AS Meridian Trade Bank

Bank Separate and Group Consolidated
Financial Statements for the year ended
31 December 2017

CONTENTS

MANAGEMENT REPORT

Dear customers, partners and shareholders,

In 2017, AS Meridian Trade Bank (hereinafter – the Bank) continued working on the transformation and improvement of the banking business model focussing on compliance and enhancements in control, advanced technologies and expansion of the base of resident customers.

The Bank's priority is the expansion of the range and volume of services provided to resident customers, and it was done so during 2017 by increasing the share of deposits by residents of Latvia and Lithuania from 40% to 44%. As at 31 December 2017, the Bank ranked number 7 among Latvian banks by the number of active customers. Focussed on small and medium businesses, the Bank provides funds to the Latvian economy and 96% of all loans were issued to local businesses and natural persons. The total number of customers as at 31 December 2017 was nearly 40 thousand, of which 92% were residents of Latvia and Lithuania.

Particular attention during 2017 and 2018 was paid by the Bank to improving its compliance controls. The Bank and Group have launched preparations for the implementation and compliance with the requirements set out in the General Data Protection Regulation ("GDPR"). The GDPR is applicable from 25 May 2018. The following measures have been carried out: analysis of data processing; identification and analysis of all data processing activities; plan for the implementation of GDPR requirements has been approved, data protection specialist has been appointed; Personal data processing and protection policy has been developed and internal training for the Bank has been performed. Personal data processing principles are considered with every banking process. Considering increasing requirements regarding data protection and constantly growing requirement for the information system safety, the Bank is improving its information systems on an ongoing basis. Compliance with the new requirements of the regulations, including amendments to the Law 'On taxes and duties' regarding the provision of information to the State Revenue Service on natural persons, requirements stemming from the Account Register Law when providing data stipulated by the law to the Account register under the supervision of the State Revenue Service. On 1 January 2018 IFRS 9 comes into effect replacing IAS 39. To implement the new standard the Bank cooperates with the external consultant and has invested the necessary resources to gather adequate skills and historic data for forward-looking impairment model. The Bank developed processes, systems and models required for the implementation of IFRS 9 and gathered the required competencies.

When describing events affecting the development of the Latvian financial industry and the Bank, on 13 February 2018 the Financial Crimes Enforcement Network ("FinCEN") under the US Department of the Treasury issued a suggestion pursuant to Section 311 of the USA PATRIOT Act, against one of the largest banks in Latvia. On 19 February 2018, following an outflow of deposits from this institution, the European Central Bank instructed the Financial and Capital Market Commission to impose a prohibition to make outgoing payments from the bank. On 12 June 2018, in an extraordinary meeting the council of the Financial and Capital Market Commission accepted the decision on the initiation of the bank's self-liquidation process. On 17 February 2018, the Corruption Prevention and Combating Bureau of Latvia apprehended a high ranking government official on charges related to bribery. These events have a significantly adverse impact on the Latvian banking sector and its international reputation. The regulatory framework for AML/CTF has become more stringent and the Latvian financial institutions are required to quickly reduce their risk exposures related to servicing non-resident customers. Regulatory requirements are adopted to prohibit servicing the so-call 'shell arrangements' where the legal person is not related to any actual business activity and the activity of the legal person generates little or no economic value. The management of the Bank consistently monitors and evaluates the situation, and performs measures under Note 43. By reducing the client base risk and implementing a strategy focused on domestic customers, in 11 months of 2018, proportion of the Latvian and Lithuanian deposits in the Bank's deposit portfolio exceed a half and reached 56%.

As one of the priorities in the Bank's strategic development plan is improvement of the ML/TF risk management process, during the reporting period the Bank made notable efforts to improve its ML/TF risk management system. The exposure to ML/TF risk is determined, measured and analysed by the Bank on a regular basis to prevent significant risks from increasing. Under the impact of the volatile regulatory environment in 2017 the Bank paid particular attention to the development of ML/TF risk management methods in a most efficient manner to achieve high AML/CTF standards in full compliance with legal requirements and by making timely improvements and investments both in human resources and technologies. The Bank improved ML/TF and sanction risk management and controls, including it acquired and implemented ACCUITY data bases that are constantly updated. The Bank implemented a new multi-stage customer risk scoring system by FICO Tonbeller (SIRON) and adjusted its operating processes by introducing a multi-level customer acceptance system which requires that high risk customer evaluation and acceptance be carried out only by more senior employees. The Bank implemented automated systems for monitoring of customer transactions developed by FICO Tonbeller (SIRON) and adjusted them to its operational processes and risk management. The Bank implemented an ACCUITY system for pre-execution control of transactions and integrated it with other banking systems. The qualifications of the employees are being evaluated according to the principles laid down in the ML/TF risk management procedure in order to establish the level of qualification and whether appropriate resources are in place to manage the ML/TF risk provided for in the strategy. Employees of the Bank improved their knowledge in external trainings involving foreign experts, including ACAMS, and overall our specialists undertook 40 training courses in AML/CTF. It is important to note that the Bank has fully implemented the recommendations formulated by independent US consulting firms Lewis Baach Kaufman Middlemis and EXIGER to raise the efficiency of the internal control system for ML/TF risk management. In the next year, the Bank plans to reduce its exposure to ML/TF risk by abandoning excessive risk customers, maintaining effective monitoring and preventing suspicious transactions.

In 2018, following the reviews by the Financial and Capital Market Commission, the FCMC has concluded an administrative agreement with the Bank, imposing legal obligations and fines to the Bank. The fines applied by FCMC were paid within the set deadline and did not impact Bank's day-to-day operations and customer service. According to administrative agreement, the Bank undertook to ensure the following independent reviews of its internal control system for the management of ML/TF risk:

1) on the compliance of the risk classification of customer base;
2) on the compliance of information technologies used in the management of ML/TF risk;
3) on the compliance of the Bank's internal control system for AML/CTF.

The first two independent reviews from a company of certified auditors, Deloitte, were acquired in the middle of 2018, receiving an evaluation and additional recommendations for the improvement of the respective area. By the end of 2018, the Bank had implemented all suggestions and recommendations resulting from the independent review, improved the technical functions of AML/CTF information technology facilities, and provided detailed register of the functionality of customers' risk-scoring system. The overall independent review of the Bank's internal control system in the area of AML/CTF is expected at the beginning of 2019 for which an agreement with Deloitte, a sworn auditor has already been concluded.

In line with the administrative agreement, in 2018 the Bank actively continued to improve its internal control system according to the planned measures approved by the Bank regarding the improvement of internal control system in the area of AML/CTF. The most significant part of the measures was carried out in the second half of 2018 by introducing significant amendments and additions to AML/CTF regulations, and by improving the functionality, scenarios and reports of the automated system for customer transaction monitoring, thus making the Banks internal control system for AML/CTF more efficient and reducing risks. By the end of 2018, the Bank has performed compliance review of all customers subject to due dilligence, and an audit by purposefully reducing the number of customers posing a heightened ML/FT risk.

In 2019, the Bank will continue to improve and develop automation systems in the area of AML/CFT, as well as improve efficiency of automated scenarios for the identification of suspicious transactions. Also, the Bank plans to reduce its ML/FT risk exposure by declining high risk clients as described under Note 43 by performing effective monitoring and preventing suspicious transactions.

During the reporting year the Financial and Capital Markets Commission has made a decision to impose a fine to AS Meridian Trade Bank in the amount of EUR 889 thousand and establish legal obligations to prevent violations detected in the internal control system in the area of credit risk management. The Financial and Capital Market Commission indicated that the Bank already is in the process of improving the efficiency of its internal control system. The fine imposed by the Financial and Capital Market Commission has no impact on the Bank's daily work and servicing of clients. However, as at 31 December 2017, the Bank had exceeded the regulatory credit risk concentration requirements in ten cases. In 2018, the

MANAGEMENT REPORT

Bank continued to improve its credit portfolio and implement the necessary improvements in its internal control system in the area of credit risk management, by involving industry professionals in the field of restructurization and recovery.

In order to increase the number of resident customers from Latvia and Lithuania, the Bank carried out a number of campaigns targeted at both natural and legal persons, including promotion campaigns in regions where the Bank has customer service centres. In 2017 the Bank continued improving customer transaction security by implementing a stronger authentication mechanism for the Internet bank. The Bank offers its customers an advanced, secure and simple solution - SMS authentication. For safe and easy operation of customers, the Bank improved remote authentication methods by introducing the mobile code calculator. 3D Secure systems were introduced for secure payments using VISA and Mastercard cards in the Internet and the contactless technology for the Maestro payment card. The reworked design of the Bank's payment card was completed. In 2018, the Bank began distributing contactless credit cards, and offering its customers-legal entities mini-POS terminals. The Bank continued to develop payment cards acceptance, incl. e-commerce, and managed to preserve and develop e-commerce customer portfolio regardless of challenges affecting the Latvian banking sector regarding foreign customers.

As part of functionality improvements to the internet bank in 2017 the Bank expanded the list of partners whose services can be paid by authorising in MultiNet. This cooperation makes it more convenient for customers to pay their bills in a swift and secure manner.

During the year the Bank was active in social media seeking to improve its recognition and strengthen its brand. To commemorate the 100th anniversary of Latvia the Bank created a calendars featuring reproductions of paintings by Latvian artists which were presented to the Bank's customers and cooperation partners to promote national art.

During the reporting year the Bank recognised impairment loss on loan portfolio, and on the Group level negative effect from the revaluation of investment property at fair value was recognised. Due to recognized losses, in the year ended 31 December 2017, the Bank and the Group were not in compliance with the individual capital adequacy ratio set by the regulator. The situation at the end of the reporting year made the Bank's and the Group's capital adequacy ratio more sensitive to any potential additional decrease in equity. The management of the Bank and the Group consistently monitors capital adequacy and as part of the change to the business model carries out a range of measures to improve profitability and strengthen capital by changing tariffs, reducing administrative expenses, improve the quality and profitability of the loan portfolio, developing e-commerce and payment card business, attracting shareholder and subordinated capital as described under Notes 43 and 44. Seeing this task as a priority, during the reporting period the Bank actively worked with potential investors to create optimally possible future operational model for the Bank.

