Regional Investment Bank

AS "Reģionālā investīciju banka"

Consolidated and annual report for the year ended 31 December

Prepared in accordance with international financial reporting standards as adopted in EU

17/04/2018

Contents

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Management report

In 2017, JSC Regionala Investiciju 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, continued its development in accordance with the previously approved strategy.

Net profit of the Bank in the reporting period amounted to EUR 2.7 million exceeding its results of the year 2016 by 5.43%. Return on equity (ROE) and return on assets (ROA), based on the results of the year, amounted to 6.74% and 0.65% respectively.

General economic situation

In 2017, Latvian economy has shown exponential growth compared to the unexpressive year 2016. According to the preliminary data adjusted for seasonality and calendar effects, the GDP expressed in real terms grew by 4.2% in the first quarter of the year 2017 (1.4% in the year 2016), by 4.8% in the second quarter (1.2% in the year 2016) and by 6.2% in the third quarter (0.5% in 2016). Sectors demonstrating the highest growth rates included construction (civil engineering and non-residential construction segment), industry, public administration, as well as catering and hospitality sector. After a substantial drawdown in the year 2016, the restoration of growth in the civil engineering and non-residential construction segment contributed to improved absorption of the financial resources allocated from the EU funds. Growth of industry, as well as catering and hospitality sector was driven by continued increase in exports against the background of economic recovery of Latvia's main foreign trade partners and record numbers of foreign tourists visiting the country. Financial and insurance services sector turned out to be virtually the only industry, demonstrating the extremely negative momentum amid the continuing outflow of both non-resident and resident funds from Latvia's banking system given the intensified regulatory requirements in the field of prevention of money laundering. Construction of residential buildings also experienced a significant drop against the background of the outflow of private funds from the financial sector. The Bank of Latvia expects that the overall tempo of real economic growth in the year 2017 will be 5.2% (according to preliminary data adjusted for seasonality and calendar effects). In the near future, the speed of economic growth is expected to decline to 4.1% in the year 2018 and to 3.2% in the year 2019. The growth in the year 2018 will be driven by even more enhanced inflow of resources from the EU structural funds; hence, construction will remain the fastest growing industry. At the same time, the Central Bank expects only moderate growth of loans, exports and manufacturing industry. The average inflation rate in the year 2017 accelerated considerably compared to the year 2016 (0.1%) and may reach 2.9%, remaining at this level also in 2018, due to strong domestic consumption, increasing labor costs and energy prices, as well as the expected increase of excise tax.

The year 2017, as expected, turned out to be a challenging year for Latvian commercial banks. For the reasons described below, the total assets of Latvian banking sector fell to EUR 28.4 billion at the end of November 2017, decreasing by EUR 1.1 billion or 3.7% compared with the data at the end of the year 2016. The decrease of the asset volume was mainly due to continued fall of the volume of deposits, mostly non-resident, in the banking system, by EUR 1.2 billion or 5.7%. The outflow of deposits resulted in a reduction of the size of securities portfolios in the balance sheet of the banks, as well as loan portfolios. As a result, over the 11 months of the year 2017, the securities portfolio fell by EUR 0.8 billion or by 14.8% to EUR 4.2 billion, whereas the consolidated loan portfolio of Latvian banking system declined by 3.6% to EUR 14.6 billion (at the end of the year 2016: EUR 15.1 billion). The quality of issued loans marginally improved: the volume of non-performing loans (over 90 days) for the first 9 months of the year 2017 fell by 6.6%, and at the end of September 2017 amounted to EUR 628 million, i.e. to 4.3% of the total amount of the loan portfolio, compared with 4.4% at the end of the year 2016.

Liquidity of the banking system at the end of the third quarter of the year 2017 was at the level of 59.3%, compared with 61.9% at the end of the year 2016. Due to decreasing asset volume, capital adequacy indicators in Latvian banking sector increased and strengthened even more, significantly exceeding the minimum capital requirements: the overall capital indicator in the sector (CAR) at the end of the third quarter of the year 2017 reached 24.2% compared to 21.5% at the end of the year 2016, whereas tier 1 capital ratio (CET1) was at the level of 21.3% compared with 18.2% previously. The main phenomenon of the year 2017 was sharp deterioration of the sector's profitability. During the period from January to November 2017, the overall profit totaled EUR 237 million compared with EUR 440 million generated over the same period in the year 2016, i.e. falling by 46%.

General economic situation *(cont'd)*

During the period from January to September 2017, ROAE fell to 9.7%, compared with 15.7% a year before. Undoubtedly, profitability of Latvian banking sector peaked in 2016 due to the one-time transaction on sale of shares of Visa Europe, as a result of which the total profit of Latvian banks increased by more than EUR 100 million. However, even without taking into account the results of this transaction, we can conclude that the banking industry, operating in both resident and non-resident segments, despite maintaining its financial resilience reserve accumulated in previous years, should seriously reflect on its business model in the face of new political, economic and regulatory realities.

Operations during the reporting period

2017 was a year full of challenges, but in spite of the unfavorable external factors, the reporting period was quite successful for the Bank. According to the Association of Latvian Commercial Banks, as at 30 September 2017 the Bank was ranked 11th among Latvian banks by total assets and 9th by profits.

Following its development strategy, the Bank continued to work on enhancing its investment and lending products. In order to increase demand for the above services and attract new customers, the Bank paid particular attention to Customer service personnel training both in Latvia and in the Bank's offices in Ukraine (Odessa, Kiev, Dnipro).

As at December 2017, the average net yield on equity portfolios managed by the Bank pursuant to fiduciary arrangements with customers amounted to approximately 23%, which, in the Bank's opinion, is an excellent result. According to public information available to the Bank, the achieved results surpass the performance of virtually all equity funds offered on Latvian market. The basic principle of equity portfolio management is the strategy of searching substantially and fundamentally undervalued companies, whose shares are traded on the markets of developed countries. This is a long-term strategy, which does not involve frequent trading and whose expected long-term profitability is 15% per annum.

Another achievement of the year 2017 within the spectrum of investment services was implementation of the first investment deposit program, 'United States technology sector'. The program ended in January 2018, and its yield reached 3.5% per annum.

As a result of more prudent lending policy, the overall loan portfolio marginally decreased by 6.5%, however, at the same time its structure changed significantly: the volume of short-term loans increased by 13.3%, the share of loans issued to residents of the Republic of Latvia increased by 3.2% and the volume of loans undergoing foreclosure decreased by 34%.

During the year, customers paid off loans worth EUR 32.7 million whereas the Bank issued new loans worth EUR 33.5 million. As of 31 December 2017, the loan portfolio amounted to EUR 126 million.

Positive dynamics was demonstrated by payment card processing services. During the reporting period, the number of transactions made using POS terminals of the Bank increased by 144% and e-commerce turnover grew by 246%.

On 1 December 2017, the FCMC set the individual capital requirement for the Group amounting to 13.2%. The Bank continues to outperform this requirement, and the Group's ratio as at 31 December 2017 was 29.74%, 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 2017, the Bank's liquidity ratio amounted to 73.46%.

Throughout the past year, not only the Bank but also the entire industry was preoccupied with the issue of combating money laundering and terrorist financing, therefore, during the reporting period the Bank continued to pay particular attention to enhancing its internal control system and introducing new IT solutions to optimize both internal and external processes, as well as to ensure compliance with the requirements set forth in numerous regulations.

In the reporting period, the Bank pursued the de-risking work with regard to its customer base commenced already in 2015; as a result, in the year 2017 the number of customers decreased by 20%, indicating reduction of exposure to anti-money laundering and combating the terrorist financing (hereinafter - AML/CFT) risk.

Management report *(cont'd)*

Operations during the reporting period *(cont'd)*

Reduction of the customer base brought about decrease of statement of financial position indicators, e.g. the volume of deposits dropped by 30.73% over the year.

During the period from July 2016 to May 2017, the Financial and Capital Market Commission (FCMC) carried out a number of audits in the Bank, covering a nine-year period from 2008 to 2016. As a result, on 26 June 2017 the Bank and the FCMC concluded an administrative agreement according to which the Bank undertook to pay a fine of EUR 570 thousand.

During the reporting period, the Bank has undergone many structural changes. In June, Olexandr Kovalsky resigned from the position of the Chairman of the Board and a Board Member Alexander Yakovlev took over his responsibilities as an acting Chairman of the Board. As a result of changes in the management composition, the Bank's internal structure was revised. With a view to enhancing the effectiveness of the accounting for banking transactions, the Bank Operations Department has been created by combining several structural units, which is now responsible for recording of all the transaction entries.

Profit distribution recommended by the Management Board

The Management Board recommends not to distribute the profit for the reporting period

Plans and prospects for the year 2018

In accordance with the Bank's development strategy, approved by the Council, in 2018 the Bank will continue to develop a new business model, the work on which commenced already in 2016. Within the said business model, the Bank's successful development is no longer related to transfers business, but is based on offering a modern banking product range to the customers combined with high quality of customer service and tailored approach to each customer. In 2018 the Bank will pay particular attention to enhancing its investment and lending products.

Over the past years, the Bank has actively worked to improve its processes in the area of AML/CFT, making significant contributions into development of information systems and staff skills. The plan for the year 2018 involves further enhancement of the Bank's IT solutions in the field of AML/CFT, as well as preparatory work for the independent audit of the Bank's internal control system planned for the year 2019.

According to the Bank's Management, the amendments to the Latvian Law on the Prevention of Money Laundering and Terrorism Financing that are expected to be adopted in April 2018 and contain prohibition to service shell companies as well as prescribe practical steps for terminating business relationships with high risk clients subject to the planned restrictions will come to be yet another phase of the Bank's endeavor commenced back in 2015 to reduce the level of ML/TF risk inherent in the Bank's customer base. Taking into consideration the current changes in the Law and the progress of their approval, the Bank's Management does not expect a scenario, which could adversely affect Bank's ability to steadfastly implement its new business model. The Bank has modelled impact of the planned restrictions on the Bank's customer base as well as performed liquidity stress testing and the results demonstrate the Bank's capacity to perform its obligations to customers and partners in full as well as to continue its operation aimed at further development and performance enhancement in the new conditions.

Alexander Jakovlev	Yuriy Rodin
Acting Chairman of the Board	Chairman of the Council

Riga, 17 April 2018

The supervisory council and the board of directors of the bank

As at 31 December 2017 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

The Board

		Date of appointment
Alexander Jakovlev	Acting Chairman of the Board	06.08.2014.
Daiga Muravska	Member of the Board	Re-elected – 19.06.2017.
Gints Gritans	Member of the Board	05.06.2015.
Andrii Homza	Member of the Board	30.11.2016.

During 2017, the following changes took place in the composition of the Board of JSC Regionala investiciju banka:

By the decision of the Council of the Bank, dated 29 June 2017, Olexandr Kovalsky, Chairman of the Board of the Bank, was removed and Alexander Jakovlev, Member of the Board, appointed acting Chairman of the Board.

Alexander Jakovlev
Acting Chairman of the Board

Yuriy Rodin
Chairman of the Council

Riga, 17 April 2018

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 15 through 87 are prepared in accordance with the source documents and present fairly the financial position of the Group and the Bank as at 31 December 2017 and the results of their operations and cash flows for the reporting year 2017.

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.

Alexander Jakovlev
Acting Chairman of the Board

Yuriy Rodin
Chairman of the Council

Riga, 17 April 2018

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of AS Reģionālā Investīciju Banka

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of AS Reģionālā Investīciju Banka and its subsidiaries (the Group) and the accompanying financial statements of AS Reģionālā Investīciju Banka (the Bank) set out on pages 15 to 87 of the accompanying Annual Report, which comprise the statements of financial position as at 31 December 2017, 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 2017, 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 38 of the consolidated financial statements, which indicates that in February and March 2018 there have been announced changes in the legislation having direct impact on the Group's and the Bank's business model and activities going forward. As stated in Note 38 the amendments to the legislation have not yet been approved at the time of signing the Report, therefore the final interpretation of the Law on the Prevention of Money Laundering and Terrorism Financing is not yet known. 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.

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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 2017 amounted to EUR 98,805 million in the Bank's financial statements and to EUR 96,304 million in the Consolidated financial statements; the impairment reversal recognised in the Consolidated and the Bank's financial statements amounted to EUR 324 thousand in 2017. The total impairment loss allowance as at 31 December 2017 amounted to EUR 27 million (the Consolidated and the Bank's financial statements). The basis of the Bank's impairment provision policy is presented in the accounting policies section in Note 3 (i) to the financial statements. Critical accounting estimates and judgments, disclosures of loans and guarantees and the credit risk management are set out in Note 3 (ee), 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 Ukraine where economic activity is remaining rather low and unstable due to the tense geopolitical situation. We identified this area to be significant for the audit because recognition of allowances for loan loss impairment 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. 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 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.	Our audit procedures included, among others, the following: We gained understanding of such processes: the loan issuance, booking and monitoring and loan impairment provisioning. We tested the key controls over the loan issuance, booking and monitoring and loan impairment provisioning processes. 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, loans included in the watch-list, 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 any impairment 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 nonperforming 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 Bank's management. As to the performing loans and receivables, we assessed whether the borrowers exhibited the possible default risk that may affect meeting their scheduled repayment obligations. We obtained the IBNR calculation prepared by the Bank. We assessed the assumptions and principles used by the Bank to calculate provisions. We regarded that the amount had been disclosed in the accounts. We reviewed the Bank's accounting policies and the management's assumptions relating to the estimation of loan loss impairment allowances. We performed analytical procedures, such as comparison of loan loss impairment allowance balances to prior year, and other substantive procedures. We also assessed the adequacy of the financial statement disclosures in Note 3 (i), 3 (ee), 4 (a) and 13.

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Key audit matter	How we addressed the key audit matter
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 2017 amounting to EUR 10,328 million and EUR 2,274 million respectively. The largest repossessed property recorded in the Consolidated financial statements amounting to EUR 8 million is located in Germany (Berlin) and there are certain legal restrictions to be resolved. Some of the real estate is located in Ukraine (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 Group's management to make significant assumptions and involves judgements. As a result of Group's management impairment assessment, impairment charge amounting to EUR 1,032 million has been recognized in year 2017. 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 valuations 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 valuation reports 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 Note 3 (l), 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.

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Key audit matter	How we addressed the key audit matter
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 2017 the carrying amount of investment in the subsidiary was reported EUR 6,6 million. The loan issued to the subsidiary amounted to EUR 2,5 million. 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 2,5 million 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 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.	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 valuation 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. 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 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 Note 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.

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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 6 of the accompanying Annual Report;
- the Statement on Management Responsibility, as set out on page 7 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.

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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.

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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, 17 April 2018

Consolidated and Bank's Statement of Comprehensive Income

	Notes	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Interest income	5	10,041,559	10,067,948	9,583,303	9,583,303
Interest expense	5	(4,226,074)	(4,226,074)	(4,497,751)	(4,497,751)
Net interest income	5	**5,815,485**	**5,841,874**	**5,085,552**	**5,085,552**
Provisions for loan impairment	13	324,507	324,507	(5,322,062)	(5,322,062)
Net interest income after provision for loan impairment		**6,139,992**	**6,166,381**	**(236,510)**	**(236,510)**
Fee and commission income	6	7,579,321	7,579,442	9,356,742	9,356,799
Fee and commission expense	6	(1,303,580)	(1,303,580)	(1,318,811)	(1,318,811)
Net fee and commission income	6	**6,275,741**	**6,275,862**	**8,037,931**	**8,037,988**
Gain from sale of available-for-sale financial assets, net		-	-	1,256,507	1,256,507
Loss from sale of financial assets at fair value through profit or loss, net		(3,286)	(3,286)	(1,724)	(1,724)
Loss from revaluation of securities at fair value through profit or loss, net		(127,793)	(127,793)	(114,742)	(114,742)
Profit/ loss from derivative financial instruments revaluation, net		308,132	308,132	(48,986)	(48,986)
Gain from trading in foreign currencies, net		1,937,941	1,937,941	2,880,341	2,880,341
Gain loss from foreign exchange translation, net		594,669	594,669	301,166	301,166
Impairment loss on other assets		(157,866)	(157,866)	(25,431)	(25,431)
Other operating income	8	342,599	314,283	482,458	482,458
Total operating income		**15,310,129**	**15,308,323**	**12,531,010**	**12,531,067**
Administrative expenses	7	(8,705,426)	(8,625,480)	(8,669,809)	(8,649,524)
Amortization and depreciation charges	16,17	(505,203)	(505,203)	(374,129)	(374,129)
Other expense	9	(2,891,643)	(2,888,200)	77,183	77,183
Profit before corporate income tax		**3,207,857**	**3,298,440**	**3,564,255**	**3,584,597**
Corporate income tax	10	(617,152)	(617,152)	(1,006,442)	(1,006,442)
Net profit for the year		**2,590,705**	**2,672,288**	**2,557,813**	**2,578,155**
Items that can be reclassified subsequently to profit or loss: Net gain from revaluation of available-for-sale financial assets		45,970	45,970	-	-
Total other comprehensive income		**45,970**	**45,970**	-	-
Total comprehensive income for the year attributable to the shareholders of the Bank		**2,636,675**	**2,718,258**	**2,557,813**	**2,578,155**

The Consolidated and Bank's financial statements on pages 15 through 87 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by

Alexander Jakovlev
Acting Chairman of the Board

Yuriy Rodin
Chairman of the Council

Riga, 17 April 2018

The accompanying notes on pages 19 through 87 form an integral part of these financial statements.

