



**AS "Akciju komerčbanka "Baltikums""  
Consolidated Financial Statement  
as of 30 June, 2006**

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## Report of Management

The 1st half of 2006 was challenging for JSC "Akciju komercbanka "Baltikums"" (hereinafter – the Bank, Commercial Bank) and its daughter companies. Despite of positive development of the main positions of the Bank's balance sheet, in the first six months of 2006 profit of JSC "Akciju komercbanka "Baltikums"" group companies was lower than in the respective period of 2005.

During the 1st half of 2006 the Bank continued to implement the tasks set forth at the time of issue of its bonds – increased its loan portfolio and developed further its market position in the chosen market niches of trade finance and shipping finance.

In the 1st half of 2006 the Bank increased substantially its total loan portfolio that reached LVL 15.6 million, as well as the loan portfolio excluding the loans against the collateral of securities that reached LVL 13.5 million. The main indicator of the Bank's use of credit resources - the average loan portfolio, excluding the loans against the collateral of securities, in the 2nd quarter substantially increased and reached LVL 15.0 million, considerably exceeding the level for the 4th quarter of 2005 and the 1st quarter of 2006. Thus, in the 2nd quarter we managed to compensate partially rather bad use credit resources of the 1st quarter. The Bank carried out active work to improve the usage of credit lines, and therefore we plan that general indicators of lending to customers in 2006 will considerably exceed those achieved in the previous years. It is a pleasure to note that the quality of the loan portfolio of the Bank continues to be high as the share of bad loans in the portfolio remained very small.

It should be also mentioned that situation in the world financial markets was not favourable for the Bank in the 2nd quarter as interest rates rose in all three major currencies for the Bank – LVL, EUR and USD. This factor negatively affected the Bank's result in the financial markets as well as put an upward pressure on the cost of customer funds for the Bank. As a positive aspect, in July and August the situation with dollar interest rates notably improved that allowed the Bank by skilful management of its portfolio of financial instruments to increase its profit substantially.

In turn, in the 2nd quarter of 2006 total commissions and fees income of the Bank substantially increased, thus, net commissions and fees income for the 1st half of 2006 substantially exceeded the level for the respective period of 2005.

In the 1st half of 2006 the Bank also made some investments oriented at development that increased its administrative expenses. As the most notable expenses position, expenses related to implementation of the chip cards project, the general rise of prices in Latvia, as well as the notable expenses for conjunction of clients and for development of products can be mentioned.

Unfavourable situation in the world financial markets, as well as increased administrative expenses did not allow the Bank in the 1st half of 2006 to maintain the level of profit that the Bank had in 2005. Thus, consolidated profit of the Group as of 30 June 2006 was LVL 104 thousand. Nevertheless, the Bank continues to develop dynamically and we believe that the results for the whole year 2006 will be better then for the previous years that is confirmed by the dynamics of the balance sheet of Bank in July and in August.

Total assets of the Bank as of June 30, 2006 were LVL 44.9 million and customer deposits amounted to LVL 29.4 million, that we consider a good level. In spite of the fact

that customer deposits as of June 30, 2006 were less in comparison with the corresponding indicator a year ago, the average customer deposits in the 1st half of 2006 considerably grew and the level was highest in the history of the Bank.

An important event for the Bank development was the opening of a new correspondent account with American Express Bank, Ltd. New York for settlements in US dollars and EUR.

We are pleased that the strategy of the Bank as well as the Bank's careful approach to its reputation have been highly evaluated by one of the world's leading banks.

AS „Akciju komercbanka „Baltikums”” highly values the trust shown by American Express Bank, Ltd. New York and hopes on successful cooperation in the future.

In July 2006, as a result of the 4-th share issue, JSC „Akciju komercbanka „Baltikums”” paid up share capital has been increased by LVL 1.28 to LVL 6.38 million. The emission was fully subscribed to and paid up by the Bank's shareholder - JSC „Baltikums Bankas Grupa”. In May 2006 the Bank increased the share capital of its daughter company Investment Management JSC „Baltikums Asset Management” by LVL 1.28 million. The funds raised as a result of the new Investment Management JSC „Baltikums Asset Management” share issue will be used for increasing the company's interest in life insurance company JSC „Baltikums Dzīvība”. The decision on the increase is related to the plan of the Bank's shareholder to restructure JSC „Baltikums Bankas Grupa” and JSC „Baltikums Apdrošināšanas Grupa”. As a result of the restructuring it is planned to separate investment and savings business from risk insurance business by putting the full spectrum of investment and savings services (asset management, management of investment and pension funds, life insurance) under the management of the Bank and its daughter companies.