By performing the measures necessary for the transformation of the Bank, in December 2018 changes in the shareholding structure of the Bank were made: A new minority shareholder joined the Bank. By promoting the strengthening of corporate governance, on 10 December 2018, in an extraordinary shareholders' meeting the Council of the Bank in a new constitution was appointed, setting 27 December 2018 as the first day of the authority of the new council. Jurijs Adamovičs, Ivars Grunte and Goča Tutberidze were appointed as Council members. The new constitution of the Council will ensure the best combination of individual competencies and suitability. Mr Adamovičs is a competent and internationally renowned professional specialising in the field of restructurization, recovery of companies and change management, setting the preparation of the Bank for the attraction of a strategic investor as his key priority. The appointment of Mr Grunte, the lead partner at TGS Baltics and a Member of the Latvian Collegium of Sworn Advocates, to a member of the Council is a clear signal to the market players of the Bank's intent to strengthen its internal corporate governance process and ensure the operation of the principle and system for the prevention of independent conflicts of interests. The key role of Mr Tutberidze as the member of the Council is to ensure succession of changes to be implemented within the restructurization of the Bank, monitoring of the management of specific risks pertaining to the Bank's operation and demonstrate stability to the Bank's long-term partners and customer base.

The management believes that after the changes the Bank will be able to implement the said measures in the amount necessary and in the designated term and will be able to successfully offer competitive services for domestic and EU customers. The new business model is related to servicing the customers from Latvia and Lithuania and relies on an

MANAGEMENT REPORT

advanced customer base and sales channels for services. The management believes that the measures both taken to date and planned in the future will strengthen the Bank's and the Group's position; however, the overall result of the planned measures will be measurable in the future.

The management of the Bank would like to extend gratitude to employees and shareholders for their contribution to the development of the Bank. Thank you to our partners and customers for their trust. We highly appreciate our successful cooperation.

On behalf of the Management of the Bank:

Best regards,

Jekaterina Meinharde
Member of the Board

Ilze Pudiste
Member of the Board

21 December 2018

INFORMATION ON THE BANK'S MANAGEMENT

Council members as of the date of signing these financial statements

Name, surname	Position	Date of appointment
Goča Tutberidze	Chairman of the Council	07 May 2014
Natālija Prohorova	Member of the Council	07 May 2014
Valerijs Haliulins	Member of the Council	16 March 2018

In 2017 Mihails Gaņevs and Andris Dzenis resigned from the Council positions.

Board members as of the date of signing these financial statements

Name, surname	Position	Date of appointment
Jekaterina Meinharde	Member of the Board	05 December 2014
Ilze Pudiste	Member of the Board	16 April 2015
Dmitrijs Kozlovs	Member of the Board	22 May 2018

In 2017 Svetlana Dzene resigned from the Board, and in 2018 Ivars Lapiņš and Sergejs Golubčikovs resigned from the Board.

STATEMENT OF RESPONSIBILITY OF THE BANK'S MANAGEMENT

The management of AS Meridian Trade Bank is responsible for the preparation of the Bank's separate financial statements and the consolidated financial statements of the Bank and its subsidiary AS MTB Finance (hereinafter – the Group).

The financial statements presented on pages 9 to 79 are prepared based on source documents and present fairly the financial position of the Bank and the Group as at 31 December 2017 and the results of its operations, and cash flows for the year then ended.

The Consolidated and the Bank's separated financial statements are prepared in accordance with the International Financial Reporting Standards, as adopted by the European Union. 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 a proper accounting system, safeguarding the Bank's and the Group's assets, and the detection and prevention of fraud and other irregularities in the Group and Bank. Management is also responsible for operating the Group and Bank in compliance with the Law on Credit Institutions, regulations of the Finance and Capital Market Commission and other legislation of the Republic of Latvia applicable to credit institutions.

On behalf of the Council and the Board:

Ilze Pudiste
Member of the Board

Goča Tutberidze
Chairman of the Council

Jekaterina Meinharde
Member of the Board

21 December 2018

BANK SEPARATE AND GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION

ASSETS	**Note**	**2017 Group EUR'000**	**2017 Bank EUR'000**	**2016 Group EUR'000**	**2016 Bank EUR'000**
Cash and balances due from the Bank of Latvia	6	103,546	103,546	71,626	71,626
Demand deposits with credit institutions	7	21,429	21,429	33,140	33,140
Held-to-maturity investments:	8	6,356	6,356	16,962	16,962
Fixed income securities		*6,356*	*6,356*	*16,962*	*16,962*
Available for sale financial investments:	9	32,478	32,478	53,283	53,283
Fixed income securities		*32,195*	*32,195*	*53,063*	*53,063*
Non fixed income securities		283	283	220	220
Loans and receivables:		79,165	95,879	104,648	122,927
Loans and term deposits due from credit institutions	10	*1,884*	*1,884*	*9,395*	*9,395*
Loans and advances to customers	11	*77,281*	*93,995*	*95,253*	*113,532*
Held-for-trading financial assets:		3	3	2	2
Fixed income securities		*3*	*3*	*2*	*2*
Intangible assets		28	28	-	-
Property and equipment	12	982	974	1,111	1,109
Investment properties	13	15,196	-	15,910	-
Other assets	14	11,673	9,313	6,256	4,129
Total assets		**270,856**	**270,006**	**302,938**	**303,178**

The accompanying notes on pages 14 to 79 form an integral part of these Bank separate and Group consolidated financial statements.

The Council and the Board of the Bank approved the issue of these Bank separate and Group consolidated financial statements as presented on pages 9 to 79 on 21 December 2018.

Ilze Pudiste
Member of the Board

Goča Tutberidze
Chairman of the Council

Jekaterina Meinharde
Member of the Board

21 December 2018

BANK SEPARATE AND GROUP CONSOLIDATED STATEMENT OF FINANCIAL POSITION

LIABILITIES	**Note**	**2017 Group EUR'000**	**2017 Bank EUR'000**	**2016 Group EUR'000**	**2016 Bank EUR'000**
Demand deposits with credit institutions	15	-	-	5	5
Financial liabilities at amortized cost:		254,805	254,807	276,732	276,732
Deposits and balances due to financial institutions		-	-	-	-
Deposits	16	*249,422*	*249,424*	*270,118*	*270,118*
Subordinated liabilities	17	*5,383*	*5,383*	*6,614*	*6,614*
Other liabilities	18	4,746	4,500	10,277	9,587
Deferred tax liabilities	27	-	-	34	34
Provisions	19	171	168	154	152
Total liabilities		**259,722**	**259,475**	**287,202**	**286,510**
Capital and reserves					
Share capital	20	16,598	16,598	15,651	15,651
Share premium		260	260	260	260
Reserve capital	20	4,155	4,155	4,155	4,155
Fair value reserve		35	35	(93)	(93)
Accumulated losses		(9,914)	(10,517)	(4,237)	(3,305)
Total equity attributable to equity holders of the Group		**11,134**	**10,531**	**15,736**	**16,668**
Total share capital and reserves		**11,134**	**10,531**	**15,736**	**16,668**
Total liabilities		**270,856**	**270,006**	**302,938**	**303,178**
Contingent liabilities and commitments	32	**5,110**	**5,110**	**3,029**	**3,029**

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Ilze Pudiste
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Chairman of the Council

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Member of the Board

21 December 2018

BANK SEPARATE AND GROUP CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Note	2017 Group EUR'000	2017 Bank EUR'000	2016 Group EUR'000	2016 Bank EUR'000
Interest income	21	3,922	4,020	5,465	5,759
Interest expenses	22	(1,587)	(1,587)	(1,427)	(1,427)
Net interest income		**2,335**	**2,433**	**4,038**	**4,332**
Commission and fee income	23	6,653	6,651	5,296	5,288
Commission and fee expense	24	(2,066)	(2,066)	(1,750)	(1,750)
Net commission income		**4,587**	**4,585**	**3,546**	**3,538**
Gain on trading with financial instruments, net	25	2,653	2,645	2,226	2,248
Other operating income		1,210	38	362	36
Other operating expenses		(1,642)	(125)	(219)	(81)
Net operating income		**9,143**	**9,576**	**9,953**	**10,073**
Administrative expenses	26	(9,380)	(9,203)	(8,976)	(8,489)
Net impairment allowance expense	11,13	(5,440)	(7,585)	(5,795)	(5,795)
Loss before tax		**(5,677)**	**(7,212)**	**(4,818)**	**(4,211)**
Loss for the reporting period		**(5,677)**	**(7,212)**	**(4,818)**	**(4,211)**
Other comprehensive income/(loss)					
Items that were or could be reclassified to profit or loss					
Available-for-sale financial assets - changes in fair value		128	128	334	334
Other comprehensive income for the reporting year		**128**	**128**	**334**	**334**
Total comprehensive loss		**(5,549)**	**(7,084)**	**(4,484)**	**(3,877)**

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Goča Tutberidze
Chairman of the Council

Jekaterina Meinharde
Member of the Board

21 December 2018

BANK SEPARATE AND GROUP CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY AS AT 31 DECEMBER 2017

Attributable to Equity Holders of the Bank

Group **EUR'000**	**Share capital**	**Share premium**	**Reserve capital**	**Fair value reserve**	**Retained earnings/ (accumulated losses)**	**Total equity**
As at 31 December 2015 (restated*)	**15,651**	**260**	**4,155**	**(427)**	**581**	**20,220**
Total comprehensive loss						
Loss for the reporting year	-	-	-	-	(4,818)	**(4,818)**
Other comprehensive income						
Other comprehensive income	-	-	-	334	-	**334**
As at 31 December 2016	**15,651**	**260**	**4,155**	**(93)**	**(4,237)**	**15,736**
Increase in share capital	947	-	-	-	-	**947**
Total comprehensive income						
Loss for the reporting year	-	-	-	-	(5,677)	**(5,677)**
Other comprehensive income						
Other comprehensive Income	-	-	-	128	-	**128**
31 December 2017	**16,598**	**260**	**4,155**	**35**	**(9,914)**	**11,134**

Bank **EUR'000**	**Share capital**	**Share premium**	**Reserve capital**	**Fair value reserve**	**Retained earnings**	**Total equity**
As at 31 December 2015 (restated*)	**15,651**	**260**	**4,155**	**(427)**	**906**	**20,545**
Total comprehensive income						
Loss for the reporting year	-	-	-	-	(4,211)	**(4,211)**
Other comprehensive income						
Other comprehensive Income	-	-	-	334	-	**334**
As at 31 December 2016	**15,651**	**260**	**4,155**	**(93)**	**(3,305)**	**16,668**
Increase in share capital	947	-	-	-	-	**947**
Total comprehensive income						
Loss for the reporting year	-	-	-	-	(7,212)	**(7,212)**
Other comprehensive income						
Other comprehensive Income	-	-	-	128	-	**128**
31 December 2017	**16,598**	**260**	**4,155**	**35**	**(10,517)**	**10,531**

The accompanying notes on pages 14 to 79 form an integral part of these Bank separate and Group consolidated financial statements.