Consolidated and Bank's Statement of Financial Position as at 31 December 2017

	Notes	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Assets					
Cash and balances with the Bank of Latvia	11	90,638,213	90,638,213	148,906,810	148,906,810
Balances due from banks	12	89,439,452	89,439,452	99,833,647	99,833,647
Loans and advances to customers	13	96,304,200	98,805,033	99,513,448	99,513,448
Financial assets at fair value through profit or loss	14	60,350,334	60,350,334	125,243,072	125,243,072
Available-for-sale financial assets	18	234,942	234,942	188,972	188,972
Derivative financial instruments	26	65,756	65,756	483,074	483,074
Intangible assets	16	573,148	573,148	524,995	524,995
Property and equipment	17	13,822,007	13,822,007	14,868,398	14,868,398
Investment in subsidiary	15	-	6,600,000	-	6,600,000
Other assets	19	15,281,163	6,628,282	5,390,091	5,390,054
Deferred expenses		254,265	254,265	247,214	247,214
Total assets		**366,963,480**	**367,411,432**	**495,199,721**	**501,799,684**
Liabilities					
Deposits from customers	21	296,482,449	296,830,563	421,912,801	428,493,320
Derivative financial instruments	26	652,318	652,318	1,378,768	1,378,768
Other financial liabilities	23	501,521	499,434	668,967	668,069
Deferred income and accrued expenses	24	888,969	888,969	712,986	712,986
Debt securities	22	16,763,810	16,763,810	19,072,989	19,072,989
Subordinated loans	35	12,367,892	12,367,892	14,072,281	14,072,281
Current income tax liabilities		75,517	75,517	555,683	555,683
Deferred tax liability	25	-	-	230,917	230,917
Total liabilities		**327,732,476**	**328,078,503**	**458,605,392**	**465,185,013**
Equity					
Share capital	27	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	-	-
Retained earnings		6,850,272	6,952,197	4,259,567	4,279,909
Total equity		**39,231,004**	**39,332,929**	**36,594,329**	**36,614,671**
Total liabilities and equity		**366,963,480**	**367,411,432**	**495,199,721**	**501,799,684**
Off-balance sheet items					
Guarantees issued	28	8,931,032	8,931,032	5,460,027	5,460,027
Financial commitments	28	21,745,831	21,745,831	20,762,556	20,762,556
Assets under management	36	88,244,813	88,244,813	111,570,097	111,570,097

The Consolidated and Bank's financial statements on pages 15 through 87 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by

Alexander Jakovlev
Acting Chairman of the Board

Yuriy Rodin
Chairman of the Council

Riga, 17 April 2018

The accompanying notes on pages 19 through 87 form an integral part of these financial statements.

Consolidated Statement of Changes in Equity for the year ended 31 December 2017

	Paid-in share capital	Reserves	Retained earnings	Revaluation reserve on available-for-sale financial assets	Total
	EUR	EUR	EUR	EUR	EUR
Balance as at 31 December 2015	**32,334,762**	-	**1,701,754**	**919,970**	**34,956,486**
Profit for the year	-	-	2,557,813	-	2,557,813
Change in the revaluation reserve	-	-	-	(919,970)	(919,970)
Total comprehensive income for the year	-	-	**2,557,813**	**(919,970)**	**1,637,843**
Denomination of the share capital into EUR	(6)	6	-	-	-
Balance as at 31 December 2016	**32,334,756**	**6**	**4,259,567**	-	**36,594,329**
Profit for the year	-	-	2,590,705	-	2,590,705
Change in the revaluation reserve	-	-	-	45,970	45,970
Total comprehensive income for the year	-	-	**2,590,705**	**45,970**	**2,636,675**
Balance as at 31 December 2017	**32,334,756**	**6**	**6,850,272**	**45,970**	**39,231,004**

Bank's Statement of Changes in Equity for the year ended 31 December 2017

	Paid-in share capital	Reserves	Retained earnings	Revaluation reserve on available-for-sale financial assets	Total
	EUR	EUR	EUR	EUR	EUR
Balance as at 31 December 2015	**32,334,762**	-	**1,701,754**	**919,970**	**34,956,486**
Profit for the year	-	-	2,578,155	-	2,578,155
Change in the revaluation reserve	-	-	-	(919,970)	(919,970)
Total comprehensive income for the year	-	-	**2,578,155**	**(919,970)**	**1,658,185**
Denomination of the share capital into EUR	(6)	6	-	-	-
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**

The accompanying notes on pages 19 through 87 form an integral part of these financial statements.

Consolidated and Bank's Statement of Cash Flows for the year ended 31 December 2017

	Notes	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Cash flows from/ (used in) operating activities					
Interest received		10,800,555	10,826,110	10,193,843	10,193,843
Interest paid		(4,256,962)	(4,256,962)	(4,456,613)	(4,456,613)
Fees and commission received		7,579,321	7,579,442	9,356,742	9,356,799
Fees and commission paid		(1,303,580)	(1,303,580)	(1,318,811)	(1,318,811)
Expense/ income from sale of available-for-sale financial assets		(2,781)	(2,781)	980,702	980,702
Income from foreign exchange		1,936,941	1,936,941	2,880,341	2,880,341
Other operating income		339,238	314,283	482,457	482,457
Personnel expenses		(6,462,584)	(6,451,824)	(5,711,430)	(5,707,569)
Administrative and other operating expenses		(3,165,310)	(3,094,033)	(2,881,196)	(2,864,772)
Income tax paid		(1,328,235)	(1,328,235)	(253,551)	(253,551)
Cash flows generated from operating activities before changes in operating assets and liabilities		**4,136,603**	**4,219,361**	**9,272,484**	**9,292,826**
Changes in operating assets and liabilities					
Decrease in securities at fair value through profit or loss		52,509,083	52,509,083	164,497,985	164,497,985
(Increase)/ decrease in balances due from banks		(2,460,759)	(2,460,759)	9,097,720	9,097,720
(Increase) in loans and advances to customers, net		(13,401,259)	(8,615,459)	(36,702,457)	(36,702,457)
(Increase)/ decrease in other assets		(2,401,016)	(1,037,169)	1,479,058	1,479,095
Decrease in deposits from customers, net		(90,614,806)	(96,847,211)	(169,548,464)	(162,967,945)
Increase in other liabilities, net		2,159,494	2,159,494	39,615	38,717
Net cash flows (used in) operating activities		**(50,072,660)**	**(50,072,660)**	**(21,864,059)**	**(15,264,059)**
Cash flows to/ from investing activities					
Investment in subsidiary		-	-	-	(6,600,000)
Purchase of intangible assets		(181,665)	(181,665)	(358,014)	(358,014)
Purchase of property and equipment		(261,183)	(261,183)	(251,827)	(251,827)
Net cash flows used in investing activities		**(442,848)**	**(442,848)**	**(609,841)**	**(7,209,841)**
Cash flows to/ from financing activities					
Issue of debt securities		-	-	17,794,806	17,794,806
Net cash from financing activities		**-**	**-**	**17,794,806**	**17,794,806**
Effect of exchange rates on cash and cash equivalents		(17,658,581)	(17,658,581)	5,409,256	5,409,256
Net increase/(decrease) in cash and cash equivalents		**(68,174,089)**	**(68,174,089)**	**730,162**	**730,162**
Cash and cash equivalents at the beginning of the year	20	244,732,565	244,732,565	244,002,403	244,002,403
Cash and cash equivalents at the end of the year	**20**	**176,558,476**	**176,558,476**	**244,732,565**	**244,732,565**

The accompanying notes on pages 19 through 87 form an integral part of these financial statements.

Notes to the financial statements

Note 1 Incorporation and principal activities

JSC Regionala investiciju 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.

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.

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.Alunana Street 2
LV-1010, Riga
Latvia
The legal and office address of SIA Grunewald Residence is:

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 17 April 2018.

Note 2 Operating environment of the bank and the group

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 2017 and 31 December 2016:

	31.12.2017 Group '000 EUR	31.12.2017 Bank '000 EUR	31.12.2016 Group '000 EUR	31.12.2016 Bank '000 EUR
Statement of financial position assets subject to Ukraine country risk:				
Balances due from banks	6,261	6,261	2,281	2,281
Loans issued and other receivables	36,058	36,058	18,358	18,358
Total	**42,319**	**42,319**	**20,639**	**20,639**
Off-balance sheet items subject to the Ukraine country risk:				
Off-balance sheet financial commitments	5,454	5,454	2,599	2,599
Total	**5,454**	**5,454**	**2,599**	**2,599**

In 2017, the macroeconomic situation in Ukraine continued to exhibit stabilization after the severe crisis experienced in 2014–2015. After the real GDP growth by 2.3% in 2016, the forecasted data for the year 2017 demonstrated a sustained upward trend: in Q1, the economic growth rate reached 2.5%, in Q2 – 2.3%, in Q3 – 2.1% and in Q4 – 1.8%, compared to the previous year. The provisional data show that the real GDP growth in 2017 might reach 2.1%. The inflation rate slightly exceeded the prior year level (12.2%) growing to 13.7%.

Note 2 Operating environment of the bank and the group *(cont'd)*

The upswing in economic activity was facilitated both by external and internal factors. In 2017, international market forces were favorable to many Ukrainian export sectors which together with the flexibility of the national currency rate allowed to increase export volumes by more than 20% in the first 10 months of the year. At the same time, in this period export of goods to EU countries grew by more than 30%. In the internal market, the leading position was still maintained by the construction sector the real growth rate of which reached 25-30% in the first 9 months of the year. The political situation in Ukraine continued to be dynamic; however, the government in its current composition had already been functioning for more than one and a half year, which allowed to start the implementation of several structural reforms. The reforms were also supported by international partners. In 2017, the International Monetary Fund allocated another tranche of USD 1 billion under the program of financial support, the European Union granted USD 600 million for macroeconomic stability support, while the World Bank granted USD 150 million for the support of small and medium entities focusing on export. Of course, the major financial event of the year was Ukraine returning to the international capital markets. In September, international investors were attracted by issuing sovereign euro bonds for the total amount of USD 3 billion with a maturity of 15 years. The gold and foreign currency reserves of the central bank increased by 21% up to USD 18.8 billion during the year; however, notwithstanding that the state budget deficit was likely to be 2.4% of GDP, which is below the earlier forecasts, in the period January – September 2017 the government debt and debt guaranteed by it increased by USD 5.2 billion reaching USD 75.9 billion. Given the fact that in the current year Ukraine must raise USD 4 billion for external debt repayment and servicing, cooperation with the International Monetary Fund and the European Union is still very important for the country, and the government will have to return to considering several issues that are significant from the point of view of internal policy, namely, legislation on the land reform and anti-corruption.

In relation to the future economic prospects, both Ukrainian state institutions and most of the international financial institutions expect that the real GDP growth could reach at least 3%. In 2017, the international rating agencies Standard & Poor's and Fitch approved Ukrainian sovereign credit rating at "B-" with a stable outlook, while the agency Moody's increased the rating to "Caa2" with a positive outlook.

A consolidation process in the Ukrainian banking system continued. In the first 11 months of 2017, the number of Ukrainian banks decreased from 96 to 86. Nevertheless, decrease was avoided in the total assets of the banking system (growth by 2.1%), loans made (growth by 0.2%), and especially this refers to the deposits of private individuals (growth by 4.3%). Due to inflation, at the end of 2017, the Central Bank of Ukraine had to increase its base rate to 14.5%; thus, during the previous year, it increased accordingly by 0.5 percentage points, while the exchange rate for the Ukrainian hryvnia (UAH) against the USD fell by 5.3% and against the euro - by 16.1%. Despite this fact, due to the inflow of retail deposits, in 2017 interest rates for 12-month deposits decreased by 3.4 percentage points to 14.3% for UAH-denominated deposits and by 2.0 percentage points to 3.7% - for USD-denominated deposits. The stability of the banking system was also ensured by the fact that the banks with public and foreign capital dominate in it. However, the issues of Ukrainian banking system are still far from the final solution. It is also confirmed by the statistics on non-performing loans. On 1 January 2017, the new regulations of the Central Bank of Ukraine with respect to the methodology of credit risk assessment came into force. The objective of the regulator was to bring Ukrainian standards closer to the international ones. As a result, it turned out that the level of non-performing loans in the banking system is the highest in the world, exceeding 50% mainly due to the loan portfolio of the nationalized Privātbanka. In the private commercial banks, this ratio is significantly lower, namely, slightly below 30%. In any case, according to global standards it is a very high ratio which entails that in 2018 one of the priorities both for the Central Bank of Ukraine and commercial banks will be improving of the loan portfolio quality.

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.

Note 2 Operating environment of the bank and the group *(cont'd)*

Impact on collateral

The amount of provision 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 provisions for impairment.

NOTE 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 2017 and 2016, are set out below:

(a) 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.

(b) 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 available for sale 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 2017, if compared to those of 2016, except for the accounting for buildings and land under the Property and Equipment category (see Note 17).

(c) 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.

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

(d) 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.

When there are doubts regarding the loan recovery, the loans are written down to their recoverable amounts and interest income is thereafter recognized based on the interest rate used in discounting the future cash flows for measuring the recoverable amount

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.

(e) Foreign currency translation

Functional and presentation currency

The functional currency of the Group companies is the currency of the primary economic environment in which the Group 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
As at 31 December 2017	1,1993
As at 31 December 2016	1,0541

(f) Income taxes

Income taxes include current and deferred taxes. Current corporate income tax is applied at the statutory rate of 15%.

Legal entities will not be 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 will be 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 will be 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 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.

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

(g) Deferred tax assets and liabilities

Until 31 December 2017, deferred tax was 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 were measured at the tax rates that were expected to apply to the period when the asset was realized or the liability was settled, based on tax rates that had been enacted or substantively enacted by the reporting date.

Deferred liabilities are not recognized for the year 2017 in accordance with amendments to the legislation of the Republic of Latvia, which entered into force on 1 January 2018. Accordingly, deferred tax liabilities which were calculated and recognized in previous reporting periods have been reversed through the current statement of comprehensive income in the financial statements for the year ended 31 December 2017; according to the International Accounting Standard, changes in the tax legislation must be presented in financial statements in the period when they are adopted.

(h) 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.

(i) Loans and provisions for loan impairment

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.

The Bank assesses at each reporting date whether there is any objective evidence that loans and advances to customers are impaired. If any such evidence exists, the loan impairment loss which has been incurred due to the deterioration of loan quality is 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) provisions relate to the existing credit losses, as well as 'incurred, but not yet identified losses'. Collective loan impairment exists if after the initial recognition of loans a decrease in the future credit cash flows which can be measured reliably, notwithstanding that this decrease cannot yet be attributed to individual loans. The amount of collective impairment is 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 may have an adverse impact on the future cash flows intended for the repayment of loans. The established methodology allow to link each group of loans with similar characteristics with information on historical loss experience and relevant market data reflecting the current conditions.