In the 2nd quarter of 2006 the Bank, in cooperation with JSC „Parex Banka”, successfully placed its second issue of bonds attracting EUR 5 million for the term of 3 years. As the most important tasks of the nearest future we see optimal investment of these funds by further increasing the Bank's loan portfolio that is being successfully carried out now. We are also developing cooperation with other banks in the field of syndicated lending as well as expanding the spectrum of corporate lending products.

Chairman of the Board

Aldis Reims

August 22, 2006

## Consolidated Income Statement

Position	30.06.2006 LVL`000	30.06.2005 LVL`000	30.06.2006 EUR`000	30.06.2005 EUR`000
Interest income	1 121	786	1 595	1 118
Interest expense	-402	-250	-572	-356
Fees and commission income	443	320	630	455
Fees and commission expense	-103	-84	-146	-120
Trading income from financial instruments and foreign exchange	-86	264	-122	376
Other operating income	24	28	34	40
Administrative expenses	-792	-634	-1127	-902
Depreciation and amortisation	-44	-48	-63	-68
Other operating expenses	-10	-8	-14	-11
Provisions for bad debts	-1	-5	-1	-7
Income from decrease of provisions	1	35	1	50
<b>Income before corporate income tax</b>	<b>151</b>	<b>404</b>	<b>215</b>	<b>575</b>
Income tax	-47	-42	-67	-60
<b>Net income</b>	<b>104</b>	<b>362</b>	<b>148</b>	<b>515</b>
Earnings per share, LVL	0.020	0.071	0.028	0.101

The exchange rate of the Bank of Latvia was 1 EUR=0.702804 LVL on June 30, 2006.

## Consolidated Balance Sheet

Position	30.06.2006 LVL` 000	30.06.2005 LVL` 000	30.06.2006 EUR` 000	30.06.2005 EUR` 000
Cash and deposits with the Bank of Latvia	3 086	2 667	4 391	3 795
Claims on domestic credit institutions	15 106	28 308	21 494	40 279
Loans, net value	15 611	13 770	22 212	19 593
Fixed income securities (bonds)	10 154	6 233	14 448	8 869
Shares and other non-fixed income securities	10	18	14	26
Derivatives	70	9	100	13
Investments in associated entities and in subsidiaries	0	0	0	0
Intangible assets	87	85	124	121
Fixed assets	56	91	80	129
Other assets	276	245	393	349
Prepayments and accrued income	440	219	626	312
<b>Total assets</b>	<b>44 896</b>	<b>51 645</b>	<b>63 882</b>	<b>73 486</b>
Liabilities to credit institutions and to foreign Central banks	3 712	4 070	5 282	5 791
Deposits	29 404	39 176	41 838	55 742
Notes payable	6 224	2 710	8 856	3 856
Other liabilities	244	145	384	209
<b>Total liabilities</b>	<b>39 584</b>	<b>46 101</b>	<b>56 324</b>	<b>65 598</b>
<b>Shareholders' equity</b>				
Share capital	5 100	5 100	7 257	7 257
Reserve capital and other reserves	17	17	24	24
Retained earnings	91	65	129	92
<b>Profit of the year</b>	<b>104</b>	<b>362</b>	<b>148</b>	<b>515</b>
<b>Shareholders' equity</b>	<b>5 312</b>	<b>5 544</b>	<b>7 558</b>	<b>7 888</b>
<b>Total liabilities and shareholders' equity</b>	<b>44 896</b>	<b>51 645</b>	<b>63 882</b>	<b>73 486</b>
<b>Off-balance items</b>				
Contingent liabilities	15	12	21	17
Financial commitments	4 797	3 582	6 826	5 097
<b>Assets/Liabilities under management</b>	<b>1 335</b>	<b>3 538</b>	<b>1 900</b>	<b>5 034</b>

The exchange rate of the Bank of Latvia was 1 EUR=0.702804 LVL on June 30, 2006.