The Council and the Board of the Bank approved the issue of these Bank separate and Group consolidated financial statements as presented on pages 9 to 79 on 21 December 2018.

Ilze Pudiste
Member of the Board

Goča Tutberidze
Chairman of the Council

Jekaterina Meinharde
Member of the Board

21 December 2018

BANK SEPARATE AND GROUP CONSOLIDATED STATEMENT OF CASH FLOWS

		2017	2017	2016	2016
		Group	Bank	Group	Bank
Cash flows from operating activities	**Note**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**
Profit/(loss) before corporate income tax		(5,677)	(7,212)	(4,818)	(4,211)
Depreciation		310	307	260	247
Increase of impairment allowance		5,440	7,585	5,795	5,795
Changes in the fair value of investment property		705	-	280	-
Disposal of investment property		26	-	180	-
Other changes		128	128	334	334
Increase in cash and cash equivalents used in operating activities before changes in operating assets and liabilities		**932**	**808**	**2,031**	**2,165**
Due from credit institutions (term over 3 months)		97	97	(26)	(26)
Loans and advances to customers		12,532	11,952	(5,687)	(9,066)
Shares and other non-fixed income securities		(64)	(64)	(220)	(220)
Fixed income debt securities		31,475	31,475	15,050	15,050
Decrease /(increase) in other assets		(5,417)	(5,185)	1,279	265
Increase/(decrease) in deposit from banks – term deposits		-	-	(711)	(711)
Increase/(decrease) in deposits		(20,695)	(20,694)	(3,224)	(3,229)
(Decrease)/increase in other liabilities		(5,551)	(5,106)	(9,430)	(9,775)
Cash flows from operating activities		**13,309**	**13,283**	**(938)**	**(5,547)**
Cash flow from investing activities					
Purchased property and other property and equipment		(208)	(199)	(282)	(282)
Sale of investment property		-	-	-	-
Acquisition of investment property		(17)	-	(4,609)	-
Net cash flow from investing activities		**(225)**	**(199)**	**(4,891)**	**(282)**
Cash flows from financing activities					
Share issue		947	947	-	-
Decrease in subordinated liabilities		(1,231)	(1,231)	(25)	(25)
Cash flows from financing activities		**(284)**	**(284)**	**(25)**	**(25)**
Net increase in cash and cash equivalents		**12,800**	**12,800**	**(5,854)**	**(5,854)**
Cash and cash equivalents at the beginning of the year		**113,350**	**113,350**	**119,204**	**119,204**
Cash and cash equivalents at the end of the year	28	**126,150**	**126,150**	**113,350**	**113,350**

The accompanying notes on pages 14 to 79 form an integral part of these Bank separate and Group consolidated financial statements.

The Council and the Board of the Bank approved the issue of these Bank separate and Group consolidated financial statements as presented on pages 9 to 79 on 21 December 2018.

Ilze Pudište
Member of the Board

Goča Tutberidze
Chairman of the Council

Jekaterina Meinharde
Member of the Board

21 December 2018

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

1 GENERAL INFORMATION

Information on the Bank

AS Meridian Trade Bank (until 6 May 2014 AS SMP Bank) was incorporated in the Republic of Latvia as a joint stock company "Multibanka" in 1994, in Riga and is licensed as a bank offering a wide range of financial services to enterprises and individuals. The legal address of the Bank is Elizabetes iela 57, Riga, Latvia. The Bank has a branch in Liepaja, 14 cash offices in Riga, and a cash office in each Ventspils, Daugavpils, Olaine, Jelgava, Saulkrasti, Jūrmala and Krāslava. The Bank has a foreign branch in Vilnius (Lithuania) with local cash offices in Klaipeda and Kaunas and a representative office in Moscow, Russian Federation.

These financial statements include the Group consolidated and Bank separate financial statements. The consolidated financial statements for year ended 31 December 2017 include the financial statements of the Bank and its subsidiary AS MTB Finance (hereinafter - the Group). The legal address of the AS MTB Finance is Elizabetes iela 57, Riga, Latvia. AS MTB Finance manages real estate properties and provide lease services.

Legislation regulating the Bank's operations

The Bank's operations are governed by the law 'On Credit Institutions', 'Commercial Law' and regulations issued by the Financial and Capital Market Commission (the FCMC). The above regulations govern capital adequacy, minimum equity, liquidity, foreign exchange positions, risk transaction restrictions with respect to one counterparty, group of related customers and related parties of the Bank, as well as other applicable requirements.

2 BASIS OF PREPARATION

Statement of Compliance

These financial statements were prepared in accordance with the International Financial Reporting Standards as adopted by the EU (IFRS) on a going concern basis. The financial statements were prepared on a historical cost basis, except for available for sale financial assets, financial assets and liabilities measured at fair value through profit or loss, trading securities and derivatives that were disclosed at fair value.

After considering key risks the management believes that the going concern basis is appropriate for the preparation of these financial statements, however material uncertainty exists with regard to the going concern basis which is described in Note 43. The financial and capital position of the Group and its business activities, the objectives and policies of risk management and the key risks to which the Group is exposed are described in section 'Risk Management'. Liquidity risk management is particularly important with regard to the going concern basis as the inability to attract sufficient funds to honour payment liabilities may cause the Bank to borrow funds at excessive cost, breach regulatory requirements, delay regular settlements or make the Group no longer compliant with the going concern basis. For more information please refer to section 'Liquidity risk management'. Of equal importance to the Group's compliance with the going concern basis is compliance with regulatory requirements, in particular those relating to capital adequacy.

Business activities are planned and carried out by the Group in view of the available capital and in line with regulatory requirements. The capital adequacy calculation and wider disclosures on current and expected capital adequacy requirements are provided in section 'Capital management'. In addition to other risk policies and procedures the Group has a comprehensive liquidity risk management and capital planning framework in place.

In light of the developments in the Latvian banking sector that took place after the reporting date as described in Note 44 ('Subsequent events') the management of the Bank and the Group consistently monitors and evaluates the market situation and its potential impact on the Bank and the Group, if any. Based on the information available to date the management is certain that the measures implemented by the Bank are sufficient and appropriate and there is no material impact on the Bank's and the Group's operations at the reporting date nor is any expected in the future.

The preparation of financial statements under IFRS approved in the EU requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities and the reported income and expenses for the reporting period. Although such estimates are based on reasonable information available to management regarding these events and activities, actual results may differ from these estimates.

Basis of measurement

The financial statements are prepared on the historical cost basis except for the following:

- financial assets and liabilities at fair value through profit or loss are stated at fair value (including financial assets held for trading);
- available-for-sale financial assets are carried at fair value;
- investment property which is carried at fair value.

Functional and Presentation Currency

All amounts in these financial statements are presented in thousands of euro (EUR'000), unless stated otherwise. Euro is the functional currency of the Bank and the Group.

3 SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been applied in the preparation of the consolidated financial statements. The accounting policies have been consistently applied except for the changes in accounting policies described at the end of Note 3.

Basis for consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from is involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

The investment in AS MTB Finance, in which the Bank holds a 100% interest and voting rights, is accounted for in the Bank's separate financial statements at cost less impairment.

Investments in equity accounted investees

The Group's investments in equity accounted investees include investments in associated companies and joint ventures.

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Investments in associates and joint ventures are accounted for using the equity method. They are initially recognised at cost, including transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and OCI in equity-accounted investees, until the date on which significant influence or joint control ceases.

Transactions eliminated on consolidation

Intra-group transactions, balances and unrealized profits arising from intra-group transactions are eliminated in the course of consolidation. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in a former subsidiary is measured by the Group at fair value when control is lost.

Currency translation

Foreign exchange transactions are translated into the respective functional currency at the reference exchange rate published by the European Central Bank on the date of the respective transaction.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at cost or fair value are translated into the functional currency at the spot exchange rate at the date of acquisition or the date that the fair value was determined, respectively. Foreign currency differences arising on retranslation are recognized in the profit and loss statement except for the differences arising on the retranslation of available-for-sale equity instruments or a financial liability designated as a hedging instrument in a hedge of the net investment in a foreign operation or in a qualifying cash flow hedge, which are recognized in other comprehensive income. Monetary assets and liabilities denominated in foreign currencies and carried at historical cost are retranslated into the functional currency at the spot exchange rate at the transaction date.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into EUR at exchange rates set by the European Central Bank at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the average exchange rates on transaction dates.

Foreign currency differences are recognized in other comprehensive income and accumulated in the translation reserves, except to the extent that the translation difference is allocated to non-controlling interest.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income and accumulated in the translation reserve.