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

The following are the other criteria also used to determine whether there is objective evidence that an impairment loss has 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.

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

(i) Loans and provisions for loan impairment *(cont'd)*

The assessment of the evidence for impairment and the determination of the amount of provision for impairment or its reversal require the application of the Management's judgment and estimates. The Management's judgments and estimates consider 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 affects 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. These judgments and estimates are reviewed periodically, and historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The Management of the Bank has made their best estimates of losses, based on objective evidence of impairment and believes those estimates presented in the financial statements are reasonable in light of available information. Nevertheless, it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the asset or liability affected.

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 until all the necessary legal procedures have been completed and the amount of the loss is finally determined.

(j) 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. 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 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. 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. The provisions for off-balance sheet transactions are established in accordance with the principles described in the paragraph on provisions of Note 3.

(k) 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.

(l) 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.

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

(m) 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.

(n) Sale and repurchase agreements

Sale and repurchase agreements are accounted for as financing transactions. Under sale and repurchase agreements, where the Group and the Bank are a 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.

(o) Derivative financial instruments

Derivative financial instruments include foreign exchange contracts, currency and interest rate swaps held by the Group and the Bank for trading purposes. Derivative financial instruments are recognized on trade date and categorized as financial assets at fair value through profit or loss. They are initially recognized at fair value and subsequently measured at their fair value with all gains and losses from revaluation reported in the profit and loss statement. All derivatives are carried as financial assets when fair value is positive and as financial liabilities when fair value is negative.

(p) 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.

(q) Available-for-sale financial assets

Available-for-sale financial assets consists of financial instruments held by the Group and the Bank for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. They are stated at fair value with all gains and losses from revaluation recognized in the statement of comprehensive income, except for foreign exchange gains and losses until derecognition at which time the cumulative gain or loss previously recognized in the statement of comprehensive income is taken to the statement of profit or loss. Dividends on investment securities available-for-sale are recognized in the statement of profit or loss when the right to receive payment is established.

(r) 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. In active markets fair values of financial assets or liabilities, including derivative financial instruments, are based on quoted market prices. If the market for a financial asset or liability is not active (as well as for unlisted securities), the Group and the Bank establish fair value by using valuation techniques. These include the use of discounted cash flow analysis and recent comparable transactions, as appropriate, and may require the application of Management's judgment and estimates.

Where, in the opinion of the Management, the fair values of financial assets and liabilities differ materially from their carrying amounts, such fair values are separately disclosed in the notes to the financial statements

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

(s) Derecognition of financial assets

The Bank derecognizes financial assets when (i) the assets are redeemed or the rights to receive cash flows from the assets have expired or (ii) the Group and the Bank has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group and the Bank has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without imposing additional restrictions.

(t) 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. These costs are amortized on the basis of their expected useful lives, not exceeding five years. Intangible assets are amortized over their estimated useful lives, not exceeding 5 years, on a straight-line basis.

(u) Property and equipment

The items of property and equipment are stated at cost less accumulated depreciation. 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 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.

(w) Operating lease

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments (excl. any financial incentives received from the lessor) are recognized as an expense in the statement of comprehensive on a straight-line basis over the lease term.

(x) Deposits from customers

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

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

(y) 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.

(z) 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.

(aa) 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.

(bb) 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. According to the Regulations of the Cabinet of Ministers of the Republic of Latvia, 69.99% (2016: 69.99%) of the social insurance contributions are used to finance the State funded pension scheme.

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.

(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

Assessment of loans and advances to customer

The Group and the Bank regularly assess the issued loans whether there has been no loan impairment. In order to determine whether an impairment loss should be recognized in the statement of comprehensive income, the Group and the Bank use estimates and assumptions in respect of the recoverable amount of the loans, including the fair value and cost to sell the collaterals and the timing of sale of collaterals. The Management of the Group and the Bank has estimated that the provisions based on the individual assessment of the loans are sufficient to cover all impairment losses related to loss events incurred before the reporting date. The main indicator of incurrence of loss event is considered to be delays in principal or interest payments. If overdue loans in the loan portfolio had increase by 1%, provisions for loan impairment losses would have increased by EUR 270 thousand (2016: EUR 350 thousand).

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

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

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 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.

Impairment of available-for-sale financial assets

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 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.

(ff) Adoption of new or revised standards and interpretations

The following new and amended IFRS and interpretations became effective in 2017, but have no significant impact on these financial statements:

- **IAS 12: Recognition of Deferred Tax Assets for Unrealized Losses (Amendments)**

The objective of the amendments is to clarify the requirements of deferred tax assets for unrealized losses in order to address diversity in practice in the application of IAS 12 Income Taxes. The specific issues where diversity in practice existed relate to the existence of a deductible temporary difference upon a decrease in fair value, to recovering an asset for more than its carrying amount, to probable future taxable profit and to combined versus separate assessment. These amendments are not applicable to the Group and the Bank.

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

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

- **IAS 7: Disclosure Initiative (Amendments)**

The objective of the amendments is to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments specify that one way to fulfil the disclosure requirement is by providing a tabular reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including changes from financing cash flows, changes arising from obtaining or losing control of subsidiaries or other businesses, the effect of changes in foreign exchange rates, changes in fair values and other changes. 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. The following annual improvement has not yet been endorsed by the EU. This improvement did not have an effect on the Group and Bank's financial statements.

- **IFRS 12 Disclosure of Interests in Other Entities:** The amendments clarify that the disclosure requirements in IFRS 12, other than those of summarized financial information for subsidiaries, joint ventures and associates, apply to an entity's interest in a subsidiary, a joint venture or an associate that is classified as held for sale, as held for distribution, or as discontinued operations in accordance with IFRS 5.

The following standards and interpretations have been published and are effective for annual periods beginning on or after 1 January 2018 or are not yet endorsed in the EU and which the Management of the Group and the Bank considers not relevant for the Group and Bank's operations:

- **IFRS 9 Financial Instruments: Classification and Measurement**

The standard is effective for annual periods beginning on or after 1 January 2018, with early application permitted. 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.

Classification and measurement

From a classification and measurement perspective, the new standard will require all financial assets, except for equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories will be replaced by:

- Fair value through profit or loss;
- Fair value through other comprehensive income;
- Amortized cost.

Having completed the initial assessment, the Group and the Bank have concluded that:

- Loans and advances to banks classified as loans and receivables under IAS 39 are expected to be measured at amortized cost under IFRS 9;
- Derivative financial instruments and financial assets designated at t fair value through profit or loss are expected to be continue to be measured at fair value through profit or loss;
- Debt securities classified as available for sale under IAS 39 are expected to be measured at fair value through other comprehensive income.

The accounting for financial liabilities will mostly be the same as under IAS 39.

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

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

IFRS 9 will also fundamentally change the loan loss impairment methodology. The standard will replace the incurred loss approach under IAS 39 with a forward-looking expected loss approach. The Group and the Bank will be required to record a provision for expected losses for all loans and other financial assets not held at fair value through profit or loss or at fair value through other comprehensive income, together with loan commitments and financial guarantee contracts.

The provision is based on the 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, in which case, the provision is based on the probability of default over the life of the asset.

The Group and the Bank have established a policy to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.

In comparison to IAS 39, the Group and the Bank expects the impairment charge under IFRS 9 to be more volatile than under IAS 39 and to result in an increase in the total level of current impairment provisions by EUR 4.6-5.8 million.

The Group and the Bank is going to group its loans into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:

- Stage 1 – Performing loans: when loans are first recognized, the Group and the Bank recognize a provision based on 12-month expected credit losses. Under IAS 39 the Group and the Bank have been recording a provision for incurred but not identified (IBNR) impairment losses). It is expected that provision for impairment losses will higher than the current IBNR provision under IAS 39.
- Stage 2 – Underperforming loans: when a loan shows a significant increase in credit risk, the Group and the Bank record a provision for the lifetime expected credit loss. Since this is a new concept compared to IAS 39, the Group and the Bank expects that this would result in a substantial additional increase in the impairment provision. The Group and the Bank consider whether there has been a significant increase in credit risk of an asset by comparing the lifetime probability of default upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In accordance with IFRS 9, a significant increase in credit risk is assumed if the borrower falls more than 30 days past due in making its contractual payments or a loan is rescheduled or any other events are identified which indicate to increased credit risk.
- Stage 3 – Impaired loans. Financial assets will be included in Stage 3 when there is objective evidence that the loan is credit impaired or the borrower falls 90 days past due with its contractual payments. For those loans, the Group and the Bank recognize impairment expected over the contract term. As the criteria of such objective evidence are the same as under the current IAS 39 methodology, the Group and the Bank do not expect a substantial increase in the impairment provision. Impairment on an individual basis will continue to be calculated on the same basis as under IAS 39.

Transition

In accordance with IFRS 9, in applying of this standard, the Group and the Bank do not intend to apply a full retrospective adjustment. The changes in the carrying value of financial assets resulting from the application of this standard will be recognized in retained earnings and reserves as at 1 January 2018.

Capital management

Considering that Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures has been applied since 1 January 2018, the Bank elected to apply a transitional period for the introduction of IFRS 9; and during the transitional period the Bank will also use the calculation specified in Article 473(a)(4). Accordingly, the impact of the year 2018 on equity will constitute 5 percent of the difference arising from the application of IFRS 9 in comparison with IAS 39; and as at 1 January 2018 the impact on the equity will be EUR 0.3 thousand.

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

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

- IFRS 15 Revenue from Contracts with Customers

The standard is effective for annual periods beginning on or after 1 January 2018. 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 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. The standard is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. The Group and the Bank have made an initial assessment as to whether the adoption of IFRS 15 could affect their consolidated and separate financial statements. The assessment especially focused on proceeds from sales of repossessed assets and commission income.

The Group and the Bank derive the most significant fee and commission income (apart of those included in the effective interest rate calculation) from rendering the following services:

- Cash transfers;
- Customer service;
- Settlement card transactions.

The results of the initial assessment revealed that the adoption of IFRS 15 will not have a vital effect on the timing of proceeds from sales of repossessed assets and commission income recognition or measurement.

- IFRS 15: Revenue from Contracts with Customers (Clarifications)

The Clarifications apply for annual periods beginning on or after 1 January 2018 with earlier application permitted. 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. It is expected that upon the first-time adoption these clarifications will have no effect on the Group and Bank's financial statements.

- 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 have started to assess the possible effect of the standard on their consolidated and separate financial statements and have concluded that, in accordance with the new standard, they will have to recognize new (additional) assets and liabilities under operating leases. The Group and the Bank plan to apply IFRS 16 as of 1 January 2019 and have concluded that the effect will not be material on the Group and Bank's financial statements.

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

The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. 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. It is expected that upon the first-time adoption these amendments will have no effect on the Group and Bank's financial statements.

- **IAS 40: Transfers to Investment Property (Amendments)**

The amendments are effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. 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. It is expected that upon the first-time adoption these amendments will have no effect on the Group and Bank's financial statements.

- **IFRS 9: Prepayment features with negative compensation (Amendments)**

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. The amendments have not yet been endorsed by the EU.

- **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.

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

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

- **IFRIC INTERPRETATION 22: Foreign Currency Transactions and Advance Consideration**

The interpretation is effective for annual periods beginning on or after 1 January 2018 with earlier application permitted. 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. This interpretation has not yet been endorsed by the EU.

- The **IASB has issued the Annual Improvements to IFRSs 2014 – 2016 Cycle,** which is a collection of amendments to IFRSs. The amendments are effective for annual periods beginning on or after 1 January 2018 for IFRS 1 First-time Adoption of International Financial Reporting Standards and for IAS 28 Investments in Associates and Joint Ventures. Earlier application is permitted for IAS 28 Investments in Associates and Joint Ventures. These annual improvements have not yet been endorsed by the EU.
  - **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.SFPIK
- **IFRIC INTERPRETATION 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. This interpretation has 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.

The Group and the Bank have elected not to adopt the new standards and interpretations in advance of their effective dates. The Group and the Bank expect that the adoption of the new standards and interpretations will have no material impact on the financial statements of the Group and the Bank in the period of initial application, except for IFRS 9 (effective for annual periods beginning on or after 1 January 2018).

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

(gg) Categories of financial instruments

Financial instruments held by the Group and the Bank can be classified as loans and receivables, financial assets/ liabilities at fair value through profit or loss, available-for-sale financial assets and financial liabilities at amortized cost. The Group and the Bank do not possess any held-to-maturity instruments. Financial instruments held by the Group and the Bank are split by categories as follows:

- Loans and receivables comprise cash and balances with the Bank of Latvia, balances due from banks, loans and advances to customers and other financial assets;
- Financial assets at fair value through profit or loss comprise financial assets at fair value through profit or loss and derivative financial instruments;
- Available-for-sale financial assets are comprised of comprise available-for-sale financial assets;
- Financial liabilities at fair value through profit or loss comprise derivative financial instruments;
- Financial liabilities at amortized cost comprise balances due to other banks, deposits from customers, subordinated loans and other financial liabilities.

Note 4 Financial 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. 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.

Note 4 Financial risk management *(cont'd)*

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

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

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Assets subject to credit risk:				
Balances on demand with the Bank of Latvia	90,638,213	90,638,213	147,836,974	147,836,974
Loans to banks	89,439,452	89,439,452	99,833,647	99,833,647
Loans to customers	96,304,200	98,805,033	99,513,448	99,513,448
Financial assets at fair value through profit or loss	60,350,334	60,350,334	125,243,072	125,243,072
Derivative financial instruments	65,756	65,756	483,074	483,074
Other financial assets	3,878,758	3,280,184	2,645,478	2,645,441
Total	**340,676,713**	**342,578,972**	**475,555,693**	**475,555,656**
Off-balance sheet items subject to credit risk:				
Contingent liabilities	8,931,032	8,931,032	5,460,027	5,460,027
Financial commitments	21,745,831	21,745,831	20,762,556	20,762,556
Total	**30,676,863**	**30,676,863**	**26,222,583**	**26,222,583**

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. One of criteria in determining credit quality is overdue days of the payment, as compared to the original agreement date. Credit quality criteria applied to loans from legal entities are the results of operating activities of the borrower, as well as perspective on development, current and planned cash flow available for settlement of liabilities, compliance with monitoring/ risk factors, value of collateral etc.

Significantly overdue loans are those overdue for more than 90 days. Impaired loans are loans for which the Group and the Bank have raised provisions arising from a loss event as well as loans overdue for more than 90 days and loans where beginning the process of loan recovery is planned. In these financial statements, information on overdue loans is disclosed starting with the first overdue day.

Loan loss events are:

- Significant financial difficulty of the borrower;
- Breach of loan covenants;
- Relieves provided to the borrower due to such economic or legal aspects, related to financial difficulties of the borrower, which the Group and the Bank would not provide otherwise;
- Rather high probability that the borrower will start bankruptcy procedure or any other type of financial reorganization;
- Not being able to meet the preconditions of the project, underlying the issuance of the loan;
- Breach of liabilities due to the borrower's related party which has an impact on the borrower's ability to fulfil its obligations;
- Decrease in the collateral value in case the repayment of the loan directly depends on the collateral value;
- Other events increasing credit risk.

The primary factors that the Group and the Bank consider in determining whether a loan is impaired are its overdue status and liquidity of related collateral, if any.

The Group and the Bank classify their loans which are not impaired as standard loans, close-watch loans and substandard loans.

Standard loans are loans, maturity of which is not doubted. Standard loans are those, impairment provisions for which based on present value of future cash flows are 0% to 1%. Standard loans are comprised of loans to legal entities with no expectancy of fulfilment of obligation, as current and future cash flows are sufficient to fulfil the obligations.

Note 4 Financial risk management *(cont'd)*

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

Close-watch loans are loans requiring additional control from the Group and the Bank, as these have potential uncertainly which, remaining the same, may potentially endanger fulfilment of obligations in the future and create loss to the Group and the Bank. Close-watch loans are all those loans where impairment provisions, calculated on the basis of present value of future cash flows, are 1% to 20%. Close-watch loans are comprised of loans, where:

- Economic or market conditions have an adverse impact on the borrower or respective industry;
- Tendencies of deterioration in the borrower's financial position are observed or the balance sheet of the borrower is indicative of instability, however, not so significant, as to endanger the repayment of the loan at present.

