concern (cont'd)

Regarding 2019, the Bank forecasts to close the year with a net profit of EUR 2.15 million. According to the Bank's development strategy and budget, the share of net interest income from Latvian and EU customers will increase maintaining interest income at the level of 2018; whereas the fall in fee and commission income (by 27% against the year result of 2018), related to the overall reduction of the customer base, will be compensated by smaller interest expense (decrease by 26%) and fee and commission expense (decrease by 39%). Moreover, stimulating the Bank's development in new market segments, the administrative expenditure part of the budget will be maintained at the level of 2018 and intends to make considerable investments in marketing, IT system development, mainly, in renovation of the Bank's premises, as well as audit of the internal control system in the AML/CTF area according to the set plans.

The Bank's shareholders have provided written confirmations regarding their support to the Bank in the process of transition to the new business model and readiness to provide financial support, if needed, to comply with the capital and liquidity requirements until 31 December 2020.

38. Subsequent events

Except as stated below, as of the last day of the reporting year until the date of signing these financial statements there have been no other events requiring adjustment of or disclosure in the financial statements or notes thereto.

At the end of 2018, the FCMC performed an inspection at the Bank concerning the observance of requirements set forth in the AML/CTF Law in relation to the prohibition on maintaining business relations with shell entities, if they comply with the features set in Section 1, Clause 151, Sub-clauses "a" and "b" of the AML/CTF Law simultaneously. On February 27, 2018, the Bank received a letter from the FCMC on the results of the said inspection: the FCMC highlights the need to take into account the FCMC's opinion on the materials examined within the framework of the inspection in further improving the internal control system of the Bank. Likewise, the FCMC specifies in its letter that the shortcomings identified during the inspection, taking into account the measures taken by the Bank to improve its internal control system, will be assessed by the FCMC in future in connection with the possible findings of the next full on-site inspection of the Bank by the FCMC.

In February 2019 sales agreement was signed on the sale of real estate Ovoschhaja 9, Vasische in Ukraine (repossessed collateral). The deal was completed on February 18, 2019. The Bank did not suffer any losses in this transaction.

Aleksandrs Jakovlevs
Acting Chairman of the Board

Mark Bekker
Deputy Chairman of the Council

Riga, 12 March 2019