## Consolidated Statement of Changes in Shareholders Equity

	Share capital, LVL'000	Reserve capital and other reserves, LVL'000	Retained earnings, LVL'000	Total, LVL'000
<b>Balance as at 31 December 2004</b>	<b>5 100</b>	<b>17</b>	<b>472</b>	<b>5 589</b>
Profit for the year	-	-	524	524
Dividends paid	-	-	-400	-400
<b>Balance as at 31 December 2005</b>	<b>5 100</b>	<b>17</b>	<b>596</b>	<b>5 713</b>
Profit for the year	-	-	104	104
Dividends paid	-	-	-505	-505
<b>Balance as at 30 June 2006</b>	<b>5 100</b>	<b>17</b>	<b>195</b>	<b>5 312</b>

	Share capital, EUR` 000	Reserve capital and other reserves, EUR` 000	Retained earnings, EUR` 000	Total, EUR` 000
<b>Balance as at 31 December 2004</b>	<b>7 257</b>	<b>24</b>	671	7 952
Profit for the year	-	-	746	746
Dividends paid	-	-	-569	-569
<b>Balance as at 31 December 2005</b>	<b>7 257</b>	<b>24</b>	<b>848</b>	<b>8 129</b>
Profit for the year	-	-	148	148
Dividends paid	-	-	-719	-719
<b>Balance as at 30 June 2006</b>	<b>7 257</b>	<b>24</b>	<b>277</b>	<b>7 558</b>

## Consolidated Cash Flows Statement

Position	30.06.2006 LVL`000	30.06.2005 LVL`000	30.06.2006 EUR`000	30.06.2005 EUR`000
<b>Cash flow from operating activities</b>				
Income before income tax	151	404	215	575
Depreciation and amortisation	39	45	55	64
(Gain) from disposal of fixed assets	-2	-24	-3	-34
Impairment losses increase/(decrease)	0	-29	0	-41
Loss on foreign exchange revaluation	219	168	312	239
<b>Increase in cash and cash equivalents from operating activities before changes in assets and liabilities</b>	<b>407</b>	<b>564</b>	<b>579</b>	<b>803</b>
Increase in deferred income and accrued expense	108	18	154	26
Decrease/(increase) in prepayments and accrued income	-152	14	-216	20
Decrease in other assets	65	-19	92	-27
Increase /(decrease) in other liabilities and provisions	12	-31	17	-44
(Increase) in investments in securities and derivatives	-3 805	-1 563	-5 414	-2 224
(Increase) in balances due from credit institutions	-28	0	-40	0
(Increase) in loans to customers	-1 685	-3 274	-3 398	-4 658
Increase /(decrease) in balances due to credit institutions	-744	170	-1 059	242
Decrease in Deposits from the public	9 001	21 143	12 807	30 084
<b>Net cash from operating activities before income tax</b>	<b>3 179</b>	<b>17 022</b>	<b>4 522</b>	<b>24 222</b>
Income taxes paid	-95	-55	-134	-78
<b>Increase in cash and cash equivalents from operating activities</b>	<b>3 084</b>	<b>16 967</b>	<b>4 388</b>	<b>24 144</b>
<b>Cash flow from investing activities</b>				
Acquisition of fixed and intangible assets	-49	-36	-70	-51
Proceeds from disposals of fixed and intangible assets	6	1 019	9	1 450
Acquisition of a daughter company, net value	0	-20	0	-28
<b>(Decrease)/increase in cash and cash equivalents used in investing activities</b>	<b>-43</b>	<b>963</b>	<b>-61</b>	<b>1 371</b>
<b>Cash flow from financing activities</b>				
Proceeds from issue of debt securities	3 514	0	5 000	0
Dividends paid	-505	-400	-719	-569
<b>Increase/(decrease) in cash and cash equivalents provided by financing activities</b>	<b>3 009</b>	<b>-400</b>	<b>4 281</b>	<b>-569</b>
<b>Net increase /(decrease) in cash and cash equivalents</b>	<b>6 050</b>	<b>17 530</b>	<b>8 608</b>	<b>24 946</b>
Cash and cash equivalents at the beginning of the year	10 184	11 926	14 491	16 966
Loss from foreign exchange revaluation	-219	-168	-312	-239
<b>Cash and cash equivalents at the end of the year</b>	<b>16 015</b>	<b>29 288</b>	<b>22 787</b>	<b>41 673</b>

The exchange rate of the Bank of Latvia was 1 EUR=0.702804 LVL on June 30, 2006.