Substandard loans are loans with clear uncertainties about the fulfilment of credit obligations in full amount and which will create loss to the Group and the Bank, if the uncertainty is not removed. Substandard loans are all those loans where impairment provisions, calculated on the basis of present value of future cash flows, are above 21%. Loans classified as substandard are comprised of loans, where:

- Cash flows of the borrower are insufficient to ensure regular payments in accordance with the agreement terms;
- The Group and the Bank received insufficient current information on the borrower's financial condition or inappropriate documentation on the conditions of the pledge and sources of fulfilment of credit obligations.

(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.

(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's and Bank's equity and that the total foreign currency open position may not exceed 20% of the equity. In 2017 and 2016 the Group and the Bank complied with these limits (see Note 30). The Group and the Bank has 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.

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

Note 4 Financial risk management *(cont'd)*

(c) Currency risk *(cont'd)*

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):

31.12.2017	Effect on profit/ loss and equity		31.12.2016	Effect on profit/ loss and equity	
	+10%	-10%		+10%	-10%
USD	(22)	20	**USD**	(30)	30
Total	(22)	20	**Total**	(30)	30

(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 32).

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.

Note 4 Financial risk management *(cont'd)*

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

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):

31.12.2017	Effect on profit/ loss and equity		31.12.2016	Effect on profit/ loss and equity	
USD	(516)	516	**USD**	(852)	852
EUR	(120)	120	**EUR**	(166)	166
Total	**(636)**	**636**	**Total**	**(1 018)**	**1 018**

(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.

The Group and the Bank does 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 on 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 31). 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.

Note 4 Financial risk management *(cont'd)*

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

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 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:

- Capital requirements for the credit risk are calculated using the standardized approach;
- The Financial Collateral Simple Method is used in order to decrease the credit risk;
- Capital requirements for the foreign exchange risks, capital requirements for the commodities risk, capital requirements for the position risk of debt securities and equities are calculated using the standardized approach;
- Capital requirements for the general risk of debt securities are calculated using the maturity method;
- Capital requirements for the operational risk are calculated using the basic index approach.

The Group and the Bank also evaluates 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.

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 2017 was 29.74% and 30.12% (31 December 2016: 31.53% and 30.51%), which is above the minimum set by Regulation (EU) No 575/2013 of the European Parliament and the Council 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 29). At the end of 2017 the FCMC 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 as at 31 December 2017 and 31 December 2016.

(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 maintains an Operational Risk Event and Loss database in which internal data on operational risk events and associated losses are collected, processed and organized.

Note 4 Financial risk management *(cont'd)*

(g) Operational risk *(cont'd)*

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 is each and every 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.

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 is 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.

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.

Note 4 Financial risk management *(cont'd)*

(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 2017-2019;
- Sanctions Compliance Program JSC Regionala investiciju banka 2017 – 2019;
- 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;
- 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.

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

Note 5 Interest income and expense

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Interest income				
Loans and advances to legal entities	6,784,096	6,810,485	5,631,576	5,631,576
Loans and advances to private individuals	873,045	873,045	710,730	710,730
Balances due from banks	1,341,650	1,341,650	1,653,308	1,653,308
Debt securities held for trading	1,025,641	1,025,641	1,587,689	1,587,689
Other interest income	17,127	17,127	-	-
Total interest income	**10,041,559**	**10,067,948**	**9,583,303**	**9,583,303**
Interest expense				
Due to private individuals	(57,759)	(57,759)	(139,513)	(139,513)
Due to legal entities	(1,370,564)	(1,370,564)	(1,844,292)	(1,844,292)
Subordinated loans	(1,052,258)	(1,052,258)	(1,072,180)	(1,072,180)
Debt securities issued	(798,784)	(798,784)	(433,362)	(433,362)
Other interest and related expense	(946,709)	(946,709)	(1,008,404)	(1,008,404)
Total interest expense	**(4,226,074)**	**(4,226,074)**	**(4,497,751)**	**(4,497,751)**
Net interest income	**5,815,485**	**5,841,874**	**5,085,552**	**5,085,552**

Interest income from impaired loans amounts to EUR 921,602 (2016: EUR 1,157,255).

Other interest and related expense include payments to the deposit guarantee fund of EUR 209,666 (2016: 280,415 EUR), as well as the payments to finance the FCMC of EUR 115,591 (2016: 115,573 EUR), financial stability fee of EUR 137,793 (2016: EUR 145,350) and negative interest rate applied to correspondent accounts of EUR 483,659 (2016: EUR 467,066).

Note 6 Fee and commission income and expense

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Fee and commission income				
Money transfers	3,662,210	3,662,331	5,656,501	5,656,558
Fees on registration of changes in loan agreements	1,538	1,538	2,525	2,525
Commission income on asset management	344,172	344,172	234,864	234,864
Account servicing	1,195,829	1,195,829	1,103,548	1,103,548
Commissions on letters of credit	467,031	467,031	533,062	533,062
Commission income on transactions with securities	64,208	64,208	114,530	114,530
Commission income on current accounts servicing	16,140	16,140	39,898	39,898
Income from general services	150,361	150,361	83,826	83,826
Other commissions (DIGIPAS)	46,655	46,655	70,144	70,144
Interbank commission income	287,666	287,666	334,589	334,589
Commission on transactions with settlement cards	908,173	908,173	684,900	684,900
Income from currency exchange	410,072	410,072	461,425	461,425
Other income	25,266	25,266	36,929	36,929
Total fee and commission income	**7,579,321**	**7,579,442**	**9,356,742**	**9,356,799**
Fee and commission expense				
Money transfers	(1,253,066)	(1,253,066)	(1,279,484)	(1,279,484)
Other expense	(50,514)	(50,514)	(39,327)	(39,327)
Total fee and commission expense	**(1,303,580)**	**(1,303,580)**	**(1,318,811)**	**(1,318,811)**
Net fee and commission income	**6,275,741**	**6,275,862**	**8,037,931**	**8,037,988**

Note 7 Administrative expense

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Remuneration paid to personnel	4,532,266	4,532,266	4,026,460	4,023,336
State statutory social insurance contributions	1,268,868	1,266,814	1,097,894	1,097,158
Remuneration paid to the Members of the Council and the Board	661,449	652,743	587,076	587,076
Communications expense	475,343	475,343	514,020	514,020
Consulting and professional fees	230,838	224,441	962,701	946,276
Set-up and maintenance costs of information systems	248,988	248,988	201,367	201,367
Non-deductible VAT	190,144	190,144	314,042	314,042
Business trips	166,486	165,627	119,821	119,821
Public utilities	113,977	113,977	126,395	126,395
Office and equipment maintenance	83,551	83,551	72,996	72,996
Fee paid to the certified auditor*	74,675	74,675	40,060	40,060
Real estate tax	69,680	66,237	76,655	76,655
Operating lease expense	51,081	51,081	62,693	62,693
Postal charges	48,585	48,585	25,283	25,283
Health insurance	36,976	36,976	40,726	40,726
Stationary	36,858	36,858	78,114	78,114
Transportation	24,843	24,843	34,011	34,011
Advertising and marketing	16,476	16,476	9,842	9,842
Security	1,527	1,527	1,810	1,810
Sponsorship	-	-	10,000	10,000
Other administrative expense	372,815	314,328	267,843	267,843
	8,705,426	**8,625,480**	**8,669,809**	**8,649,524**

The average number of staff employed by the Group and the Bank in 2017 was 215, including 4 Members of the Board, 5 Members of the Council and 206 other employees (2016: 199, including 4 members of the Board, 5 Members of the Council and 190 other employees). The remuneration paid to the Members of the Council and the Board is disclosed in Note 33.

* 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 49,000 (2016: EUR 36,960), other audit tasks - EUR 2,000 EUR (2016: EUR 3,100); to other specialists - EUR 23,675 (2016: EUR 0).

Note 8 Other operating income

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Rentals	222,153	218,793	385,887	385,887
Penalties	83,249	83,249	32,505	32,505
Other income	37,197	12,241	64,066	64,066
Total other operating income	**342,599**	**314,283**	**482,458**	**482,458**

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

Note 9 Other Administrative expense

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Payments to funds and membership fees	(248,720)	(248,720)	(200,431)	(200,431)
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 disposal of repossessed collateral, net	(35,569)	(35,569)	277,614	277,614
Other expense	(3,443)	-	-	-
Penalties*	(636,099)	(636,099)	-	-
Total other expense	**(2,891,643)**	**(2,888,200)**	**77,183**	**77,183**

* In 2016, the FCMC started an inspection of the efficiency of the Bank's internal control system in the area of anti-money laundering and combating the terrorist financing (hereinafter - AML/CFT). The inspection period covered the years from 2008 to 2016. The resulting conclusions revealed weaknesses in the internal control system and procedures mainly related to the quality and level of detail in the documentation on the results of the customer due diligence. Based on the inspection results, 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.

The Bank has introduced several changes to improve and enhance its internal control systems in the AML/CFT area. The measures taken include reviewing of the Bank's internal procedures and regulations as well as reviewing of its customer base. Specific consideration was given to the quality of documentation on customer due diligence and conclusions of the Bank's responsible employees as well as to the introduction of additional automated control mechanisms. As a result of the measures taken, the effectiveness of the Bank's internal control system has considerably improved, the number of the employees responsible for the AML/CFT area increased, new forms are used for the analysis of the customer due diligence data, as agreed with the FCMC,.

The Bank paid EUR 65,264 to Visa Europe Limited for exceeding the reclamation threshold.

Note 10 Corporate income tax

	2017 Group EUR	2017 Bank EUR	2016 Group EUR	2016 Bank EUR
Corporate income tax for the reporting year	637,006	637,006	561,487	561,487
Amount of tax paid abroad	211,063	211,063	247,747	247,747
Change in deferred corporate income tax (see also Note 25)	(230,917)	(230,917)	197,208	197,208
Total corporate income tax	**617,152**	**617,152**	**1,006,442**	**1,006,442**

* The amount of tax paid abroad consists of withholding tax paid in Ukraine. Corporate income tax 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.

Note 11 Cash and balances with the Bank of Latvia

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Cash	1,025,419	1,025,419	1,069,836	1,069,836
Balances on demand with the Bank of Latvia	89,612,794	89,612,794	147,836,974	147,836,974
	90,638,213	**90,638,213**	**148,906,810**	**148,906,810**

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

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 20 December 2017 to 30 January 2018 was set at EUR 2,980,303 (2015: EUR 4,021,348). The Bank was in compliance with the reserve requirement of the Bank of Latvia in 2017 and 2016.

Note 12 Balances due from banks

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Due from banks registered in Latvia	13,580,328	13,580,328	22,713,344	22,713,344
Due from banks registered in non-OECD countries	34,145,126	34,145,126	36,852,154	36,852,154
Due from banks registered in OECD countries	41,713,998	41,713,998	40,366,032	40,366,032
Balances due from banks, gross	89,439,452	89,439,452	99,931,530	99,931,530
Provisions for impairment of balances due from banks			(97,883)	(97,883)
Balances due from banks, net	**89,439,452**	**89,439,452**	**99,833,647**	**99,833,647**

As at 31 December 2016, the balances due from banks included receivables from Zlatobank amounting to EUR 97,883, which had informed the Group and the Bank of suspending its operations. The Group and the Bank created provisions amounting to 100% of these receivables and in 2017 wrote them off. Other balances due from banks are not overdue and are not impaired. Balances due from banks are not secured.

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

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
On demand	62,752,051	62,752,051	75,764,685	75,764,685
Balances with maturity of three months or less	23,168,212	23,168,212	20,061,070	20,061,070
Other balances due from banks	3,519,189	3,519,189	4,105,775	4,105,775
Balances due from banks, gross	89,439,452	89,439,452	99,931,530	99,931,530
Provisions for impairment of balances due from banks	-	-	(97,883)	(97,883)
Balances due from banks, net	**89,439,452**	**89,439,452**	**99,833,647**	**99,833,647**

Note 12 Balances due from banks *(cont'd)*

The table below discloses the Group and Bank's balances due from banks according to their ratings as at 31 December 2017 and 31 December 2016:

Rating	31.12.2017 Due from banks EUR	31.12.2017 Due from banks %	31.12.2016 Due from banks EUR	31.12.2016 Due from banks %
Aaa to Aa3	-	-	33,005	0,03%
A1 to A3	21,872,641	24,46%	4,911,581	4,91%
Baa1 to Baa3	25,034,600	27,99%	33,493,460	33,53%
Ba1 to Ba3	5,561,413	6,22%	7,138,005	7,14%
B1 to B3	1,923,410	2,15%	11,690,941	11,70%
Below B3	24,767,314	27,69%	18,678,484	18,69%
	79,159,378	**88,51%**	**75,945,476**	**76,00%**
Without rating	10,280,074	11,49%	23,986,054	24,00%
Provisions for impairment of balances due from banks	-	-	(97,883)	-
Balances due from banks, net	**89,439,452**	**100,00%**	**99,833,647**	**100,00%**

Note 13 Loans and advances to customers

Analysis of loans by customer profile and type of loans:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Loans to legal entities	112,308,189	114,809,022	122,280,132	122,280,132
Loans to private individuals, except for mortgages	9,406,337	9,406,337	10,175,017	10,175,017
Mortgages	1,590,305	1,590,305	2,066,285	2,066,285
Gross loans and advances to customers	**123,304,831**	**125,805,664**	**134,521,434**	**134,521,434**
Less: provisions for loan impairment	(27,000,631)	(27,000,631)	(35,007,986)	(35,007,986)
Total loans and advances to customers	**96,304,200**	**98,805,033**	**99,513,448**	**99,513,448**

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

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

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

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

The table below discloses changes in the Group and Bank's provisions for loan impairment in 2016:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Provisions for loan impairment as at 1 January 2016	**33,154,537**	**1,634,060**	**1,402,062**	**36,190,659**
Increase in provisions for loan impairment for the year	5,324,455	(2,378)	(15)	5,322,062
Write-off of loans	(7,232,345)	(164)	-	(7,232,509)
Impact of foreign currency revaluation	692,364	-	35,410	727,774
Provisions for loan impairment as at 31 December 2016	**31,939,011**	**1,631,518**	**1,437,457**	**35,007,986**

Risk concentration in the loan portfolio by industry profile:

	31.12.2017 Group EUR	%	31.12.2017 Bank EUR	%	31.12.2016 Group EUR	%	31.12.2016 Bank EUR	%
Trade and commercial activities	47,320,329	38,38	47,320,329	37,61	27,469,209	20,42	27,469,209	20,42
Private individuals	10,996,642	8,92	10,996,642	8,74	12,241,303	9,10	12,241,303	9,10
Agriculture and food industry	5,206,663	4,22	5,206,663	4,14	6,228,047	4,63	6,228,047	4,63
Construction and operations with real estate	13,909,347	11,28	16,410,180	13,04	25,370,363	18,86	25,370,363	18,86
Transport and communications	29,793,285	24,16	29,793,285	23,68	38,601,255	28,70	38,601,255	28,70
Manufacturing	8,967,536	7,27	8,967,536	7,13	10,522,899	7,82	10,522,899	7,82
Tourism and hotel services, restaurant business	1,901,576	1,54	1,901,576	1,51	2,017,050	1,50	2,017,050	1,50
Financial services	4,241,432	3,44	4,241,432	3,37	3,607,029	2,68	3,607,029	2,68
Other	968,021	0,79	968,021	0,78	8,464,281	6,29	8,464,281	6,29
Total loans and advances to customers (before provisions for impairment)	**123,304,831**	**100%**	**125,805,664**	**100%**	**134,521,436**	**100%**	**134,521,436**	**100%**

As at 31 December 2017, the total amount of loans issued to 10 largest Group's and Bank's customers was EUR 63,442,161 (2016: EUR 71,316,278), which comprises 50.43% of the total credit portfolio (2016: 53.01%).

As at 31 December 2017, the loans to 10 largest Group's and Bank's customers were secured by deposits amounting to EUR 7,591,813 (31 December 2016: EUR 8,591,871).