The exchange rates for the most significant currencies as set by the European Central Bank at reporting date are as follows:

Currency	*Reporting date*	
	31.12.2017	**31.12.2016**
USD	1.1993	1.0541
RUB	69.3920	64.3000

Financial instruments

Classification

Financial instruments are classified into the following categories:

Financial assets and liabilities at fair value through profit or loss are financial assets or liabilities that are acquired or incurred principally for the purpose of selling or repurchasing in the near term; or that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or that are a derivative (except for a derivative that is a designated and effective hedging instrument); or that are upon initial recognition designated by the entity as assets or liabilities at fair value through profit or loss.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group or the Bank have the positive intention and ability to hold to maturity, and which are not designated at fair value through profit or loss, or available for sale, or loans and receivables.

Available-for-sale instruments are those financial assets that are designated as available-for-sale and are not classified as loans and receivables, held-to-maturity instruments or financial instruments at fair value through profit or loss.

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

Liabilities carried at amortised cost include deposits and balances from banks and current accounts and deposits from customers, subordinated liabilities and other financial liabilities.

Financial liabilities carried at amortized cost are initially measured at fair value less directly attributable transaction costs and are subsequently remeasured to amortized cost using the effective interest rate.

Subordinated deposits have a fixed term of at least five years from the date of placement and they are repayable before maturity only in the event of termination of the Bank's operations or the Bank's bankruptcy and such deposits rank before shareholders' claims. Subordinated debt securities are repayable before maturity only in the event of termination of the Bank's operations or the Bank's bankruptcy and such deposits rank before shareholders' claims.

Recognition

The Group and the Bank initially recognises loans and receivables, deposits and debt securities issued on the date at which they are originated. All other financial assets and liabilities are recognised in the statement of financial position on the trade date when the Group or the Bank becomes a party to the contractual provisions of the instrument.

Measurement

A financial asset or liability is initially measured at fair value plus, in the case of a financial asset or liability other than designed at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- held-to-maturity investments and loans and receivables that are measured at amortized cost using the effective interest method; and
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost.
- a gain or loss on an available-for-sale financial asset is recognized in other comprehensive income (except for impairment losses and foreign exchange gains and losses on debt financial instruments) until the asset is derecognized, at which time the cumulative gain or loss previously recognised in equity is recognized in the income statement. Interest on an available-for-sale financial asset is recognized in the income statement using the effective interest rate method. All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortised cost. Amortised cost is calculated using the effective interest method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability. When calculating the effective interest rate, the Group and Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

Gains and losses on subsequent measurement

A gain or loss arising from a change in the fair value of a financial asset or liability is recognised as follows:

- a gain or loss on a financial instrument classified as designed at fair value through profit or loss is recognised in the statement of profit or loss;
- for financial assets and liabilities carried at amortised cost, a gain or loss is recognised in the statement of profit or loss when the financial asset or liability is derecognised or impaired.

Derecognition

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

The Group and Bank also derecognize certain assets when they write off balances pertaining to the assets deemed to be uncollectible.

Repurchase and reverse repurchase agreements

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

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

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

Derivatives

Derivative financial instruments including foreign exchange contracts, currency and interest rate swaps and other derivative financial instruments are initially recognized in the statement of financial position at their fair value. Attributable transaction costs are recognised in the profit and loss statement of the relevant period. Fair values are obtained from quoted market prices or discounted cash flow models, as appropriate. OTC derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The Group and the Bank do not use hedge accounting.

Offsetting

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

Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment. Cost includes expenses that are directly attributable to the acquisition of the asset.

Depreciation is charged to the profit and loss statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date when the asset becomes available for use or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Depreciation methods, useful lives and residual values are assessed annually. The annual depreciation rates are as follows:

Buildings	5%
Furniture and cars	20%
Computers	35%
Other fixed assets	20%

Intangible assets

Intangible assets acquired by the Group or the Bank are stated at cost less accumulated amortisation and impairment losses.

Software licences are capitalised on the basis of the costs incurred to acquire and customise the specific software. Depreciation is charged to the profit and loss statement on a straight-line basis over the estimated useful lives of the individual assets. The estimated useful lives are 5 to 7 years.

Repossessed assets

As part of the normal course of business the Group and Bank occasionally take possession of property that originally was pledged as security for a loan. When the Group and Bank acquire (i.e. gains a full title to) a property in this way, the property's classification follows the nature of its intended use by the Group and Bank. When the Group and Bank is uncertain of its intentions with respect to property that it has repossessed, those properties are classified as investment property. Other types of collateral (repossessed finance lease objects) are classified as other assets and carried at cost net of impairment loss.

Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business or for administrative purposes. Starting from 2016, all investment properties are carried at fair value through profit and loss. The fair value of investment property is based on a valuation by an independent appraiser who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued. The fair value of the Group's investment property is measured by independent appraisers on a regular basis.

Recognition of income and expenses

All significant categories of income and expenses are recognised on an accrual basis.

Interest income is recognized as it accrues in the profit and loss statement using the effective interest method. 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.

Loan origination fees and other fees including the related direct costs that are considered an integral part of the total loan profitability are deferred and amortised to the interest income over the estimated life of the financial instrument using the effective interest rate method.

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

Fair value measurement principles

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 in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The fair value of liabilities represents the risk of default.

A number of the Group's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities carried at fair value or disclosures on their fair value should be made in the financial statements.

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

The Group and the Bank have an established control framework with respect to the measurement of fair values. This includes a valuation team that has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values, and reports directly to the CFO.

Specific controls include:

- Verification of observable pricing;
- Re-performance of model valuations;
- A review and approval process for new models against observed market transactions;
- Analysis and investigation of significant daily valuation movements;
- Review of significant unobservable inputs, valuation adjustments and significant changes to the fair value measurement of Level 3 instruments compared to previous month.

The methods described below have been used for the determination of fair values.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions with the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognized in the profit and loss statement depending on the individual facts and circumstances of the transaction but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

When available, the Bank and the Group measure the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the fair value is established by the Group and the Bank using a valuation technique. Valuation techniques include recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique should make maximum use of market inputs, rely as little as possible on estimates specific to the Group and the Bank, incorporate all factors that market participants would consider in setting a price, and be consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank and the Group calibrate valuation techniques and test them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

Where third-party information, such as broker quotes or pricing services, are used to measure fair value, the Group and the Bank assesses and documents the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS. This includes:

- Verifying that equity broker or pricing service is approved by the Group and the Bank for use in pricing the relevant type of financial instrument;
- Understanding how the fair value has been arrived at and the extent to which it represents actual market transactions;
- When prices for similar instruments are used to measure fair value, how these prices have been adjusted to reflect the characteristics of the instrument subject to measurement;

In determining the fair value of assets or liabilities the Group and the Bank use observable market data to the extent possible. Fair value is classified into different levels of the fair value hierarchy based on the inputs used in the measurement techniques:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability might be categorized in different levels of the fair value hierarchy, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Group and the Bank recognize transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred. For further analysis of the basis for fair value refer to Note 40.

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

Impairment losses

Financial assets

At each reporting date the Group assesses whether there is objective evidence that the financial assets other than carried at fair value through profit or loss are impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

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

The Group and Bank consider evidence of impairment for loans and advances and held-to-maturity investment securities at specific asset level. All loans and receivables from customers and held-to-maturity investment securities are assessed for specific impairment.

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

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

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

Non financial assets

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

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. The main assets and cash generating units considered by the Group comprise investment properties. Certain properties are valued on an individual basis and some others in aggregate as cash generating units – development projects. Impairment losses are recognized as profit or loss in the profit and loss statement. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

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

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

Loan commitments

In the normal course of business, the Group and the Bank enter into credit related commitments comprising irrevocable credit line facilities, letters of credit and guarantees, and provides other forms of credit insurance.

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

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

Financial guarantee liabilities and provisions for other credit related commitments are included within other liabilities.

Taxation

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years. Current corporate income tax assets and liabilities are measured at the amount expected to be obtained from or paid to tax authorities. Several Group companies pay income tax upon profit distribution (e.g. dividends). Beginning with 2018, the Bank and the Latvian Group subsidiaries are required to pay income tax on distributed profits. Correspondingly, with regards to Group companies registered in these jurisdictions, income tax on profit distribution is recognised as expense at the moment dividends are declared. Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exception, deferred tax is not initially recognised for assets or liabilities in a transaction that is not a business combination, if the transaction during its initial recognition affects neither accounting nor taxable profit. Deferred tax liabilities are not recognized for the temporary differences arising on the initial recognition of goodwill and for the part of goodwill that is not deductible for tax purposes. Deferred income tax is determined based on tax rates set as at the balance sheet date and expected to be effective when the temporary differences reverse or tax loss carried forward are utilised. Deferred tax is calculated using the rate applicable to retained earnings until the decision is made on profit distribution. As a result, in jurisdictions where income tax is payable on distributed profit (such as dividends) deferred tax asset or liabilities are recognised using the tax rate applicable to retained earnings. Deferred tax assets and liabilities are netted only within the individual companies of the Group and only if certain criteria are met. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. The carrying amount of deferred tax asset, if any, is reviewed at each reporting date and reduced to the extent it matches taxable income that could be generated in the future and used against. The future taxable profits and the amount of tax benefits that are probable in the future are based on a medium term financial forecast prepared by management and extrapolated results thereafter. The financial forecast is based on management expectations that are believed to be reasonable under the circumstances.

Cash and Cash Equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with the Bank of Latvia and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Group and the Bank in the management of its short-term commitments, excluding amounts due to the Bank of Latvia and credit institutions with maturities of less than 3 months.

Leases

Classification

Only risks and rewards incidental to ownership of the leased asset during the lease period should be considered in determining the classification of lease. Relevant risks include the possibility of losses from idle capacity or technological obsolescence and from decreases in the value of the asset; relevant rewards may include the gain from the increase in value of the asset or realization of the residual value at the end of the lease. Conversely, risks associated with construction of the asset prior to lease commencement, financing such construction and the costs of providing services using the leased asset, are not incidental to ownership of the leased asset during the lease period and in the Management's view generally should be disregarded in determining the classification of the lease. The classification of a lease is determined at the inception of the lease and is not revised unless the lease agreement is modified.