## Notes

### 1. GENERAL INFORMATION

The Bank was established on 22nd June 2001, when it was incorporated in the Republic of Latvia as a joint stock company. The address of the Bank is Maza Pils Street 13, Riga, LV 1050. The Bank is a commercial bank specialising in the servicing of export and import operations, trade finance and investment management. The Bank operates in accordance with Latvian legislation and the licence issued by the Bank of Latvia.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (1) Basis for preparation of the financial statements

The Bank maintains its accounting records in accordance with the legislation of the Republic of Latvia. The Bank's financial year corresponds to the calendar year.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and Financial and Capital Market Commission regulations. The financial statements are based on the accounting records prepared in accordance with the cost accounting principle or fair value, as appropriate. The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities held for trading and available-for-sale assets except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The accounting policies used in the preparation of the financial statements are consistent with those used in the financial statements for the period ending 30 June 2005.

#### (2) Foreign currency translation

The currency of the Republic of Latvia – lat (LVL) – is used in the financial statements. All assets and liabilities and off-balance sheet claims and liabilities in foreign currencies are revalued in lats using the end of period exchange rates determined by the Bank of Latvia. Gains and losses arising from revaluation are included in the profit and loss statement for the period.

The foreign currency exchange rates for the principal currencies that were used as of the end of the period were as follows:

	As of 30 June 2006	As of 30 June 2005
EUR	0,702804	0,702804
GBP	1,018000	1,005900
LTL	0,204000	0,204000
RUB	0,020700	0,020400
UAH	0,112000	0,115000
USD	0,560000	0,583000

Transactions in foreign currencies are revalued in lats according to the date of the transaction using exchange rates set by the Bank of Latvia.

#### (3) Going concern

The consolidated and Bank's financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business.

#### **(4) Basis of consolidation**

In 2003 the Bank acquired 100% of the share capital in IPAS "Baltikums Asset Management" and SIA "Baltikums Līzings". In 2005 the Bank acquired 99,24% of the share capital in AS "Pirmais atklātais pensiju fonds". The consolidated accounts as of 31 March 2006 include the financial statements of the Bank and the three subsidiaries.

Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary acquired is recorded as goodwill. The financial statements of the subsidiaries are consolidated in the Group's financial statements on a line-by-line basis by adding together similar types of assets and liabilities as well as income and expenses.

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

In cases when the Group and Bank amounts are not materially different, only the Bank amounts are presented in the notes.

#### **(5) Financial instruments**

##### **a) Classification:**

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

Originated loans and receivables are loans and receivables that the Bank has created by providing funds to customers other than those created with the intent to be sold immediately or in the short-term. Originated loans and receivables include loans and advances to banks and customers other than purchased loans.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These include certain debt instruments.

Available-for-sale assets are financial assets that are not held for trading purposes, originated loans and receivables, or held to maturity.

##### **b) Recognition**

Financial instruments are recognized in the balance sheet on a settlement date basis. Originated loans and receivables are recognised on the day they are transferred to or originated by the Bank.

### **c) Measurement**

Financial instruments are measured initially at fair value plus transaction costs if the financial instruments are not at fair value through profit and loss account.

Subsequent to initial recognition, all financial assets and liabilities at fair value through profit and loss and all available-for-sale assets are measured at fair value, except for any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured. These are stated at cost, including transaction costs, less impairment losses. The fair value is assessed based on quoted market prices.

All non-trading financial assets and liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost using the effective interest rate method. All such financial instruments are subject to revaluation for impairment.

### **d) Fair value measurement principles**

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Bank/(Group) would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

### **e) Gains and losses on subsequent measurement**

Gains and losses arising from a change in the fair value of all financial assets and liabilities at fair value through profit and loss are recognised in the income statement. Gains and losses arising from a change in the fair value of available-for-sale securities are recognised directly in equity. The Bank does not apply hedge accounting.