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

Note 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	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	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 provisions for impairment)	**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	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	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 provisions for impairment)	**114,809,022**	**9,406,337**	**1,590,305**	**125,805,664**

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

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

Since the Bank's subsidiary did not have any loans issued to nor collaterals received as at 31 December 2016, the table below presents the information on the secured loans issued by the Group and the Bank as at 31 December 2016:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
	EUR	EUR	EUR	EUR
Unsecured	13,887,684	1,723,315	677,840	16,288,839
Loans with sufficient collateral:				
- residential real estate	846,532	54,049	507,708	1,408,289
- other real estate	54,623,775	8,394,842	-	63,018,617
- cash deposits	5,829,457	-	-	5,829,457
- securities				
- guarantees and other assets	8,247,974	2,811	-	8 250 785
Loans with insufficient collateral:				
- residential real estate	864,279	-	-	864,279
- other real estate	29,817,171	-	880,737	30,697,908
- cash deposits	2,800,569	-	-	2,800,569
- securities	848,224	-	-	848,224
- guarantees and other assets	4,514,467	-	-	4,514,467
Total loans and advances to customers (before provisions for impairment)	**122,280,132**	**10,175,017**	**2,066,285**	**134,521,434**

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

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

The table below shows the loans by credit quality 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
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 (total 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**
Less: provisions for loan impairment	**(24,049,753)**	**(1,674,660)**	**(1 276 218)**	**(27,000,631)**
Net loans and advances to customers	**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.

The loans past due but not impaired include the amount of gross loans. As at 31 December 2017, the amounts past due amounted to EUR 1,067,987 (31 December 2016: EUR 324,526).

Loans past due and individually impaired include the amount of gross loans. As at 31 December 2017, the amounts past due amounted to EUR 18,184,842 (31 December 2016: EUR 27,293,924).

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

Note 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 (total 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**
Less: provisions for loan impairment	**(24,049,753)**	**(1,674,660)**	**(1 276 218)**	**(27,000,631)**
Net loans and advances to customers	**90,759,269**	**7,731,677**	**314 087**	**98,805,033**

The loans past due but not impaired include all amounts due from borrowers. As at 31 December 2017, the amounts past due amounted to EUR 1,067,987 (31 December 2016: EUR 324,526).

Loans past due and individually impaired include all amounts due from borrowers. As at 31 December 2017, the amounts past due amounted to EUR 18,184,842 (31 December 2016: EUR 27,293,924).

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

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

The table below shows the loans by credit quality issued by the Group and the Bank as at 31 December 2016:

	Loans to legal entities EUR	Loans to private individuals, except for mortgages EUR	Mortgages EUR	Total EUR
Loans that are neither past due nor impaired				
- Standard loans	64,766,285	8,506,605	507,708	73,780,598
- Close-watch loans	-	-	-	-
- Substandard	-	-	-	-
Total neither past due nor impaired	**64,766,285**	**8,506,605**	**507,708**	**73,780,598**
Past due but not impaired				
- past due less than 30 days	7,873,989	-	-	7,873,989
- past due from 30 to 90 days	-	36,741	-	36,741
- past due from 91 to 180 days	-	135	-	135
- past due 181 to 360 days	30	5	-	35
- past due over 360 days	50	13	-	63
Total past due but not impaired	**7,874,069**	**36,894**	**-**	**7,910,963**
Individually impaired loans (total amount)				
- not past due	20,854,363	-	-	20,854,363
- past due less than 30 days	3,004,089	-	1,235,300	4,239,389
- past due from 30 to 90 days	110,205	-	-	110,205
- past due from 91 to 180 days	210,803	-	-	210,803
- past due 181 to 360 days	-	-	-	-
- past due over 360 days	25,460,318	1,631,518	323,277	27,415,113
Total individually impaired loans (gross)	**49,639,778**	**1,631,518**	**1,558,577**	**52,829,873**
Less: provisions for loan impairment	**(31,939,011)**	**(1,631,518)**	**(1,437,457)**	**(35,007,986)**
Net loans and advances to customers	**90,341,121**	**8,543,499**	**628,828**	**99,513,448**

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

The recoverable amount of collateral in respect of the Group 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 EUR	Loans to private individuals, except for mortgages EUR	Mortgages EUR	Total 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 Group and Bank's policy is to classify each loan as 'not impaired' until objective evidence of the loan impairment is obtained.

The tables below present the recoverable amount of collateral in respect of the Group and Bank's loans past due but not impaired and loans individually impaired as at 31 December 2016:

	Loans to legal entities EUR	Mortgages EUR
Recoverable amount of collateral – loans past due but not impaired		
- Residential real estate	30,000	-
- Other real estate objects	6,045,308	-
- Cash deposits	3,604,971	-
- Other assets	3,269,514	-
Recoverable amount of collateral – individually impaired loans		
- Residential real estate	792,938	-
- Other real estate objects	40,905,830	880,737
- Cash deposits	2,800,569	-
- Other assets	19,041,349	-
Total	**76,490,479**	**880,737**

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 which, 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.

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

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

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 provisions for impairment)	Recoverable amount of collateral	Carrying amount of asset (before provisions for impairment)	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	-
Mortgage loans	208,195	559,672	1,382,110	774,606
Total	**98,319,804**	**206,618,589**	**24,985,027**	**11,986,411**

The analysis 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 provisions for impairment)	Recoverable amount of collateral	Carrying amount of asset (before provisions for impairment)	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	-
Mortgage loans	208,195	559,672	1,382,110	774,606
Total	**100,820,637**	**209,393,033**	**24,985,027**	**11,986,411**

Since the Bank's subsidiary did not have any loans issued to nor collaterals received as at 31 December 2016, the analysis of the Group's and the Bank's collateral as at 31 December 2016 is as follows:

	Assets with collateral value exceeding the loan balance		Assets with insufficient collateral	
	Carrying amount of asset (before provisions for impairment)	Recoverable amount of collateral	Carrying amount of asset (before provisions for impairment)	Recoverable amount of collateral
	EUR	EUR	EUR	EUR
Loans to legal entities	69,552,970	141,800,613	52,727,162	22,473,722
Loans to individuals – consumer loans	8,451,702	15,066,384	1,723,315	-
Mortgage loans	507,708	1,410,971	1,558,577	121,121
Total	**78,512,380**	**158,277,968**	**56,009,054**	**22,594,843**

Note 14 Financial assets at fair value through or loss

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Latvian government bonds	1,505,882	1,505,882	13,865,090	13,865,090
OECD government bonds	54,316,443	54,316,443	96,436,701	96,436,701
Non-OECD government bonds	-	-	9,868,444	9,868,444
OECD corporate bonds	3,980,143	3,980,143	4,641,261	4,641,261
Non-OECD corporate bonds	540,411	540,411	423,094	423,094
Unquoted shares	7,455	7,455	8,482	8,482
	60,350,334	**60,350,334**	**125,243,072**	**125,243,072**

The analysis of the Group and Bank's securities by issuers' ratings as at 31 December 2017 and 31 December 2016 is disclosed below:

Rating	31.12.2017. Securities EUR	%	31.12.2016. Securities EUR	%
Aaa to Aa3	46,157,114	76,48%	84,880,393	67,78%
A1 to A3	12,136,715	20,11%	25,153,172	20,08%
Baa1 to Baa3	2,012,915	3,34%	13,974,134	11,16%
Ba1 to Ba3	16,052	0,03%	278,388	0,22%
B1 to B3	20,083	0,03%	-	-
Below B3	7,455	0,01%	-	-
	60,350,334	**100%**	**124,286,086**	**99,24%**
Without rating	-	-	956,986	0,76%
	60,350,334	**100%**	**125,243,072**	**100%**

Note 15 Investment in subsidiary

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 31.12.2017	(Loss) for the reporting year
Grunewald Residence SIA	Jura Alunana 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. For financing a partial payment of the purchase price of the real estate as well as related real estate development costs, the Bank has issued an additional loan to the subsidiary amounting to EUR 2.5 million. The loan is secured by collateral, i.e., the above mentioned real estate and third party's deposit of EUR 2.8 million. 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. At the same time, the subsidiary has commissioned one of the leading architectural practices in Berlin a design for the real estate development (see also Note 28).

According to the estimates of an independent valuer, the value of the real estate as at 31 December is EUR 8.1 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.

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. Therefore, notwithstanding the subsidiary's operating loss in 2017, the Bank's management believes that the investment in the subsidiary is not impaired.

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

Note 16 Intangible assets

Changes in the Group and Bank's intangible assets in 2017 and 2016 can be specified as follows:

	Software 2017 EUR	Prepayments 2017 EUR	Total software 2017 EUR	Software 2016 EUR	Prepayments 2016 EUR	Total software 2016 EUR
Cost						
At the beginning of the year	1,717,001	229,766	1,946,767	1,588,755	-	1,588,755
Reclassified	-	(229,766)	(229,766)	-	-	-
Additions	384,108	27,323	411,431	128,246	229,766	358,012
Disposals	(202)	-	(202)	-	-	-
At the end of the year	**2,100,907**	**27,323**	**2,128,230**	**1,717,001**	**229,766**	**1,946,767**
Amortization						
Accumulated amortization at the beginning of the year	1,421,772	-	1,421,772	1,333,437	-	1,333,437
Charge for the year	133,512	-	133,512	88,335	-	88,335
On disposals	(202)	-	(202)	-	-	-
Accumulated amortization at the end of the year	**1,555,082**	**-**	**1,555,082**	**1,421,772**	**-**	**1,421,772**
Net carrying amount at the beginning of the year	**295,229**	**229,766**	**524,995**	**255,318**	**-**	**255,318**
Net carrying amount at the end of the year	**545,825**	**27,323**	**573,148**	**295,229**	**229,766**	**524,995**

As at 31 December 2017, 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 1,330,043 (31 December 2016: EUR 1,314,140).

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)*

Note 17 Property and equipment

Changes in the Group 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-payments 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**

As at 31 December 2017, 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 1,258,363 (31 December 2017: EUR 1,269,839).

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, 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.

Note 17 Property and equipment *(cont'd)*

Changes in the Group and Bank's property and equipment in 2016 can be specified as follows:

	Land and building EUR	Transport vehicles EUR	Computers EUR	Office equipment EUR	Other assets EUR	Pre-payments EUR	Total EUR
Cost							
As at 31.12.2015	**14,748,664**	**89,012**	**780,746**	**588,312**	**100,927**	**-**	**16,307,661**
Additions	-	-	79,988	7,076	-	164,763	251,827
Disposals	-	-	(69,216)	(796)	-		(70,012)
As at 31.12.2016	**14,748,664**	**89,012**	**791,518**	**594,592**	**100,927**	**164,763**	**16,489,476**
Depreciation							
As at 31.12.2015	**119,448**	**47,025**	**693,453**	**502,556**	**42,814**	**-**	**1,405,296**
On disposals	-	-	(69,216)	(796)	-	-	(70,012)
Charge for 2016	179,172	13,036	61,577	25,893	6,116	-	285,794
As at 31.12.2016	**298,620**	**60,061**	**685,814**	**527,653**	**48,930**	**-**	**1,621,078**
Net carrying amount as at 31.12.2015	**14,629,216**	**41,987**	**87,293**	**85,756**	**58,113**	**-**	**14,902,365**
Net carrying amount as at 31.12.2016	**14,450,044**	**28,951**	**105,704**	**66,939**	**51,997**	**164,763**	**14,868,398**

Note 18 Available-for-sale financial assets

The available-for-sale financial assets 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.

Note 19 Other assets

Other assets in breakdown between financial assets and non-financial assets as at 31 December 2017 and 2016 can be specified as follows:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Financial assets, incl.:	3,878,758	3,280,184	2,645,478	2,645,441
– Security deposits	1,201,604	1,201,604	1,379,357	1,379,357
– Accounts receivable	370,537	255,395	510,133	510,133
– Interbank settlements in progress	1,008,661	1,008,661	49,510	49,510
– Other financial assets**	1,297,956	814,524	706,478	706,441
Non-financial assets	11,516,593	3,462,286	2,839,093	2,839,093
– repossessing collaterals	10,328,063	2,273,756	2,269,005	2,269,005
– Investment gold	1,188,530	1,188,530	570,088	570,088
Total other assets, gross	**15,395,351**	**6,742,470**	**5,484,571**	**5,484,534**
Provisions for impairment	(114,188)	(114,188)	(94,480)	(94,480)
Total other assets, net:	**15,281,163**	**6,628,282**	**5,390,091**	**5,390,054**

Accounts receivable and other financial assets represent balances due from customers and business partners amounting to EUR 114,188 (2016: 94,480 EUR), which have been fully provided for. Other financial assets are neither past due nor impaired.

Note 19 Other assets *(cont'd)*

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

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

Changes in the provisions for impairment of other financial assets of the Group and the Bank in 2016 can be specified as follows:

	Receivables	Balances due from customers	Total
	EUR	EUR	EUR
Provisions for impairment of other financial assets as at 1 January 2016	**-**	**80,707**	**80,707**
Increase in provisions for impairment of other financial assets	-	25,431	25,431
Write-offs of other financial assets	-	(13,773)	(13,773)
Provisions for impairment of other financial assets as at 31 December 2016	**-**	**94,480**	**94,480**

Note 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/ parish	Methods used in fair value measurement
1	Land	Riga	Riga	Market (comparables) approach
2	Rural property	Tukums	Džūkste	Market (comparables) approach
3	Apartment	Riga	Riga	Market (comparables) approach
4	Multi-apartment building	Riga	Riga	This property has several valuations –one considers dismantling of two floors, other – putting into operations as it is. The property's value is stated in line with the prudence principle – it is assumed that the upper floors of the building must be dismantled. In determining the property's value the income approach was used (the calculations were based on the assumption that the apartments are sold within 3 years; the discount rate - 16%) If the discount rate decreases or increases by 1%, the property's value would increase or decrease by EUR 20,000.
5	Office premises	Odes	Odes	Market (comparables) approach
6	Warehouse premises	Kharkiv	Vasiščeva	Market (comparables) approach, income capitalization approach (capitalization rate - 15%)
7	Warehouse and production premises	Kiev	Fastov	Market (comparables) approach, income capitalization approach (capitalization rate - 13.5%)
8	Land	Berlin	Berlin	Income approach (capitalization rate - 4%, cash flow - 23 years); the value of the land plot is derived from its sale in the 23rd year of the projected cash flow. If the discount rate decreases or increases by 1%, the property's value would increase by EUR 2,060,000 or decrease by EUR 1,630,000 (see also Note 15)

In the reporting year, impairment of non-financial assets of EUR 1,031,940 was recognized (2016: EUR 0) and disclosed in the statement of comprehensive income under other expense. The impairment was recognized for the properties in Ukraine the fair value of which was measured in USD or UAH and had decreased as a result of fluctuations in foreign exchange rates. Additional impairment of these properties was recognized taking into consideration the low activity in the real estate market in Ukraine. The value of these properties was discounted at the rate of 13% - 15% per annum assuming that the properties will be sold within 4 years. If the USD and UAH exchange rate against the EUR decreases or increases by 10%, the real estate value in Ukraine would decrease by EUR 190,000 or increase by EUR 230,000 respectively. If the underlying discount rate increases or decreases by 1%, the value of the respective properties would increase by EUR 32,000 or decrease by EUR 31,000

Note 20 Cash and cash equivalents

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Cash and balances on demand with the Bank of Latvia (Note 11)	90,638,213	90,638,213	148,906,810	148,906,810
Balances due form other banks with original maturity of 3 months or less	85,920,263	85,920,263	95,825,755	95,825,755
Total	**176,558,476**	**176,558,476**	**244,732,565**	**244,732,565**

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

Note 21 Deposits from customers

(a) Analysis of deposits from customer by customer profile

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Legal entities				
– current/ settlement accounts	229,487,569	229,835,683	354,799,013	361,379,532
– term deposits	27,435,077	27,435,077	25,908,469	25,908,469
Private individuals				
– current/ settlement accounts	33,520,614	33,520,614	35,975,160	35,975,160
– term deposits	6,039,189	6,039,189	5,230,159	5,230,159
Total deposits from customers:	**296,482,449**	**296,830,563**	**421,912,801**	**428,493,320**
Sector profile:				
Private companies	255,621,873	255,969,987	380,324,762	386,905,281
Private individuals	39,559,803	39,559,803	41,205,319	41,205,319
Financial institutions	1,283,020	1,283,020	368,623	368,623
Non-profit institutions	8,120	8,120	4,802	4,802
Latvian government	9,633	9,633	9,295	9,295
Total deposits from customers:	**296,482,449**	**296,830,563**	**421,912,801**	**428,493,320**

(b) Analysis of deposits from customer by place of residence

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Residents	17,437,441	17,785,555	23,307,659	29,888,178
Non-residents	279,045,008	279,045,008	398,605,142	398,605,142
Total deposits from customers:	**296,482,449**	**296,830,563**	**421,912,801**	**428,493,320**

The average interest rate on term deposits in 2017 was 3.19% (2016: 2.55 %) and the average interest rate on demand deposits was 0.00% (2016: 0.00%). All deposits bear a fixed interest rate.