Finance lease

A finance lease is lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

When assets are leased out under finance lease terms, the net investment in finance lease is recognized as a receivable. The net investment in finance lease represents the difference between the gross receivable and the unearned finance income.

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

Operating lease

An operating lease is a lease other than a finance lease.

Assets leased out under an operating lease are presented within property and equipment in the statement of financial position net of accumulated depreciation. They are depreciated over their expected useful lives on a basis consistent with similar owned Property and equipment.

Provisions

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

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

Dividends

The Group and the Bank receive dividends from the equity instruments that are recorded to income when the right to receive payment is established.

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

Employee benefits

Short term employee benefits, including salaries and social security contributions, bonuses and vacation benefits are included in net operation expenses on an accrual bases. The Group and the Bank pay fixed security contributions to the State Social Fund on behalf of its employees during the employment period in accordance with local legal requirements and the Group and Bank will have no obligations to pay further contributions relating to employee services in respect to pension of retired employees.

Adoption of new and/or amended IFRSs and IFRIC interpretations

a) Adoption of new or revised standards and interpretations

Certain new IFRSs became effective for the Group on 1 January 2017. Listed below are those new or amended standards or interpretations which the Group has adopted in preparation of these financial statements. The following guidance effective from 1 January 2017 did not have any impact on these financial statements:

- *Amendments to IAS 7*

- *Annual improvements to IFRS.*

Certain new standards, amendments to standards and interpretations have been published that become endorsed for the annual accounting periods beginning after 1 January 2017 or are not yet effective in the EU and have not been applied in preparing these Group consolidated financial statements. The Group does not plan to adopt these standards early. The following are the standards and interpretations which may be relevant to the Group:

IFRS 9 – Financial Instruments (replaces IAS 39). The standard will be effective for annual periods beginning on or after 1 January 2018, and will be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early adoption is permitted.

At the date of these financial statements the Bank and the Group are in the process of drafting the processes, systems and models required for the implementation of IFRS 9 and is gathering the required competencies. The implementation policy of IFRS 9 has been approved. Now certain improvements are being developed. The development efforts are expected to continue for some time in the foreseeable future. The Bank and the Group have commenced the project. A working group has been set up which is dealing with the accounting and presentation aspects of the new standard as well as related matters like IT requirements, required procedures and instructions as well as development of appropriate expected credit loss models. The working group has representatives of risk management and accounting units and the member of the Board who is responsible for the implementation project. The implementation project of IFRS 9 is carried out on a Group wide basis. External competence is attracted where and when deemed necessary. As part of the project, the Group has developed and revised a number of models and IT systems, and the related processes and documents are being improved and this process may result in the need to review certain aspects of the models that have already been implemented. To the extent possible, the Group leveraged on existing definitions, processes, systems, models and data used for regulatory and risk management purposes in order to implement IFRS 9 impairment requirements, although in certain areas new models and revisions to the existing models were required. The Group has invested resources to obtain the relevant skills and historical data for the purposes of the forward-looking impairment model.

For key assets, the Bank and the Group assessed whether the financial asset brought solely payments of principal and interest (SPPI) on the time value of money and credit risk. Based on the assessment of business models, changes in the classification and measurement requirements that will be introduced by the new standard are not expected to have a material impact on the loans and exposures to securities of the Bank and the Group. The Bank continues to make an SPPI assessment and additional analysis for certain financial assets.

A financial asset is measured at amortized cost if the following conditions are met: a) the assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, b) its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. In addition, for a non-trading equity instrument, the Bank and the Group may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances.

The Bank and the Group does not plan to make significant changes to the classification of financial instruments. Based on an initial assessment, the Bank and the Group believes that the majority of loans and advances, loans and advances to customers, cash collateral for reverse repo agreements and balances with financial institutions that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9.

It is expected, however, that held to maturity debt securities under IFRS 9 will be carried at amortised cost. Under IFRS 9, available-for-sale debt securities will be reclassified into FVOCI category. For debt instruments measured at FVOCI, interest revenue, expected credit losses and foreign exchange gains and losses are recognised in profit or loss in the same manner as for amortised cost assets. Other gains and losses are recognised in OCI and are reclassified to profit or loss on derecognition. Financial assets and liabilities classified as held for trading will be retained by the Bank and the Group in the FVTPL category.

The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that impairment allowances will need to be recognised before a loss event.

Loans are classified by the Bank and the Group into three groups based on the following impairment methodology.

Stage 1 – Performing loans: when loans are first recognized, the Bank and the Group recognize an allowance based on twelve months expected credit losses.

Stage 2 – Loans with a significant increase in credit risk: when a loan shows a significant increase in credit risk since initial recognition, the Bank and the Group records an allowance for the lifetime expected credit loss. The Bank and the Group expect to use the following criteria to determine a significant increase in credit risk: contractual payments are overdue by more than 30 days, the loan is included in the watch list, the value of the collateral is lower than the carrying amount of the loan, a negative outlook for the industry.

Stage 3 – impaired loans with objective evidence of impairment. The Bank and the Group recognize lifetime expected credit losses for these loans and in addition, accrue interest income on the amortised cost of the loan net of allowances. The criteria of objective evidence does not differ from those in IAS 39. Consequently, the amount of allowances is not expected to change significantly. The individual impairment allowance will continue to be calculated on the same basis as under IAS 39, and collateral values will be adjusted to reflect the amounts that can be expected to be realized. The definition of 'default' as used by the Bank and the Group to classify financial assets into Stage 3 does not differ from the one provided in Article 178 of Regulation 575, i.e. exposure delayed 90 and more days (less days for some products), significant restructuring, insolvency or bankruptcy or similar legal proceedings started and other indicators of unlikeliness to pay. To enable calibration and adjustment of the ECL model the Bank has made a parallel run since the middle of 2017.

The Bank and the Group will record impairment for FVOCI debt securities depending on whether they are classified as Stage 1, 2, or 3, as explained above. However, in this case the expected loss will not reduce the carrying amount of these financial assets in the financial statements where it remains at fair value. Instead, other comprehensive income recognise the amount equalling impairment loss as accrued impairment which would be recognised had the asset been measured at amortised cost and the respective amounts are presented in profit / loss statement.

The Bank and the Group will use the 'low risk' concept in relation to FVOCI debt securities with no substantial increase in credit risk since initial recognition. Such instruments will generally include trade, investment grade securities where the borrower has strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Losses on 'low risk' assets will be calculated as for Stage 1 assets.

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When estimating lifetime ECLs for undrawn loan commitments, the Bank will:

a) estimate the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment, and b) calculate the present value of cash shortfalls between the contractual cash flows that are due to the Bank and the cash flows that the Bank expects to receive for that expected portion of the loan drawn down.

For financial guarantee contracts, the Bank will calculate the lifetime ECLs based on the present value of the expected payments to reimburse the holder for a credit loss that is incurs less any amounts that the guarantor expects to receive from the holder, the debtor or any other party.

For revolving facilities such as credit cards and overdrafts, the Bank will measure ECLs by determining the period over which it expects to be exposed to credit risk, taking into account the credit risk management actions that it expects to take once the credit risk has increase and that serve to mitigate losses.

Following a decrease in credit risk, a financial asset may be classified from Stage 3 into Stage 2 or from Stage 2 into Stage 1. The Bank will use a sufficiently long probation period to establish that a financial asset can be moved from Stage 3 to Stage 2 and from Stage 2 to Stage 1.

Expected credit loss will be determined by the Bank and the Group using the so-called EAD x PD x LGD method, where EAD is exposure at default, PD is probability of default and LGD is loss given default. To estimate probability weighted cash flows the Bank and the Group plan to use single scenario expected cash flow method with overlays for alternative scenarios.

As part of the portfolio based EAD x PD x LGD method each component is determined separately and then all components are aggregated on the portfolio level. PD evaluation is made by the Bank using migration matrices based on historical performance of portfolios of financial assets adjusted for forward-looking information. EAD evaluation is made by the Bank using payment schedules adjusted, where necessary, for advance payments and taking into account off-balance-sheet transactions.

Model validation is planned to include reviews of input data, underlying assumptions used for Expected Credit Loss estimation, and review of model outputs by comparing them to back-testing results. Back-testing is planned to be performed by comparing the actual historical performance of portfolio to the Expected Credit Loss estimation results as per developed models.

The Bank and the Group are in the final stage of the IFRS 9 implementation impact assessment. The estimated impact of the reversal of existing allowances and recognition of a new impairment allowance for loans and receivables according to IFRS 9 is a net increase in allowances by EUR 1.8 million for the Group and the Bank. The increase is primarily connected with loans. It decreases capital and reserves. In order to reduce the negative impact of implementation of IFRS 9 on the capital ratios of the Bank and the Group, for the purpose of capital adequacy calculation the Group and the Bank use the 5 year transition period provided under Regulation (EU) 2017/2395 (of 12 December 2017) concerning the impact of IFRS 9 on equity (CET1). During 2018, it is permitted to charge 95% of the allowance for expected loss back to equity. In planning their future operations, the Group and the Bank take account of the implementation impact of IFRS 9 and foresee measures to be taken to reduce the negative impact as described in Note 43.

- *IFRS 16 Leases (replaces IAS 17, IFRIC 4, SIC-15, SIC-27).* Effective for reporting periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15. The new standard establishes principles for the recognition, measurement, presentation and disclosure of leases in a way that is different to the currently applied accounting treatment. For qualifying lease assets, upon lease commencement, a lessee has to recognise a right-of-use asset and a lease liability. The right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs. Subsequently the right-of-use asset is measured using a cost model, unless specific other conditions persists. A right-of-use asset is measured at cost less any accumulated depreciation and impairment. The lease liability is initially measured as a discounted value of payments agreed over the lease term. A discount rate which discounts future payments to estimated present value is applied. For lessors classification of lease as an operating lease or a finance lease remains; therefore, the Group as a lessor estimates no significant direct effect form the new standard if it was implemented at the end of this reporting period. For the Group as a lessee the major class of current operating lease contracts which qualify for right-of-use asset are rent agreements for the branch network and certain other premises used for Group operating needs and rent agreements for POS terminals. The majority of these agreements can be terminated early. Many of these agreements can be extended after expiry. The Group owns the building where the headquarters is located and it is leased by the Bank (other other tenants) from one of the Group subsidiaries. As both of these parties are under joint control the duration of lease can be extended or shortened as the management sees it fit.