### **f) Derecognition**

A financial asset is derecognised when the Bank loses control over contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.

Available-for-sale assets, financial assets and liabilities at fair value through profit and loss, held-to-maturity instruments and originated loans and receivables are derecognised on the day they are transferred by the Bank.

## **(6) Interest income and expenses**

Interest income and expense are recognised in the income statement as they accrue, taking into account the effective yield of the asset/liability or an applicable floating rate. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Recognition of interest income is discontinued when there is uncertainty regarding the repayment of interest or principal.

## **(7) Fee and commission income**

Fee and commission income is recognised when earned or incurred.

## **(8) Investments**

### **Subsidiaries**

Subsidiaries are entities in which the Group, directly or indirectly, has power to control or exercise control over financial and operating policies.

Investments in subsidiaries are carried at cost in the Bank's financial statements. The Bank recognizes income from the investment only to the extent that the Bank receives distributions from accumulated profits of the subsidiary arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

### **Investments in associates**

Associates are those enterprises in which the Bank has significant influence, but not control, over the financial and operational policies. The consolidated financial statements include the Bank's share of the total recognized gains and losses of associates on an equity accounted basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Bank's share of losses exceeds cost, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred obligations in respect of the associate.

## **(9) Loans**

Loans and advances are classified as originated loans and receivables and carried at amortised cost, where cost is defined as the fair value of cash consideration given to originate those loans. Loans are recognized in the balance sheet at the amount of the outstanding value, less impairment for doubtful debts.

The Bank mainly grants commercial and industrial loans to customers.

## **(10) Impairment**

The carrying amounts of the Bank's assets, other than deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated.

### **Calculation of recoverable amount**

The recoverable amount of the Bank's loans and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. The recoverable amount of the Bank's available-for-sale investments is their fair value.

### **Reversals of impairment**

An impairment loss in respect of loans and receivables is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

## **(11) Interest bearing borrowings**

Interest-bearing borrowings are recognised initially at fair value, net of any transaction costs incurred. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

## **(12) Depreciation and amortisation of fixed and intangible assets**

Fixed assets and intangible assets are recorded at cost, less accumulated depreciation. Depreciation is calculated on a straight-line basis. Based on the useful lives of fixed assets, the following rates are applied:

Intangible assets	20%
Furniture and equipment	20%
Computers	25%
Other	20%

Gains and losses on disposals of fixed assets are recognised in the profit and loss statement in the period of disposal.

Useful lives, residual values and depreciation methods are reviewed annually .

## **(13) Cash and cash equivalents**

Cash and cash equivalents are composed of cash and amounts due from the Bank of Latvia and other credit institutions on demand, and deposits in other credit institutions with a maturity less than 3 months less balances due to other credit institutions with a maturity less than 3 months.

## **(14) Off-balance-sheet items**

Off-balance-sheet items include guarantees, letters of credit and unused credit lines provided to customers as well as unused limits of credit cards.

## **(15) Corporate income tax**

Corporate income tax at the rate of 15% is calculated by the Bank in accordance with the Latvian tax regulations.

Deferred tax is recognized using the balance sheet liability method, taking into account temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax calculated is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates applied or substantially applied at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced by the amount that is not probable that the related tax benefit will be realized.

## **(16) Provisions**

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

## **(17) Assets under management**

Assets managed by the Bank on behalf of customers are not treated as assets of the Bank. The Bank assumes no risk on the assets.

A significant amount of managed assets are involved in repurchase (repo) transactions with other commercial banks. The Bank discloses on the balance sheet amounts due to

credit institutions for cash received in repo transactions and the amounts due from the providers of liabilities under management as loans granted.

### **(18) Repo transactions**

Repo transactions are recognized as financing transactions.

When the Bank is the seller of securities, securities are continued to be recognized on the balance sheet. Proceeds from the sale are recognized as a liability to the purchaser of the securities.

When the Bank is the purchaser of securities, the purchased securities are not recognized on the balance sheet. The amount paid for securities is recognized as a loan provided to the seller. The Bank is involved in two types of such transactions – classic repo and buy/sell back transactions.

The result of repo and buy/sellback transactions is recognized in the profit and loss statement as interest income or expense according to the accrual principle.