Deposits from customers by industry are revealed below:

	31.12.2017 Group EUR	%	31.12.2017 Bank EUR	%	31.12.2016 Group EUR	%	31.12.2016 Bank EUR	%
Manufacturing	1,362,152	0.46	1,362,152	0.46	6,163,729	1.46	6,163,729	1.44
Construction and real estate	9,986,205	3.37	10,334,319	3.48	11,646,790	2.76	18,227,310	4.25
Trade and commercial activities	159,712,515	53.87	159,712,515	53.80	223,861,243	53.06	223,861,243	52.24
Financial and insurance services	35,225,496	11.88	35,225,496	11.87	59,151,048	14.02	59,151,048	13.80
Transport and communications	44,850,221	15.13	44,850,221	15.11	69,164,040	16.39	69,164,040	16.14
Agriculture and food industries	81,843	0.03	81,843	0.03	986,040	0.23	986,040	0.23
Private individuals	39,559,803	13.34	39,559,803	13.33	41,205,319	9.77	41,205,319	9.62
Other	5,704,214	1.93	5,704,214	1.92	9,734,592	2.31	9,734,592	2.28
Total deposits from customers	296,482,449	100%	296,830,563	100%	421,912,801	100%	428,493,321	100%

The total amount of deposits attributable to 20 largest depositors as at 31 December 2017 was EUR 133,716,620 (2016: EUR 176,338,553), comprising 45.05% of the Bank's total portfolio (2016: 41.15%).

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

Note 22 Debt securities

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Debt securities	16,763,810	16,763,810	19,072,989	19,072,989
	16,763,810	**16,763,810**	**19,072,989**	**19,072,989**

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 2 times a year on 26 October and 26 April. Balance at 31 December 2017 amounted to EUR 1,849,308 (31 December 2016: EUR 2,104,046).

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 2 times a year on 22 December and 22 June. Balance at 31 December 2017 amounted to EUR 11,937,036 (31 December 2016: EUR 13,581,337).

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 2017 amounted to EUR 2,977,466 (31 December 2016: EUR 3,387,606 EUR)

Note 23 Other financial liabilities

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Liability suspense account*	55,702	55,702	53,762	53,762
Settlements on behalf of a closed bank	16,585	16,585	16,585	16,585
Cash in transit	5,334	5,334	155,584	155,584
Accounts payable	423,900	421,813	443,036	442,138
	501,521	**499,434**	**668,967**	**668,069**

*The liability suspense account as at 31 December 2017 and 31 December 2016 includes the amounts erroneously transferred to the Bank, which were returned to the senders at the beginning of 2018 and 2017 respectively.

Note 24 Deferred income and accrued expenses

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Vacation pay reserve	358,648	358,648	319,181	319,181
Accrual for the guarantee fund and FCMC financing	136,635	136,635	93,025	93,025
State statutory social insurance contributions	284,505	284,505	203,842	203,842
Other accrued expenses	109,181	109,181	96,938	96,938
	888,969	**888,969**	**712,986**	**712,986**

Note 25 Deferred income tax

The changes in the Group and Bank's deferred income tax are as follows:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Deferred income tax liabilities/ (assets) at the beginning of the reporting year	230,917	230,917	33,709	33,709
Change in deferred income tax in the reporting year (see Note 10)	(230,917)	(230,917)	197,208	197,208
Deferred income tax liabilities at the end of the reporting year	**-**	**-**	**230,917**	**230,917**

On 28 July 2017, the Parliament of Latvia passed amendments to Latvian tax legislation applicable to the reporting periods beginning on 1January 2018. The amendments concern corporate income tax regime and certain other taxes in Latvia. The new regime introduces a concept where corporate income tax is payable only on dividend pay-outs (irrespective of the profit earned in the particular period) and certain expenses which for tax purposes are considered profit distributions (e.g. non-business expenses and representation expenses that exceed a specific threshold). The Group and the Bank have written off the previously recognized deferred tax liabilities as prescribed by the law. As a result, one-off income of EUR 230,917 was recognized in the reporting period.

Note 26 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:

	31.12.2017			31.12.2016		
	Notional	Fair value		Notional	Fair value	
	amount EUR	Assets EUR	Liabilities EUR	amount EUR	Assets EUR	Liabilities EUR
Currency swaps	56,074,212	64,031	(652,280)	103,806,735	477,082	(1,378,768)
Currency forwards	612,368	724	(38)	954,965	5,992	-
Options	17,400	1,001	-	-	-	-
Total	**56,703,980**	**65,756**	**(652,318)**	**104,761,700**	**483,074**	**(1,378,768)**

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

Note 26 Derivative financial instruments

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

	31.12.2017			31.12.2016		
	Notional	Fair value		Notional	Fair value	
	amount	Assets	Liabilities	amount	Assets	Liabilities
	EUR	EUR	EUR	EUR	EUR	EUR
Aaa to Aa3	-	-	-	984,848	2,138	-
A1 to A3	-	-	-	60,306,565	306,565	(275,676)
B1 to B3	6,077,821	9,271	(10,809)	39,155,545	155,545	(141,779)
Caa1 and below				-	-	-
Without rating	50,626,159	56,485	(641,509)	4,314,742	18,826	(961,313)
Total	**56,703,980**	**65,756**	**(652,318)**	**104,761,700**	**483,074**	**(1,378,768)**

Note 27 Share capital

The Bank's issued and fully paid share capital as at 31 December 2017 was EUR 32,334,756 (31 December 2016: EUR 32,334,762). The nominal value of one share was EUR 1.00 (31 December 2016: 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.

In the body of shareholders whose equity interest exceeded 10% the following changes took place - in July 2017, AB Pivdenny sold 1% of its shares (323,350 shares) to Mark Bekker.

The shareholders of the Bank as at 31 December 2017 and 31 December 2016:

	31.12.2017 EUR	%	31.12.2016 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	4,772,908	14.76
Mark Bekker	3,418,808	10.57	3,095,458	9.57
Other shareholders (with less than 10% of shares)	5,905,782	18.27	5,905,782	18.27
Total paid share capital	**32,334,756**	**100%**	**32,334,756**	**100%**

Note 28 Off-balance sheet items and encumbered assets

In 2017, the Bank signed an agreement on architectural services for EUR 142 thousand plus VAT, about putting into operation a property in Riga which had been repossessed under the debt recovery procedure. As at the date of issuing these financial statements, 42% of the contractual amount was paid. The remaining part will be paid after the property is put into operation which is expected by the end of April 2018.

In 2017, the Group signed an agreement on services provided by a German architect for EUR 900 thousand plus VAT, regarding the development of the property in Berlin which had been repossessed under the debt recovery procedure (design and receipt of building permit). As at the date of issuing these financial statements, 78% of the contractual amount was paid. The remaining part will be paid after building permit is received which is expected in spring 2018. In relation to the above mentioned real estate, an agreement with a German law office on providing legal assistance was also signed for EUR 0.5 million plus VAT. The respective fee will be paid when the rent agreements concerning the real estate are terminated or the real estate is sold to a third party (see also Note 15).

Note 28 Off-balance sheet items and encumbered assets *(cont'd)*

Contingent liabilities

The contingent liabilities can be specified as follows:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Guarantees	8,931,032	8,931,032	5,460,027	5,460,027
	8,931,032	**8,931,032**	**5,460,027**	**5,460,027**

The Group and the Bank have issued guarantees amounting to EUR 8,931,032 (31 December 2016: EUR 5,460,027). 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.

Off-balance sheet financial commitments

The outstanding loan commitments can be specified as follows:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Loan commitments	9,602,234	9,602,234	8,675,928	8,675,928
Undrawn credit lines	12,143,597	12,143,597	12,086,628	12,086,628
Total loan commitments	**21,745,831**	**21,745,831**	**20,762,556**	**20,762,556**

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.

The loan commitments are denominated in the following cu:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
USD	6,645,685	6,645,685	7,288,434	7,288,434
EUR	2,956,549	2,956,549	1,387,494	1,387,494
Total loan commitments	**9,602,234**	**9,602,234**	**8,675,928**	**8,675,928**

The undrawn credit lines are denominated in the following currencies:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
USD	8,435,617	8,435,617	5,848,937	5,848,937
EUR	3,707,980	3,707,980	6,237,691	6,237,691
Total undrawn credit lines	**12,143,597**	**12,143,597**	**12,086,628**	**12,086,628**

Note 28 Off-balance sheet items and encumbered assets *(cont'd)*

Encumbered assets

The pledged and restricted assets as at 31 December 2017 and 31 December 2016 can be specified as follows:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Balances due from banks	17,026,611	17,026,611	15,237,015	15,237,015
Other assets	1,514,778	1,514,778	1,341,101	1,341,101
Totals	**18,541,389**	**18,541,389**	**16,578,116**	**16,578,116**

All encumbered assets serve as security for the Group and Bank's financial liabilities as at 31 December 2017 and31 December 2016.

The carrying amount of encumbered assets approximates their fair value both as at 31 December 2017 and as at 31 December 2016.

The encumbered assets of the Group and the Bank as at 31 December 2017 were comprised 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.

The encumbered assets of the Group and the Bank as at 31 December 2016 were comprised of:

- Security deposits of EUR 1,341,101 for potential claims from Visa Inc and MasterCard Europe SPRL. The agreements with these organization provide for ensuring a sufficient amount of resources available in the deposit accounts with Lloyds TSB Bank plc (Visa Inc) and U.S Bank (MasterCard Europe Sprl) 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 4,877,727 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 10,359,288 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.

Note 29 Capital adequacy

The calculation of the Group's capital adequacy ratio according to the requirements of the Financial and Capital Market Commission as at 31 December 2017 and 31 December 2016 is as follows:

Description	31.12.2017 EUR	31.12.2016 EUR
Total own funds	**56,479,236**	**62,361,492**
– Tier 1 capital	38,611,886	35,429,199
– Common equity Tier 1 capital	38,611,886	35,429,199
– Tier 2 capital	17,867,350	26,932,293
Total risk exposure amount	**189,887,472**	**197,766,838**
– Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	154,754,958	154,213,000
– Total risk exposure amount for position, foreign exchange and commodities risks	7,046,938	15,584,413
– Total risk exposure amount for operational risk	27,969,088	27,969,425
– Total exposure amounts for credit valuation adjustment	116,488	-
Capital adequacy ratios		
– Common equity Tier 1 Capital ratio	20,33%	17,91%
– Surplus (+) / Deficit (-) of Common equity Tier 1 capital (4.5%)	30,066,950	26,529,691
– Tier 1 Capital ratio	20,33%	17,91%
– Surplus (+) / Deficit (-) of Tier 1 capital (6%)	27,218,638	23,563,189
– Total capital ratio	29,74%	31,53%
– Surplus (+) / Deficit (-) of total capital (8%)	41,288,238	46,540,145
– Capital retention reserve (%)	2,5%	2,5%
– Capital retention reserve	4,747,187	4,944,171

The calculation of the Bank's capital adequacy ratio according to the requirements of the Financial and Capital Market Commission as at 31 December 2017 and 31 December 2016 is as follows:

Description	31.12.2017 EUR	31.12.2016 EUR
Total own funds	**56,581,161**	**62,361,492**
– Tier 1 capital	38,713,811	35,429,199
– Common equity Tier 1 capital	38,713,811	35,429,199
– Tier 2 capital	17,867,350	26,932,293
Total risk exposure amount	**187,834,627**	**204,366,801**
– Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	152,702,076	160,812,963
– Total risk exposure amount for position, foreign exchange and commodities risks	7,046,938	15,584,413
– Total risk exposure amount for operational risk	27,969,125	27,969,425
– Total exposure amounts for credit valuation adjustment	116,488	-
Capital adequacy ratios		
– Common equity Tier 1 Capital ratio	20,61%	17,34%
– Surplus (+) / Deficit (-) of Common equity Tier 1 capital (4.5%)	30,261,253	26,232,693
– Tier 1 Capital ratio	20,61%	17,34%
– Surplus (+) / Deficit (-) of Tier 1 capital (6%)	27,443,733	23,167,191
– Total capital ratio	30,12%	30,51%
– Surplus (+) / Deficit (-) of total capital (8%)	41,554,391	46,012,148
– Capital retention reserve (%)	2,5%	2,5%
– Capital retention reserve	4,695,866	5,109,170

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

Note 30 Analysis of assets and liabilities by currency profile

The table below provides the analysis of the Group's assets, liabilities and shareholders' equity as well as off-balance sheet items arising from currency swaps as at 31 December 2017 by currency profile:

	USD EUR	EUR EUR	Other EUR	Total EUR
Assets				
Cash and deposits with the Bank of Latvia	373,766	90,264,447	-	90,638,213
Balances due from banks	66,546,628	16,543,945	6,348,879	89,439,452
Loans and advances to customers	69,057,008	27,247,192	-	96,304,200
Financial assets at fair value through profit or loss	58,844,452	1,505,882	-	60,350,334
Available-for-sale financial assets	-	234,942	-	234,942
Intangible assets	10,113	563,035	-	573,148
Property and equipment	-	13,822,007	-	13,822,007
Derivative financial instruments	1,001	64,755	-	65,756
Prepaid expenses	29,271	224,189	805	254,265
Other assets	2,415,659	11,676,798	1,188,706	15,281,163
Total assets	**197,277,898**	**162,147,192**	**7,538,390**	**366,963,480**
Liabilities and equity				
Deposits from customers	213,105,747	76,582,597	6,794,105	296,482,449
Debt securities	16,763,810	-	-	16,763,810
Derivative financial instruments	-	652,318	-	652,318
Deferred income and accrued expenses	38	863,204	25,727	888,969
Corporate income tax liabilities	-	75,517	-	75,517
Other liabilities	50,584	450,937	-	501,521
Subordinated loans	12,367,892	-	-	12,367,892
Equity	-	39,231,004	-	39,231,004
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 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)**
As at 31 December 2016				
Total assets	**262,343,983**	**217,537,111**	**15,318,627**	**495,199,721**
Total liabilities and shareholders' equity	**357,227,718**	**124,798,362**	**13,173,641**	**495,199,721**
Net long / (short) position for statement of financial position items	**(94,883,735)**	**92,738,749**	**2,144,986**	**-**
Off-balance sheet items arising from foreign exchange				
Off-balance sheet claims arising from foreign exchange contracts	99,784,222	3,300,000	-	103,084,222
Off-balance sheet liabilities arising from foreign exchange contracts	4,544,888	99,450,000	-	103,994,888
Net long / (short) position on foreign exchange	95,239,334	(96,150,000)	-	(910,666)
Net long / (short) position	**355,599**	**(3,411,251)**	**2,144,986**	**(910,666)**

Note 30 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 2017 by currency profile:

	USD EUR	EUR EUR	Other EUR	Total EUR
Assets				
Cash and deposits with the Bank of Latvia	373,766	90,264,447	-	90,638,213
Balances due from banks	66,546,628	16,543,945	6,348,879	89,439,452
Loans and advances to customers	69,057,008	29,748,025	-	98,805,033
Financial assets at fair value through profit or loss	58,844,452	1,505,882	-	60,350,334
Investment in the subsidiary	-	6,600,000	-	6,600,000
Available-for-sale financial assets	-	234,942	-	234,942
Intangible assets	10,113	563,035	-	573,148
Property and equipment	-	13,822,007	-	13,822,007
Derivative financial instruments	1,001	64,755	-	65,756
Prepaid expenses	29,271	224,189	805	254,265
Other assets	2,415,659	3,023,917	1,188,706	6,628,282
Total assets	**197,277,898**	**162,595,144**	**7,538,390**	**367,411,432**
Liabilities and equity				
Deposits from customers	213,105,747	76,930,711	6,794,105	296,830,563
Debt securities	16,763,810	-	-	16,763,810
Derivative financial instruments	-	652,318	-	652,318
Deferred income and accrued expenses	38	863,204	25,727	888,969
Corporate income tax liabilities	-	75,517	-	75,517
Other liabilities	50,584	448,850	-	499,434
Subordinated loans	12,367,892	-	-	12,367,892
Equity	-	39,332,929	-	39,332,929
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 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)**
As at 31 December 2016				
Total assets	**262,343,983**	**224,137,074**	**15,318,627**	**501,799,684**
Total liabilities and shareholders' equity	**357,227,718**	**131,398,325**	**13,173,641**	**501,799,684**
Net long / (short) position for statement of financial position items	**(94,883,735)**	**92,738,749**	**2,144,986**	**-**
Off-balance sheet items arising from foreign exchange				
Off-balance sheet claims arising from foreign exchange contracts	99,784,222	3,300,000	-	103,084,222
Off-balance sheet liabilities arising from foreign exchange contracts	4,544,888	99,450,000	-	103,994,888
Net long / (short) position on foreign exchange	95,239,334	(96,150,000)	-	(910,666)
Net long / (short) position	**355,599**	**(3,411,251)**	**2,144,986**	**(910,666)**

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

Note 31 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 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
Assets								
Cash and balances with the Bank of Latvia	-	90,638,213	-	-	-	-	-	**90,638,213**
Balances due from banks	-	78,666,200	7,307,562	47,029	3,418,661	-	-	**89,439,452**
Loans and advances to customers	5,246,837	1,703,026	7,193,274	6,558,912	42,167,434	33,204,138	230,579	**96,304,200**
Financial assets at fair value through profit or loss	-	8,512,777	25,886,531	13,046,834	551,625	12,345,112	7,455	**60,350,334**
Available-for-sale financial assets	-	-	-	-	-	-	234,942	**234,942**
Intangible assets	-	-	-	-	-	-	573,148	**573,148**
Property and equipment	-	-	-	-	-	-	13,822,007	**13,822,007**
Derivative financial instruments	-	65,756	-	-	-	-	-	**65,756**
Prepaid expenses	-	-	-	-	254,265	-	-	**254,265**
Other assets	3,557	1,566,053	-	-	1,839,382	9,168,371	2,703,800	**15,281,163**
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**
Liabilities and equity								
Deposits from customers	-	264,146,389	11,945,462	2,070,158	10,598,445	7,652,878	69,117	**296,482,449**
Debt securities	-	59,096	-	28,319	-	16,676,395	-	**16,763,810**
Derivative financial instruments	-	652,318	-	-	-	-	-	**652,318**
Deferred income and accrued expenses	-	397,022	49,000	-	442,947	-	-	**888,969**
Corporate income tax liabilities	-	75,517	-	-	-	-	-	**75,517**
Other liabilities	-	501,521	-	-	-	-	-	**501,521**
Subordinated loans	-	5,681	-	-	1,667,639	10,694,572	-	**12,367,892**
Share capital and reserves	-	-	-	-	-	-	39,231,004	**39,231,004**
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)**

As at 31 December 2016

	Past due	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
Total assets	**8,185,655**	**295,695,061**	**36,641,540**	**11,764,143**	**52,369,998**	**72,130,826**	**18,412,498**	**495,199,721**
Total liabilities and equity	-	**397,579,827**	**10,254,839**	**633,743**	**10,143,436**	**39,993,547**	**36,594,329**	**495,199,721**
Off-balance sheet liabilities	-	829,354	4,268,258	8,421,483	6,341,407	6,280,591	81,490	26,222,583
Liquidity	**8,185,655**	**(102,714,120)**	**22,118,443**	**2,708,917**	**35,885,155**	**25,856,688**	**(18,263,321)**	**(26,222,583)**

Note 31 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 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
Assets								
Cash and balances with the Bank of Latvia	-	90,638,213	-	-	-	-	-	**90,638,213**
Balances due from banks	-	78,666,200	7,307,562	47,029	3,418,661	-	-	**89,439,452**
Loans and advances to customers	5,246,837	1,703,859	7,193,274	6,558,912	42,167,434	35,704,138	230,579	**98,805,033**
Financial assets at fair value through profit or loss	-	8,512,777	25,886,531	13,046,834	551,625	12,345,112	7,455	**60,350,334**
Available-for-sale financial assets	-	-	-	-	-	-	6,600,000	**6,600,000**
Intangible assets	-	-	-	-	-	-	234,942	**234,942**
Property and equipment	-	-	-	-	-	-	573,148	**573,148**
Derivative financial instruments	-	-	-	-	-	-	13,822,007	**13,822,007**
Prepaid expenses	-	65,756	-	-	-	-	-	**65,756**
Other assets	-	-	-	-	254,265	-	-	**254,265**
Total assets	3,557	1,562,479	-	-	1,244,382	1,114,064	2,703,800	**6,628,282**
Liabilities and equity								
Deposits from customers	-	59,096	-	28,319	-	16,676,395	-	**16,763,810**
Debt securities	-	264,494,503	11,945,462	2,070,158	10,598,445	7,652,878	69,117	**296,830,563**
Derivative financial instruments	-	652,318	-	-	-	-		**652,318**
Deferred income and accrued expenses	-	397,022	49,000	-	442,947	-		**888,969**
Corporate income tax liabilities	-	75,517	-	-	-	-	-	**75,517**
Other liabilities	-	499,434	-	-	-	-		**499,434**
Subordinated loans	-	5,681	-	-	1,667,639	10,694,572		**12,367,892**
Share capital and reserves	-	-	-	-	-	-	39,332,929	**39,332,929**
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)**

Note 31 Analysis of assets and liabilities by maturity profile *(cont'd)*

	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
As at 31 December 2016								
Total assets	**8,185,618**	**295,695,061**	**36,641,540**	**11,764,143**	**52,369,998**	**72,130,826**	**25,012,498**	**501,799,684**
Total liabilities and equity	**-**	**404,159,448**	**10,254,839**	**633,743**	**10,143,436**	**39,993,547**	**36,614,671**	**501,799,684**
Off-balance sheet liabilities	-	829,354	4,268,258	8,421,483	6,341,407	6,280,591	81,490	26,222,583
Liquidity	**8,185,618**	**(109,293,741)**	**22,118,443**	**2,708,917**	**35,885,155**	**25,856,688**	**(11,683,663)**	**(26,222,583)**

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 73.46% as at 31 December 2017 (31 December 2016: 81.33%). 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 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

The table below presents the Bank'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	-	264,531,682	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

Note 31 Analysis of assets and liabilities by maturity profile *(cont'd)*

The table below presents the Group and Bank's contractual undiscounted cash flows of the financial liabilities as at 31 December 2016:

	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	-	74,708	-	352,196	426,904	22,036,571	-	22,890,379
Deposits from customers	-	401,891,789	9,866,056	689,298	9,676,697	7,575,053	-	429,698,893
Other liabilities	-	668,069	-	-	-	-	-	668,069
Subordinated loans	-	92,225	165,491	251,469	506,537	16,582,252	-	17,597,974
Total liabilities	**-**	**402,726,791**	**10,031,547**	**1,292,963**	**10,610,138**	**46,193,876**	**-**	**470,855,315**
Off-balance sheet liabilities	-	829,354	4,268,258	8,421,483	6,341,407	6,280,591	81,490	26,222,583

The table below presents the Group and Bank's contractual undiscounted cash flows of the financial liabilities 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**

The table below presents the Group and Bank's contractual undiscounted cash flows of the financial liabilities as at 31 December 2016:

	Within 1 month EUR	1 - 3 months EUR	Over 3 months EUR	Total EUR
Derivatives offset on a gross basis				
Foreign exchange derivatives:				
- inflow	103,382,931	-	-	**103,382,931**
- outflow	104,278,626	-	-	**104,278,626**

Note 32 Repricing maturity of assets and liabilities

The Group's assets and liabilities categorized by the earlier of contractual repricing or maturity dates as at as at 31 December 2017:

	Within one month	1–3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Items not sensitive to the interest risk	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Assets								
Cash and balances with the Bank of Latvia	89,612,794	-	-	-	-	-	1,025,419	**90,638,213**
Balances due from banks	70,799,389	-	-	-	-	-	18,640,063	**89,439,452**
Loans and advances to customers	8,749,809	15,995,831	6,393,768	37,295,331	30,005,833	30,031	334,430	**98,805,033**
Financial assets at fair value through profit or loss	8,512,777	25,886,531	13,046,835	551,625	12,345,111	-	7,455	**60,350,334**
Available-for-sale financial assets	-	-	-	-	-	-	234,942	**234,942**
	-	-	-	-	-	-	6,600,000	**6,600,000**
Intangible assets	-	-	-	-	-	-	573,148	**573,148**
Property and equipment	-	-	-	-	-	-	13,822,007	**13,822,007**
Other assets	-	-	-	-	-	-	6,948,303	**6,948,303**
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**
Liabilities and equity								
Deposits from customers	2,185,856	3,813,452	585,376	6,214,296	317,454	-	283,714,129	**296,830,563**
Debt securities	-	-	-	-	16,676,395	-	87,415	**16,763,810**
Other liabilities	-	-	-	-	-	-	2,116,238	**2,116,238**
Subordinated loans	-	-	-	1,667,640	10,694,571	-	5,681	**12,367,892**
Total liabilities	**2,185,856**	**3,813,452**	**585,376**	**7,881,936**	**27,688,420**	**-**	**285,923,463**	**328,078,503**
Equity	**-**	**-**	**-**	**-**	**-**	**-**	39,332,929	**39,332,929**
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)***	***-***
As at 31 December 2016								
Total assets	**300,424,672**	**43,630,165**	**14,398,436**	**37,786,177**	**58,473,985**	**1,119,848**	**45,966,401**	**501,799,684**
Total liabilities and equity	**1,642,853**	**522,711**	**598,498**	**3,664,282**	**38,265,095**	**-**	**457,106,245**	**501,799,684**
Sensitivity of statement of financial position items to interest rate risk	***298,781,819***	***43,107,454***	***13,799,938***	***34,121,895***	***20,208,890***	***1,119,848***	***(411,139,844)***	***-***

Note 32 Repricing maturity of assets and liabilities *(cont'd)*

The Bank's assets and liabilities categorized by the earlier of contractual repricing or maturity dates as at as at 31 December 2017:

	Within one month	1–3 months	3–6 months	6–12 months	1–5 years	Over 5 years	Items not sensitive to the interest risk	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Assets								
Cash and balances with the Bank of Latvia	89,612,794	-	-	-	-	-	1,025,419	**90,638,213**
Balances due from banks	70,799,389	-	-	-	-	-	18,640,063	**89,439,452**
Loans and advances to customers	8,749,809	15,995,831	6,393,768	37,295,331	30,005,833	30,031	334,430	**98,805,033**
Financial assets at fair value through profit or loss	8,512,777	25,886,531	13,046,835	551,625	12,345,111	-	7,455	**60,350,334**
Available-for-sale financial assets	-	-	-	-	-	-	234,942	**234,942**
	-	-	-	-	-	-	6,600,000	**6,600,000**
Intangible assets	-	-	-	-	-	-	573,148	**573,148**
Property and equipment	-	-	-	-	-	-	13,822,007	**13,822,007**
Other assets	-	-	-	-	-	-	6,948,303	**6,948,303**
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**
Liabilities and equity								
Deposits from customers	2,185,856	3,813,452	585,376	6,214,296	317,454	-	283,714,129	**296,830,563**
Debt securities	-	-	-	-	16,676,395	-	87,415	**16,763,810**
Other liabilities	-	-	-	-	-	-	2,116,238	**2,116,238**
Subordinated loans	-	-	-	1,667,640	10,694,571	-	5,681	**12,367,892**
Total liabilities	**2,185,856**	**3,813,452**	**585,376**	**7,881,936**	**27,688,420**	**-**	**285,923,463**	**328,078,503**
Equity	**-**	**-**	**-**	**-**	**-**	**-**	39,332,929	**39,332,929**
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)***	**-**
As at 31 December 2016								
Total assets	**300,424,672**	**43,630,165**	**14,398,436**	**37,786,177**	**58,473,985**	**1,119,848**	**45,966,401**	**501,799,684**
Total liabilities and equity	**1,642,853**	**522,711**	**598,498**	**3,664,282**	**38,265,095**	**-**	**457,106,245**	**501,799,684**
Sensitivity of statement of financial position items to interest rate risk	***298,781,819***	***43,107,454***	***13,799,938***	***34,121,895***	***20,208,890***	***1,119,848***	***(411,139,844)***	**-**

* Deposits from customers which are not sensitive to interest rate risk include guarantee deposits totaling EUR 18,141,170 (2016: EUR 18,175,017)

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

Note 33 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 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 were 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 expenses	(80,194)	(549,056)	-	-
Provisions for loan impairment	-	192,178	-	-
Fee and commission income	-	35,464	121	7,379
Fee and commission expense	(68,636)	-	-	-
Administrative and other operating expenses	(108,603)*	-	600	-

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

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 2017.

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

Note 33 Related party disclosures *(cont'd)*

Transactions with related parties as at 31 December 2016 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: 5.7-24%)	11,715,365	2,916,232	-	6,984
Correspondent account	6,916,489	-	-	-
Investment in subsidiary	-	-	6,600,000	-
Deposits from customers (contractual interest rate: 0.0%)	-	2,789,047	6,580,519	91,619
Subordinated loans (contractual interest rate: 7.0-8.5%)	1,423,647	6,027,178	-	-

Income and expense from transactions with related parties in 2016 were as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Subsidiary of the Bank	Other related parties
Interest income	1,544,528	178,809	-	553
Interest expenses	(552,445)	(182,197)	-	-
Provisions for loan impairment	-	(954,558)	-	-
Fee and commission income	-	38,182	57	405
Fee and commission expense	(36,001)	-	-	-
Administrative and other operating expenses	(18,938)	-	-	-

Off-balance sheet liabilities towards related parties as at 31 December 2016 can be specified as follows:

	Entities owned by the Bank's shareholders	Other related parties
Undrawn credit lines	-	6,150
Assets under management	5,937,928	-

Loans issued to and repaid by related parties in 2016 can be specified as follows:

	Parent company of the Bank	Entities owned by the Bank's shareholders	Other related parties
Issued to related parties	11,713,678	-	72,181
Repaid by related parties	13,067,802	320,216	68,306

Transactions with the parent company of the Bank include the total amount of the current loans issued and repaid in 2016.

Note 33 Related party disclosures *(cont'd)*

Remuneration to the Board and Council of the Bank is disclosed below:

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016 Bank EUR
Short-term benefits:				
- Salaries	661,449	652,743	587,076	587,076
- State statutory social insurance contributions	173,270	171,216	140,819	140,819
Total	**834,719**	**823,959**	**727,895**	**727,895**

Note 34 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.

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.