Consequently, it is estimated for IFRS 16 purposes that the Bank has committed to lease the building for another three years which is consistent with the planning period for internal property and equipment. The amount of the right-of-use asset and the respective lease liability to be recognised had the new standard been adopted before the end of the reporting period would be approximately EUR 14 million for the Bank and EUR 8 million for the Group. Most of the contracts may be terminated early but this is not considered in the estimate as currently there is no such intention.

- *IFRS 15 – Revenue from Contracts with Customers* (Effective for annual periods beginning on or after 1 January 2018). Early application is permitted. The new Standard provides a framework that replaces the existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control over goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised: 1) over time, in a manner that depicts the entity's performance; or 2) at a point in time, when control of the goods or services is transferred to the customer. IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The majority of revenue that the Group generates is sourced from financial instruments or is related to services under which revenue is recognised as the service is provided to the customer. Consequently, this type of revenue does not require making complex judgements in relation to recognition and the new standard is not expected to have a material impact on such flows of revenue. However, the Group and the Bank are still to make a detailed review of their revenue recognition policies in relation to the new standard. The following are the standards and interpretations which are not expected to have a material impact on the Group:

- *Amendments to IFRS 2 - Classification and Measurement of Share-based Payment Transactions.* Effective for annual periods beginning on or after 01 January 2018; to be applied retrospectively. Early adoption is permitted. The amendments clarify share-based payment accounting on the following areas: 1) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; 2) share-based payment transactions with a net settlement feature for withholding tax obligations; and 3) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.

- *Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 'Insurance Contracts'.* Effective for annual periods beginning on or after 1 January 2021; to be applied retrospectively. The amendments address concerns arising from implementing IFRS 9 before implementing the replacement standard that the IASB is developing for IFRS 4. The amendments introduce two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when applying IFRS 9 before the forthcoming insurance contracts standard.

- *Amendments to IFRS 10 and IAS 28 - Sale or contribution of assets between an investor and its associate or joint venture.* The effective date has not yet been determined by the IASB, however earlier adoption is permitted. The Amendments clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business, such that a full gain or loss is recognised when a transaction between an investor and its associate or joint venture involves the transfer of an asset or assets which constitute a business (whether it is housed in a subsidiary or not), while a partial gain or loss is recognised when a transaction between an investor and its associate or joint venture involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

- *Amendments to IAS 12 - Recognition of Deferred Tax Assets for Unrealised Losses.* Effective for annual periods beginning on or after 01 January 2018; to be applied retrospectively. The amendments clarify how and when to account for deferred tax assets in certain situations and clarify how future taxable income should be determined for the purposes of assessing the recognition of deferred tax assets.

- *Amendments to IAS 40 – Transfers of Investment Property.* The amendments reinforce the principle for transfers into, or out of, investment property in IAS 40 Investment Property to specify that such a transfer should only be made when there has been a change in the use of the property. Based on the amendments a transfer is made when and only when there is an actual change in use – i.e. an asset meets or ceases to meet the definition of investment property and there is evidence of the change in the use. A change in management intention alone does not support a transfer.

- *IFRIC 22 – Foreign Currency Transactions and Advance Consideration.* Effective for reporting periods beginning on or after 01 January 2018. The Interpretation clarifies how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. In such circumstances, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

- *Annual improvements to IFRS.* The Group is in the process of evaluating the potential effect if any of other changes from these new standards and interpretations.

4 RISK MANAGEMENT

The Board of the Bank and the Group has developed a system for the identification, supervision and management of the key financial risks. The Bank's Council has approved this risk management system. This system is being constantly updated to take into account market conditions and the development of the Bank's and the Group's main operations. The following policies have been approved in order to achieve the Bank's and the Group's objectives related to capital adequacy, credit risk, operational risk management and anti-money laundering and terrorism financing:

1. Liquidity risk management policy;
2. Credit policy;
3. Credit risk management policy and strategy;
4. Risk transactions and risk control policy for large transactions;
5. Currency risk management policy;
6. Country risk management policy;
7. Interest rate risk management policy;
8. Policy on the prevention of laundering of proceeds derived from criminal activity and terrorism financing;
9. Compliance risk management policy;
10. Capital and liquidity adequacy assessment policy;
11. Operational risk management policy.

The Board of the Bank is responsible for the implementation of the risk management policy approved by the Council of the Bank.

Comprehensive management of the risk control functions at the Bank is ensured by Chief Risk Officer (CRO). The CRO ensures that the following functions are performed:

- Set-up, supervision and timely improvement of the Bank's risk management system;
- Providing, on a regular basis, to the Bank's Council, Board and heads of relevant units comprehensive and clear information on the Bank's overall risk profile, all key risks to the Bank and compliance with the risk strategy;
- Advising and supporting the Bank's Council and Board in the development of strategies (including for risk) and in making other decisions related to the Bank's risks.

To promote independence, the CRO's duties exclude such functions that are connected with the performance of the activities to be controlled.

Liquidity risk

Liquidity risk is defined as the risk that the Bank and the Group may be unable to sustain its current and future cash flows and secure borrowings to prevent threats to the Bank's daily operations or overall financial position of the Bank (liquidity risk of financing) and risk that the Bank and the Group may be unable to sell its financial assets in the desired term without material losses due to a market collapse or insufficient market depth (market liquidity risk).

The Group and Bank have maintained adequate amounts of liquid assets to ensure compliance with liquidity ratio required by the normative acts of the Republic of Latvia of 30% against the Bank and the Group's current liabilities as at 31 December 2017 and 31 December 2016. According to the requirement set by the Financial and Capital Market Commission, during 2017 the Bank was required to maintain an individual liquidity ratio of 50%. The Bank is in compliance with this restriction. The Bank's liquidity ratio as at 31 December 2017 is 80.41% and that as at 31 December 2016 was 77.08%.

The Group and Bank have approved internal limits for liquidity net position of the term structures of assets and liabilities in all currencies, EUR and USD. Internal limits for liquidity are used for risk analysis and control of liquidity and desirable structure of financing sources. An early warning system was developed in order to help identify exposure of the Bank's and the Group's liquidity position and necessity to attract additional sources. On the basis of data from early notification indices the Bank and the Group identify adverse trends impacting liquidity and analyse these trends and assess whether any hedging measures are required for liquidity risk. The Bank's Treasure Division organises and manages the daily process of resource management in order to ensure solvency, liquidity and profitability of the Bank. The Risk Management Department of the Bank evaluates and plans the term structure of assets and liabilities on a regular basis and carries out control over liquidity risk management, incl. monitors compliance with the required liquidity norms and internal limits defined by the Bank and the Group. Liquidity stress testing is performed using 6 scenarios. Scenarios include both internal and external factors. Stress testing is performed to the following stress levels: internal and typical to the Bank unfavourable events, changes of general market conditions, banking crisis and general market crisis at the same time. The impact of various shock scenarios on the regulating liquidity ratio and the Bank's income is analysed. The Board of the Bank and the Group develops and the Council approves a Business Continuity Plan for liquidity crises that specifies: preventive measures for the reduction of the likelihood of liquidity crisis, methods of timely identification of liquidity crisis and risk assessment, measures that have to be taken immediately in order to overcome liquidity crisis. The plan is tested on a regular basis. For maturity analysis of assets and liabilities refer to Note 37.

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Credit risk

Credit risk is the risk that:

- a counterparty, or obligor, fails to meet contractual obligations to the Group and Bank;
- the value of collateral will not cover the claim; and
- financial loss of the Bank and the Group occurring as a result of default by a borrower or counterparty on their obligation to the Bank and the Group.

To minimize credit risk, the Bank and the Group have developed policies for the management of credit exposures (both for the statement of financial position and estimated and possible liability exposures), including guidelines to limit portfolio concentration. The Credit Committee and the Asset Measurement Committee have been established and are rigorously monitoring the Bank and the Group's credit risk. The Bank and the Group'sCredit Policy and Credit Risk Management Policy and Strategy is reviewed and approved by the Board and Council.

The Bank and the Group's Credit Policy establishes:

- Fundamental principles for performing lending operations;
- Credit risk diversification instruments;
- Fundamental principles for the credit assessment of borrowers;
- Principles for the credit assessment of counterparties, issuers and insurance companies;
- Principles for the evaluation of collateral;
- Documentation rules for the lending process;

The Bank and the Group's Credit Risk Management Policy and Strategy establishes:

- Fundamental principles of credit risk management;
- Objectives of credit risk management;
- Primary methods for identification, assessment and monitoring (continuous supervision) of credit risk;
- Primary methods for credit risk control and mitigation.

Measurement of credit risks includes:

- risk assessment to make a decision on granting a loan;
- monitoring and management of credit risk;
- profit adjustment representing risk;
- risk analysis of credit portfolios;
- capital adequacy and capital distribution assessment;
- regular stress testing credit risk by the use of different scenarios.

Credit risk control at the Bank and the Group is carried out by a dedicated unit – Credit Risk Management Department. The Bank and the Group continuously monitor the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on the customer's most recent financial statements and other information submitted by the borrower, or otherwise obtained by the Bank. The current market value of collateral is regularly determined by either independent appraisal companies or the Bank's specialists, and in the event of negative movements in market prices the borrower is usually requested to put up additional security.

The Bank and the Group'smaximum exposure to financial position credit risk is generally reflected in the carrying amounts of financial assets on the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The Bank and the Group determine concentration limits and monitor credit risk concentration by industry/sector, geographic location, type of loan, country of residence, loan currency and type of collateral. Overall, concentration of the loan portfolio is verified across seven positions. For the analysis of concentration of credit risk in respect of loans and advances to customers refer to Note 11 "Loans" and Note 39 "Maximum credit risk". In order to meet the requirements defined in the policy of risk transactions and large risk transactions, the Bank and the Group perform an assessment and control of risks associated with all assets and liabilities, including contingent liabilities of the Bank and the Group on a regular basis. Limits are regarded as the main tool for the control of risk transactions.