## **3. RISK MANAGEMENT**

The Bank pays significant attention to risk identification and management. The most significant risks to which the Bank is exposed to are credit risk, interest rate risk, liquidity risk, foreign exchange risk, operational and reputational risk.

Risk management principles are set forth in the Bank's risk management policies which are approved by the Council. Financial Analysis and Risk Management Department, the Asset and Liability committee, Credit committee and Anti Money Laundering committee are responsible for ensuring the implementation of the risk management policies.

### **(1) Credit risk**

Credit risk is the risk of potential losses resulting from non-fulfilment of contractual obligations by the Bank's debtor or counterparty.

Credit risk is managed in accordance with the Credit risk management policy approved by the Council. This policy details the basic principles of credit risk management, identification, assessment, restriction and control.

The management of risks related to ordinary loans involves assessment of the potential borrower's credit standing that is performed by the Financial Analysis and Risk Management Department. Decisions on granting loans are made by the Credit Committee based on the above analysis and evaluation of collateral. Subsequent to loan granting, the Financial Analysis and Risk Management Department performs a regular analysis of the borrower's financial position, which enables the Bank to take prompt action in the case of deterioration of the borrower's financial position.

Credit risk that is related to inter-bank operations (or operations with financial institutions), including the credit risk related to inter-bank settlements, is controlled by the Asset and Liability Committee that sets limits for transactions with each counter party.

The Bank monitors the concentration of significant balance sheet and off balance items' credit risk by geographical regions (i.e., countries, groups of countries, specific regions within the countries etc), client groups (i.e., central governments, local authorities, state enterprises, private enterprises, private individuals, etc) and industries.

### **(2) Foreign exchange risk**

Foreign exchange risk is the risk of potential losses as a result of the revaluation of balance sheet and off-balance sheet items denominated in foreign currencies.

The Bank continuously monitors the open positions of foreign currencies and regularly assesses the structure of assets and liabilities by currency. In order to improve the currency structure of its balance sheet, the Bank issued bonds in EUR currency, taking into account the increasing share of EUR denominated assets.

The Asset and Liability Committee sets limits for the open position in each currency providing an acceptable overall level of foreign currency risk.

### **(3) Interest rate risk**

Interest rate risk is the risk of potential losses the Bank may incur as a result of interest rate fluctuations.

For the purpose of controlling the interest rate risk, the Asset and Liability Committee performs regular analysis of assets and liabilities by maturity and type of interest.

### **(4) Liquidity risk**

Liquidity risk is the risk of potential losses as a result of sales of assets or acquisition of resources at unfavourable prices in order for the Bank to fulfil its liabilities to creditors.

Liquidity risk management is based on the analysis of the structure of assets and liabilities performed by the Bank's Financial Analysis and Risk Management Department. That includes the analysis of dynamics in customer funds by customer group and assessment of the possibilities of external borrowing. Based on this information, the Asset and Liability Committee monitors the Bank's ability to fulfil all its commitments. Operating short-term liquidity management, i.e. attraction and placement of resources, in the Bank is performed by the Resources Department of the Bank based on the short-term liquidity forecast.

### **(5) Country risk**

Country risk is the risk of potential losses arising from transactions with residents of foreign countries (or their securities) due to changes in the economic, political, and legal environment of the respective countries.

Before entering into transactions with residents of foreign countries, the Bank performs an assessment of the influence of economic, social, political and legal circumstances on the residents' ability to fulfil their obligations.

### **(6) Operational risks**

The Bank's organizational structure, precise job specifications, clear division of responsibilities as well as control procedures allow the Bank to monitor operational risks. The Bank has also developed an action plan for various crisis situations.

The Bank has set up an independent "Internal audit service" (IAS) with its main functions to ensure that the Bank's activities comply with existing legislation, approved plans, policies and other internal Bank documents and to monitor the compliance of the Bank's department activities with internal control procedures.

### **(7) Reputational risk**

The Bank recognizes the importance of preventing of money laundering and preventing of terrorism financing. Reputation risk management department was set up in the Bank to implement an internal control system, which monitors the timely control of clients and

their business partners. IAS regularly monitors execution of money laundering and terrorism financing prevention policy and procedures.

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