Note 34 Fair values of financial assets and liabilities *(cont'd)*

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 as at 31 December 2016 and 31 December 2017 are disclosed below:

	31.12.2017		31.12.2016	
	Carrying amount	Fair value	Carrying amount	Fair value
	EUR	EUR	EUR	EUR
Assets measured at amortized cost				
Cash and balances with the Bank of Latvia	90,638,213	90,638,213	148,906,810	148,906,810
Balances due from banks	89,439,452	89,439,452	99,833,647	99,833,647
Loans to legal entities	88,258,436	96,470,638	90,341,121	92,315,872
Loans to private individuals, except for mortgages	7,731,677	8,556,368	8,543,499	8,667,848
Mortgages	314,087	407,072	628,828	636,242
Other financial assets	3,878,758	3,878,758	2,645,478	2,645,478
Total assets measured at amortized cost	**280,260,623**	**289,390,501**	**350,899,383**	**353,005,897**
Liabilities measured at amortized cost				
Deposits from customers	296,482,449	296,899,574	421,912,801	423,756,096
Debt securities	16,763,810	16,763,810	19,072,989	19,072,989
Subordinated loans	12,367,892	12,511,188	14,072,281	14,179,853
Other financial liabilities	501,521	501,521	668,069	668,069
Total liabilities measured at amortized cost	**326,115,672**	**326,676,093**	**455,726,140**	**457,677,007**

Note 34 Fair values of financial assets and liabilities *(cont'd)*

Carrying amounts of the Bank's assets measured at amortized cost and their fair values as at 31 December 2016 and 31 December 2017 are disclosed below:

	31.12.2017		31.12.2016	
	Carrying amount	Fair value	Carrying amount	Fair value
	EUR	EUR	EUR	EUR
Assets measured at amortized cost				
Cash and balances with the Bank of Latvia	90,638,213	90,638,213	148,906,810	148,906,810
Balances due from banks	89,439,452	89,439,452	99,833,647	99,833,647
Loans to legal entities	90,759,269	99,072,521	90,341,121	92,315,872
Loans to private individuals, except for mortgages	7,731,677	8,556,368	8,543,499	8,667,848
Mortgages	314,087	407,072	628,828	636,242
Other financial assets	3,280,184	3,280,184	2,645,441	2,645,441
Total assets measured at amortized cost	**282,162,882**	**291,393,810**	**350,899,346**	**353,005,860**
Liabilities measured at amortized cost				
Deposits from customers	296,830,563	297,247,688	428,493,320	430,336,615
Debt securities	16,763,810	16,763,810	19,072,989	19,072,989
Subordinated loans	12,367,892	12,511,188	14,072,281	14,179,853
Other financial liabilities	499,434	499,434	668,069	668,069
Total liabilities measured at amortized cost	**326,461,699**	**327,022,120**	**462,306,659**	**464,257,526**

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

Note 34 Fair values of financial assets and liabilities *(cont'd)*

The Group's assets by fair value hierarchy levels as at 31 December 2017 and 31 December 2016 (at carrying amounts) are disclosed below):

	31.12.2017			31.12.2016		
	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	-	-	483,074	-
Available-for-sale financial assets	-	-	234,942	-	-	188,972
Financial assets at fair value through profit or loss	58,265,632	2,084,702	-	110,881,832	14,361,240	-
Total assets measured at fair value	**58,265,632**	**2,150,458**	**234,942**	**110,881,832**	**14,844,314**	**188,972**
Assets for which fair value is disclosed						
Cash and balances with the Bank of Latvia	-	90,638,213	-	-	148,906,810	-
Balances due from banks	-	89,439,452	-	-	99,833,647	-
Loans and advances to customers	-	-	96,304,200	-	-	99,513,448
Other financial assets	-	3,878,758	-	-	2,645,478	-
Total assets for which fair value is disclosed	**-**	**183,956,423**	**96,304,200**	**-**	**251,385,935**	**99,513,448**

	Level 1 EUR	Level 2 EUR	Level 3 EUR	Level 1 EUR	Level 2 EUR	Level 3 EUR
Liabilities measured at fair value						
Derivative financial instruments	-	652,318	-	-	1,378,768	-
Total liabilities measured at fair value	**-**	**652,318**	**-**	**-**	**1,378,768**	**-**
Liabilities for which fair value is disclosed						
Deposits from customers	-	296,482,449	-	-	421,912,801	-
Debt securities	-	-	16,763,810	-	-	19,072,989
Subordinated loans	-	-	12,367,892	-	-	14,072,281
Other financial liabilities	-	501,521	-	-	668,069	-
Total liabilities for which fair value is disclosed	**-**	**296,983,970**	**29,131,702**	**-**	**422,580,870**	**33,145,270**

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

Note 34 Fair values of financial assets and liabilities *(cont'd)*

The Group's assets by fair value hierarchy levels as at 31 December 2017 and 31 December 2016 (at carrying amounts) are disclosed below):

	31.12.2017			31.12.2016		
	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	-	-	483,074	-
Available-for-sale financial assets	-	-	234,942	-	-	188,972
Financial assets at fair value through profit or loss	58,265,632	2,084,702	-	110,881,832	14,361,240	-
Total assets measured at fair value	**58,265,632**	**2,150,458**	**234,942**	**110,881,832**	**14,844,314**	**188,972**
Assets for which fair value is disclosed						
Cash and balances with the Bank of Latvia	-	90,638,213	-	-	148,906,810	-
Balances due from banks	-	89,439,452	-	-	99,833,647	-
Loans and advances to customers	-	-	98,805,033	-	-	99,513,448
Other financial assets	-	3,280,184	-	-	2,645,441	-
Total assets for which fair value is disclosed	**-**	**183,357,849**	**98,805,033**	**-**	**251,385,898**	**99,513,448**

Liabilities measured at fair value						
Derivative financial instruments	-	652,318	-	-	1,378,768	-
Total liabilities measured at fair value	**-**	**652,318**	**-**	**-**	**1,378,768**	**-**
Liabilities for which fair value is disclosed						
Deposits from customers	-	296,830,563	-	-	428,493,320	-
Debt securities	-	-	16,763,810	-	-	19,072,989
Subordinated loans	-	-	12,367,892	-	-	14,072,281
Other financial liabilities	-	499,434	-	-	668,069	-
Total liabilities for which fair value is disclosed	**-**	**297,329,997**	**29,131,702**	**-**	**429,161,389**	**33,145,270**

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

Note 35 Subordinated loans

Subordinated loans as at 31 December of 2017 and 31 December 2016 were as follows:

	31.12.2017 Group EUR	%	31.12.2017 Bank EUR	%	31.12.2016 Group EUR	%	31.12.2016 Bank EUR	%
Fortum Trade Services LTD (maturity: 2019-2021)	7,499,686	7.00-8.50	7,499,686	7.00-8.50	6,027,178	7.00-8.50	6,027,178	7.00-8.50
AB Pivdenny (maturity: 2021)	-	-	-	-	1,423,648	8.00	1,423,648	8.00
Venture Resource Investments LTD (maturity: 2019)	-	-	-	-	1,900,726	8.00	1,900,726	8.00
UK Industries Group LTD (maturity: 2021)	-	-	-	-	1,898,618	8.00	1,898,618	8.00
Heshvan Limited (maturity: 2020-2021)	1,970,767	8.00-8.50	1,970,767	8.00-8.50	-	-	-	-
Crownfield Nordic Limited Partnership (maturity: 2018)	1,667,964	7.00	1,667,964	7.00	1,897,722	7.00	1,897,722	7.00
Milandale Limited (maturity: 2021)	417,003	8.00	417,003	8,00	-	-	-	-
Maxiplan L.P (maturity: 2020)	353,785	8.50	353,785	8.50	402,518	8.50	402,518	8.50
Igor Chudenkov (maturity: 2020)	350,287	8.50	350,287	8.50	398,538	8.50	398,538	8.50
Andrey Volodin (maturity: 2020)	108,400	8.50	108,400	8.50	123,333	8.50	123,333	8.50
Total subordinated loans	**12,367,892**		**12,367,892**		**14,072,281**		**14,072,281**	

Note 36 Subordinated loans

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

	31.12.2017 Group EUR	31.12.2017 Bank EUR	31.12.2016 Group EUR	31.12.2016. Bank EUR
Legal entities:				
- non-residents	86,632,296	86,632,296	103,524,097	103,524,097
Private individuals:				
- residents	199,006	199,006	199,966	199,966
- non-residents	1,413,511	1,413,511	7,846,034	7,846,034
Total	**88,244,813**	**88,244,813**	**111,570,097**	**111,570,097**

Note 37 Return on equity and return on assets

	31.12.2017 Group	31.12.2017 Bank	31.12.2016 Group	31.12.2016 Bank
Return on equity (ROE) (%)	6.55%	6.74%	7.06%	7.12%
Return on assets (ROA) (%)	0.66%	0.65%	0.50%	0.50%

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.

Note 38 Going concern

In March 2018, the Financial and Capital Market Commission (FCMC) announced that it is planned to introduce legislative restrictions on activities with companies, which have a "shell company" indication. Until mid-April 2018, the Cabinet of Ministers and the Saeima plan to consider and approve the relevant amendments to the Law on the Prevention of Money Laundering and Terrorism Financing (hereafter referred to as the Law). According to currently proposed wording of the Law, after the amendments to the Law enter into force, it will be prohibited to open new accounts in Latvian banks for "shell companies" meeting high-risk characteristics, namely, features specified in Article 151(1)(a),(b) of the Law simultaneously.

In addition, banks will be given a certain period to terminate cooperation with existing companies of this high-risk category.

The abovementioned amendments to the legislation have not yet been approved at the time of signing these Financial Statements, therefore the final interpretation of the Law is not yet known. At the time of signing these Financial Statements, the significant part of the Group's and the Bank's client base (according to the volume of deposits held with the Bank) might be classified as "shell companies" according to the current AML legislation, nevertheless, these clients do not fully fall under the prohibition, if amendments to the Law are finally approved by Saeima in the version approved on April 10, 2018 by the Cabinet of Ministers of the Republic of Latvia.

The above mentioned conditions give rise to a material uncertainty which may cast significant doubt on Group's and Bank's ability to continue as a going concern and, therefore on its ability to realize its assets and discharge its liabilities in the normal course of business. However, taking into account the fact that at the time of signing these Financial Statements, the Cabinet of Ministers of the Republic of Latvia has already approved and submitted for approval in the Saeima the initial version of the amendments, the management of the Group and the bank does not expect the approval of more stringent restrictions by the Saeima and following development of the negative scenario for business model of the Group and Bank.

Based on the historical dynamics, current trends, as well as the assumptions of the Bank's management regarding the future situation in the economy and financial sector of Latvia, Ukraine and other related countries, and taking into account the planned restrictions on servicing "shell companies" (according to currently proposed changes in legislation), the Bank revised its business model for the period from 2018 to 2021.

In the framework of the model, the Bank's management has reviewed the application of the "shell company" definition to the Bank's client portfolio as well as the proposed changes to the legislation, namely, the high-risk characteristics of the "shell companies". As described in Notes 9 and 39, the Bank has already performed detailed review of its client base and their underlying business in line with the AML regulations and the portfolio is well known to the Group and the Bank. According to the Managements assessment, as of 21st March 2018 approximately 50% of deposits in total amounting to 156 million EUR have been received from clients that according to the current legislation might be classified as "shell companies". Out of these 156 million EUR, the clients with deposits in total amounting to 70 million have been identified as potentially meeting high-risk characteristics and not corresponding to the Bank's internal policy of restricting the transactional business, therefore the Bank initiates the termination of cooperation with the indicated clients within the terms prescribed by the new edition of the Law. Another 3% of deposits or approximately 9 million EUR have been received from clients whose classification still should be reviewed.

In order to satisfy the potential cash outflow as a result of closing the said accounts with high-risk characteristic, the Bank's management plans to use funds currently held with the Bank of Latvia as well as other correspondent banks. However, if the changes in the legislation would be more strict, any further cash outflow could be financed by selling the governmental Bonds and other securities owned by the Bank. Such disbursements would still allow the Bank to maintain its liquidity ratios in line with the requirements of FCMC. If any further funds would be needed, the Bank could potentially use its office building as a collateral or sell the repossessed assets.

Note 38 Going concern *(cont'd)*

Besides, the Bank's management has identified the clients that currently are classified as "shell companies" or that still should be investigated, but where is strong evidence of a real business, hence the management is of the opinion that these clients might potentially be transformed to meet the characteristics of a "non-shell company". The nine largest clients of these on 21st March 2018 held deposits worth 44 million EUR with the Bank.

In the longer term, the expected clients' deposits outflow might be partially compensated by attraction of deposits in the territory of the European Union from existing clients as well as through new product "Deposit solution". Furthermore, new clients could be attracted, including new companies from groups of clients already serviced by the Bank, to which the restrictions prescribed by the Law do not apply.

Going forward, the model assumes offering priority banking products targeted at the real economy, clients EU residents and individual private investors. Starting from year 2019, it is planned to increase the share of commission income from e-commerce services and investment products.

The Bank's management has also submitted the required documentation to the FCMC to increase the loan portfolio exposure in Ukrainian market up to 1.5 capital (currently capped at 1 capital). The management has already identified potential Ukrainian resident clients operating in the segment of agriculture and real estate to increase the portfolio by estimated 27 million EUR.

Taking into account that year 2018 will be the year of a new business model introduction with simultaneous transition to EUR as a base currency, the Bank's managements in the initial plan has projected potential losses of around 1 million EUR. However, the management is currently working on additional scenarios to minimise the potential losses through optimization of administrative expenses and increasing business efficiency. Starting from 2019 the model demonstrates that the Bank could return to positive results, however, the profit margin is dependent on whether the FCMC would approve the increased loan portfolio exposure in Ukraine as well as realisation of other assumptions.

The model provides strict observance of all the Bank's individual capital and liquidity requirements set by the FCMC, for the period of the following 4 years. The FCMC is informed about the new strategic development model of the Bank.

The Bank's shareholders as well as parent bank Pivdennyj have issued the letter confirming 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 capital and liquidity requirements until 31st December 2019.

Note 39 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.

In February 2018, one of the Group and Bank's correspondent banks, ABLV Bank received the decision of the Council of the Financial and Capital Market Commission (FCMC) "On Occurrence of Unavailability of Deposits". At the extraordinary general shareholders' meeting on 26 February 2018, ABLV Bank made the decision on voluntary liquidation. Considering the published balance sheet data of ABLV Bank as at February 2018 and the sequence and procedure for satisfying creditors' claims, the Management believes that the Group and the Bank will be in a position to fully recover its funds amounting to EUR 1.5 million currently deposited with the correspondent account until the end of the year 2018. No material effect on the Group and Bank's capital and liquidity ratios is anticipated and the dynamics and stability of customer deposits do not appear to be adversely affected.

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

Note 39 Subsequent events *(cont'd)*

On 1 February 2018, the Bank submitted to the FCMC its final report on the fulfilment of legal obligations set forth in the Administrative Agreement concluded between the Bank and the FCMC on 26 June 2017. In the final report the Bank provided a detailed account of the measures taken over the year 2017 in the AML/CTF area enhancing the overall efficiency of the internal control system and the ability to manage the risks related to AML/CTF and sanctions. In its letter dated 23 February 2018, the FCMC confirmed reviewing of the submitted final report and taking into consideration the Bank's assurance of fulfilling all the obligations set forth in the Administrative Agreement within the time period prescribed thereof. Taking into account the above-mentioned measures which included adjusting the Bank's customer policy, changing the Bank's internal structure, re-organizing the Bank's internal processes and increasing the number of employees responsible for AML/CTF simultaneously advancing the level of their professional skills, the Bank believes that its internal control system has been significantly upgraded and corresponds to the existing risk profile of the Bank.

In 2018 and beyond, the Bank will continue to implement measures aimed at enhancing its internal control system in accordance with its development and AML/CTF risk management strategies.

On 16 February 2018, SIA Ikšķiles Ielas Nams, the Bank's wholly-owned subsidiary, was registered with the Commercial Register with its share capital amounting to EUR 700,000 contributed in kind consisting of a real estate at Ikšķiles iela 2, Ogre. The aforementioned property was repossessed under the debt recovery procedure. The subsidiary was established with an aim to sell its shares after the contribution in kind was done. The transaction was completed on 27 February 2018 incurring no loss to the Bank.

In April 2018, the Cabinet of Ministers and the Saeima plan to consider and approve amendments to the Law on the Prevention of Money Laundering and Terrorism Financing. According to currently available wording of the Law, after the amendments to the Law enter into force, it will be prohibited to open new accounts in Latvian banks for "shell companies" meeting high-risk characteristics, namely, features specified in Article 151(1)(a),(b) of the Law simultaneously. In addition, banks will be given a transition period to terminate cooperation with existing customers of this high-risk category. At the time of signing the Report, the abovementioned amendments have not yet been approved and the Group and Bank's Management is closely following and assessing the situation (see Note 38).

Having considered the abovementioned developments, as well as conceivable scenarios of cooperation with partners ensuring execution of settlements in U.S. dollars, the Bank is planning to gradually reduce the volume of USD payment services and adopt the EUR as the base currency of Bank's operation over the year 2018.

Alexander Jakovlev
Acting Chairman of the Board

Yuriy Rodin
Chairman of the Council

17 April 2018, Riga