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Capital management

Regulation No 575/2013 requires credit institutions to maintain Common Equity Tier 1 capital ratio of 4.5%, Tier 1 capital ratio of 6% and total capital ratio of 8%. Capital ratios are calculated by the Bank as follows: Common Equity Tier 1 capital ratio is Tier 1 equity of the Bank expressed as a percentage against total exposures; Tier 1 capital ratio is Tier 1 capital expressed as a percentage against total exposures; and total capital ratio is equity expressed as a percentage against total exposures. Total exposures are the sum of notional risk weighted assets and contingent liabilities are determined as the sum of capital requirements of risks multiplied by 12.5. According to the requirement set by the Financial and Capital Market Commission, during 2017 the Bank was required to maintain an individual capital adequacy ratio of 10.2%. In addition, according to the Credit Institutions Law the Bank is required to maintain a sufficient level of tier 1 capital to cover the total capital buffer requirement which consists of a capital buffer of 2.5% of total exposures and the specific countercyclical capital buffer determined as the total value of exposures multiplied by the countercyclical capital buffer rate specific for the particular credit institution. This requires that the individual capital adequacy ratio of the Bank be maintained at 10.2% which is increased by the total capital buffer requirement of 2.5% calculated as the sum of the capital buffer and the countercyclical capital buffer specific for the particular credit institution

Assets have been weighted in accordance with pre-defined risk grades, determining risks in accordance with the amount of capital, necessary to maintain these assets. Off-balance sheet loan liabilities are weighted in accordance with lending risk adjustment grades and risk grades defined for liabilities of partners. The following risk grades are applied: 0%, 20%, 35%, 50%, 100%, 150%.

Capital management is carried out at the Bank according to the Capital and Liquidity Adequacy Assessment Policy. The process of capital adequacy assessment is organised at the Bank by CRO and implemented by the Risk Management Department.

An integral part of the capital adequacy assessment process at the Bank is the calculation, planning and maintenance of capital adequacy. The Bank's objectives when managing capital, which complies with the term "equity" in the statement of financial position, are:

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

Capital adequacy and the use of regulatory capital are monitored by the Bank's management on a regular basis, employing techniques based on the guidelines developed by the Basel Committee and the European Union directives, as implemented by the Financial and Capital Market Commission.

For the calculation of capital adequacy refer to Note 38 and for the impact on the ability of the Bank and the Group to continue as a going concern to Note 43.

Capital adequacy calculation of the Bank and the Group in accordance with the FCMC regulations implies several transitional adjustments as implemented by the EU and FCMC. Some of the transitional adjustments are expected to have a favourable impact for a number of future years which will then gradually reduce over time. The transitional adjustments are applicable to 2018 and later periods. For the purpose of capital adequacy calculation the Group and the Bank use the 5 year transition period provided under Regulation (EU) 2017/2395 (of 12 December 2017) concerning the impact of IFRS 9 on equity (CET1). Had IFRS 9 been implemented as at 31 December 2017 and had the transitional adjustments not been applied, the Bank's capital adequacy ratio would have reduced by 1.4 basis points and that of the Group by 1.4 basis points. In planning their future operations, the Group and the Bank take account of the implementation impact of IFRS 9 and foresee measures to be taken to reduce the negative impact as described in Note 43. It is laid down in Guideline (EU) 2017/697 of the European Central Bank ("ECB") for national competent authorities that from 1 January 2018, 80% of deferred tax assets that rely on future profitability should be deducted from CET1 and from 1 January 2019, 100%. As at 31 December 2017, according to the transitional provisions of Regulation (EU) 575/2013 and according to the national option 30% of deferred tax assets that rely on future profitability were deducted from the capital requirement. The Group's and the Bank's long-term capital position for regulatory purposes is planned and managed in line with expected regulatory requirements.

Currency risk

Currency risk represents the potential losses from revaluation of balance sheet and off-balance-sheet items denominated in foreign currencies due to movements in foreign exchange rates. Gold is regarded as foreign currency. The objective of currency risk management is to mitigate the impact of adverse changes in exchange rates by minimising open positions in foreign currencies. The Bank does not use foreign currency open positions to generate income from speculative operations. During 2017, the Group and the Bank performed daily controls of compliance with limits defined in Currency risk management policy, for transactions with foreign currency. The Bank and the Group are subject to the Credit

Institutions Law which requires that the open position in an individual currency should not exceed 10% of the Bank's capital and the total open foreign currency position should not exceed 20% of the Bank's capital applicable to limiting large exposures according to Regulation No 575/2013. In accordance with the Currency Risk Management Policy, structural units of the Group and Bank are cooperating with the Risk Management Department in evaluation of the currency risk component of the planned transactions and elaboration of hedging method for it. For currency analysis refer to Note 36.

Interest rate risk

Interest risk is represented by possible negative influence on the Group and the Bank's income that can result from possible changes of interest rates. The GAP analysis is used for measurement of interest rates risk. Assets, liabilities, guarantees and contingent liabilities, subjected to interest rate risk, are divided in accordance with minimum period, left till possible repricing dates of interest rates. Basis risk is the likelihood to incur losses due to changes in interest rates on financial instruments with equal repricing dates but different base rates. Basis risk is managed by repricing loans (at floating interest rates) and deposits (with floating interest rates) to the same base rates. Repricing risk is the likelihood to incur losses due to changes in interest rates and different remaining maturities of assets, liabilities and contingent items. Yield curve risk is the likelihood to incur losses due to unexpected changes in the slope and shape of the yield curve. Repricing risk and yield curve risk are managed by matching interest rate sensitive assets and liabilities in each term interval (i.e. maintaining the net position of interest rate risk in each term interval within internal limits). Optionality risk is the likelihood to incur losses when the financial instrument directly (options) or indirectly (loans with early repayment option, demand deposits etc.) provides the customer with an option. Optionality risk is managed by setting sufficient commission fees for early withdrawal of a deposit and early repayment of a loan. The Group and Bank calculate the influence on yearly net interest income, with parallel increase of interest rates for 100 base points. In order to assess the impact of adverse changes in interest rates on profitability and economic value in market emergencies the Bank performs interest rate risk stress testing. In accordance with requirements of Interest rate risk management policy, interest rate risk has to be assessed whenever limits for financial instruments are determined. For the results of sensitivity analysis refer to Note 34.

Country risk

Country risk is represented by possible losses in cases, where a debtor of the Group and Bank, being non-resident, will not be able to meet its liabilities against the Group and Bank, due to political, social or economic circumstances of the country of residency of the debtor. Country risk is managed by the Board of the Bank. Based on analyses of economic, political and social conditions of each particular country, limits are determined for geographic concentration of assets, liabilities and off-balance sheet items, for the purpose of management of country risk. The evaluation provided by international rating agencies is considered when assessing country risk. Limitations have been approved for placement of assets in countries graded as non-OECD, as well as for limitations on residual balances of nostro accounts. Limits for partners and transaction types are determined based on evaluation of risks of country and partners. Compliance with the limits is ensured by the Risk Management Department via regular control. For geographical concentration refer to Note 33.

Anti money laundering and counter terrorism financing

The Bank's objective in managing the money laundering and terrorism financing (hereinafter – ML/TF) risk is to safeguard its reputation and stability in relationships with its customers and the society in general, cooperate with and provide services to trustworthy customers and cooperation partners whose business is understandable to the Bank to avoid, to the extent possible, being involved in money laundering and terrorism financing and to prevent damages resulting from the loss of customers and trust.

The improvement of the ML/TF risk management process is among the priorities of the Bank's Strategic Development Plan and during the reporting period the Bank made robust measures to improve the ML/TF risk management system, by establishing an internal control system for the ML/TF risk management in line with the specific business activities of the Bank based on an assessment of the level of ML/TF risk characteristic for its customers, operational geographies, services and products, and delivery channels that impact the Bank's exposure to the ML/TF risk.

ML/TF risk is managed by means of a new approach to assessing ML/TF risk which stipulates controlling the maximum permitted risk indicators against those set in the ML/TF risk management strategy. The exposure to ML/TF risk is determined, measured and analysed by the Bank on a regular basis to prevent significant ML/TF risks from increasing.

As part of ML/TF risk management, the Bank assesses sufficiency of its resources to manage ML/TF risk, including the amount of capital required to cover operational risks of the Bank. It is consistently assessed and controlled by the Bank by the help of a comprehensive capital adequacy assessment which results in a capital adequacy report based on the analysis of the risk profile of the Bank (including its Lithuanian branch).

The ML/TF risk is managed by the Bank by observing:

- applicable regulations of the countries in which the Bank operates;
- the operational development strategy of the Bank with the ML/TF risk management considered a significant element of it;
- the ML/TF risk management strategy, which details the framework for the ML/TF risk management and the internal control system for AML/CTF, measures restricting and reducing the ML/TF risk and the permissible exposure to the ML/TF risk for each year;
- the AML/CTF policy which specifies measures for implementing the ML/TF risk management strategy, and the responsibilities and accountability of structural units and employees in managing the ML/CF risk;
- internal requirements of the Bank concerning AML/CTF.

Under the impact of the volatile regulatory environment in 2017 the Bank paid particular attention to the development of ML/TF risk management methods in a most efficient manner to achieve high ML/TF risk prevention standards in full compliance with legal requirements and by making timely improvements and investments both in human resources and technologies.

The Bank's priorities during the reporting period as concerns the ML/TF risk management were the following:

- improvement of the ML/TF risk management system in line with the new regulation and technical capabilities;
- The Bank improved ML/TF and sanction risk management and controls, including it acquired and implemented constantly updated ACCUITY data bases on sanctioned persons, companies, ships, regions, dual use goods, EDD to prevent servicing transaction of persons subject to sanctions;
- The Bank implemented a new multi-stage customer risk scoring system by FICO Tonbeller (SIRON) and adjusted its operating processes by introducing a multi-level customer acceptance system;
- The Bank implemented automated systems for monitoring of customer transactions developed by FICO Tonbeller (SIRON), integrated them with the Bank's systems and adjusted them to its operational processes and risk management;
- The Bank implemented an automated ACCUITY system for pre-execution control of transactions and integrated it with other banking systems;
- The Bank has made significant additions to the capacity of the organisational structure for ML/TF risk management. The qualifications of the employees are being evaluated according to the principles laid down in the ML/TF risk management procedure in order to establish the level of qualification and whether appropriate resources are in place to manage the ML/TF risk provided for in the Strategy. Active work is carried out by Control Committee, which is a collegial structure that assesses the key ML/TF risks and makes decisions to implement preventive measures. Employees of the Bank improved their knowledge in external trainings involving foreign experts, including ACAMS. Overall, in 2017 the Bank's employees attended 40 training courses on AML/CTF;
- The Bank has fully implemented the recommendations formulated by independent USA consulting firms to raise the efficiency of the internal control system for ML/TF risk management.

The Bank started changing its business strategy back in 2016 and significantly reduced its reliance on services provided to non-resident customers gradually reduced the number of USD payments and the number and scope of transactions of high-risk non-resident customers. Also, the Financial and Capital Market Commission carried out a review of the Bank in 2017 in the field of anti-money laundering and counter terrorism financing regarding the previous periods, and provided guidelines and suggestions for the improvement of the Bank's internal control system, which the Bank continued to realise and implement in 2018.

According to the administrative agreement concluded in 2018, the Bank undertook to ensure the following independent AML/CFT risk management internal control system reviews:

1) on the compliance of the risk classification of customer base;
2) on the compliance of information technologies used in the management of ML/TF risk;
3) on the compliance of the Bank's internal control system for AML/CTF.

The first two reviews from a company of certified auditors, Deloitte, were acquired in the middle of 2018, receiving an evaluation and additional recommendations for the improvement of the respective area. By the end of 2018, the Bank had implemented all suggestions and recommendations resulting from the independent review, improved the technical functions of AML/TF information technology facilities, and registered in detail the functionality of customers' risk-scoring system.

The overall independent review of the Bank's internal control system in the area of AML/CTF is expected at the beginning of 2019. For the audit, the Bank has contracted a company of certified auditors Deloitte, and the audit is planned in January-March 2019.

In line with the administrative agreement, in 2018 the Bank actively continued to improve its internal control system according to the planned measures approved by the Bank regarding the improvement of internal control system in the area of AML/CTF. The most significant part of the measures was carried out in the second half of 2018 by introducing amendments and additions to AML/CTF regulations, and by improving the functionality, scenarios and reports of the automated system for customer transaction monitoring, thus making the Banks internal control system for AML/CTF more efficient and reducing risks. By the end of 2018, the Bank has performed compliance review of all customers subject to due dilligence, and an audit by purposefully reducing the number of customers posing a heightened ML/FT risk.

In the following period, the Bank plans to continue reducing its ML/FT risk exposure by declining high risk customers by effectively monitoring transactions and preventing suspicious transactions.

In 2018 the Bank continued and in 2019 will actively work to improve its automation systems in the area of AML/CFT, as well as improve efficiency of automated scenarios for the identification of suspicious transactions. Note 43 and 44 comprise additional information on the latest trends in financial market, changes in regulations related to anti-money laundering and the subsequent response by the Bank.

Operational risk

Operational risk is the risk of losses resulting from inadequate or improper internal processes, human and systems error, or the impact of external events, including legal risk but excluding strategic and reputational risk. Aiming to set up a system for the management of operational risk that would reduce the frequency of risk occurrences and the amount of loss to a level acceptable to the Bank and to safeguard the Bank's assets and capital, the Council has approved an appropriate policy. In order to implement this policy, the Board has approved a procedure that specifies the methods for identification, assessment, regular monitoring, control and mitigation of operational risk. Operational risk is managed by the Bank employing the following approaches: reporting of operational risk events; maintaining a data base of operational risk; establishing and controlling operational risk indicators any changes in which may indicate an increased likelihood of risk; self-assessing operational risk; and stress testing using both internal data and information on external operational risk events. The Bank uses hedging to reduce risk. Operational risk is managed by Risk Management Department.

To support the Bank's business continuity and to decrease operational losses due to *force majeure* circumstances the Board drafts and the Council approves and improves the business continuity plan and the information system recovery plan.

Operational compliance risk

Operational compliance risk is the risk that the Bank or its subsidiary may incur losses or legal obligations, be subject to sanctions or suffer impairment of reputation as a result of a failure to comply or a breach of compliance laws, regulations and standards. Operational compliance risk is inherent in all operations of the Bank. Management of operational compliance risk involves control, due identification, documentation, assessment, classification and efficient prevention of this risk or decreasing it to a level that the Bank finds acceptable, and follow-up of the risk. The operational compliance control is directed at the existing Bank's operations and due planning and execution of measures to prevent or decrease operational compliance risk with regard to new products and services of the Bank or other lines of business. Management of operational compliance risk is effected according to a policy approved by the Board using the following measures and approaches: systemic compliance reviews of the Bank's structural units, policies, internal procedures, other normative and informative materials; assessment of innovations; identification of operational compliance risks caused by external conditions; analysis of the reports of the Bank's structural units; analysis of statistical and analytical performance data; expert sounding board; analysis of reports of internal and external auditors and regulator or other parties; maintenance of an operational compliance risk data base and control over due prevention of identified risks or decreasing such risks to an acceptable level. Operational compliance risk is managed by the Compliance Control Unit who reports to the management on a regular basis.

5 ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS as adopted by the EU requires management to make judgments, estimates and assumption that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Although these estimates are based on management's best knowledge of current events and actions, the actual results ultimately may differ from those estimates.

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

Key sources of estimation uncertainty:

Going concern

These consolidated and separate financial statements are prepared on a going concern basis. The application of the going concern basis requires management to make a number of considerations and exercise judgment. Refer to Note 43.

Impairment of financial instruments (other than loans and receivables)

The signs of impairment are determined based on a comparison of the financial instrument's carrying amount and fair value. The Group and the Bank uses the market price as the main source to determine the fair value of the financial instruments. If the Group and the Bank identify fluctuations on the financial and capital markets, the market price is not considered to be a reliable source for impairment indication. Therefore, in the absence of direct quotation, the Group and the Bank uses valuation models based on quoted market prices of similar products.

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

Allowances for doubtful debts

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

Impairment of Non-financial Assets

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. The recoverable amount of an asset or cash generating unit is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specificē to the asset.

An impairment loss is recognized if the carrying amount of an asset exceeds its estimated recoverable amount.

Fair value of investment property

The fair value of investment property was determined by external, independent property valuators, having appropriate recognised professional qualifications and recent experience in the location and category of the property being valued. Income or market methods (or combination thereof) are predominantly used in the fair value determination.

6 CASH AND DUE FROM THE BANK OF LATVIA

	2017	2017	2016	2016
EUR'000	**Group**	**Bank**	**Group**	**Bank**
Cash	4,125	4,125	4,110	4,110
Balance with the Bank of Latvia (including minimum reserve deposit)	99,421	99,421	67,516	67,516
Total	**103,546**	**103,546**	**71,626**	**71,626**

Due from the Bank of Latvia represents the EUR nominated balance on the correspondent account with the Bank of Latvia.

According to the regulations of the European Central Bank, the Bank is required to maintain obligatory reserves with the Bank of Latvia equal to 1% of the closing monthly balances due of deposits with agreed maturity or period of notice up to 2 years and debt securities issued with initial maturity up to 2 years. For all other liabilities included in the reserve calculation the applicable rate is 0%.

The compulsory reserve is compared to the Bank's average monthly balance on the correspondent account with the Bank of Latvia. The Bank's average cash and correspondent balance should exceed the compulsory reserve requirement.

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

On 1 January 2014 the Republic of Latvia joined the euro-zone and the Latvian Lat was replaced by the euro, as a result as of 1 January 2014 the obligatory reserve rates are determined by the European Central Bank, previously these rates were determined by Bank of Latvia.

As at 31 December 2017 and 31 December 2016 the Bank was in compliance with the above requirements.

The Bank significantly reduced its claims against credit institutions and increased deposits with the Bank of Latvia accordingly to reduce costs related to negative interest rates on cash deposits.

7 DEMAND DEPOSITS WITH CREDIT INSTITUTIONS

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Credit institutions of OECD countries	8,326	8,326	6,901	6,901
Latvian credit institutions	12,292	12,292	22,456	22,456
Credit institutions of non-OECD countries	811	811	3,783	3,783
	21,429	**21,429**	**33,140**	**33,140**

The Bank maintained relationship with 25 correspondent banks (2016: 25).

The Bank significantly reduced its claims against credit institutions and increased deposits with the Bank of Latvia accordingly to reduce costs related to negative interest rates on cash deposits.

The main correspondent banks of the Bank and the Group:

	2017 EUR'000	2016 EUR'000
AS Rietumu Banka, Latvia	10,311 (48.1%)	19,689 (59.4%)
Raiffeisen Bank International AG, Austria	5,842 (27.3%)	3,740 (11.3%)
ABLV Bank, AS, Latvia	1,676 (7,8%)	2,667 (8,0%)
Lietuvas Banka, Lithuania	223 (1.0%)	122 (0.4%)

8 HELD-TO-MATURITY INVESTMENTS

(a) Latvian government bonds with fixed income

	Term	2017 Group EUR'000	2017 Bank EUR'000	2016 Group EUR'000	2016 Bank EUR'000
Latvian government bonds with fixed income (S&P – A, Moody's – A3)	2017	-	-	3,885	3,885
	2018	2,110	2,110	2,215	2,215
	2021	1,590	1,590	1,705	1,705
		3,700	**3,700**	**7,805**	**7,805**

(b) Fixed income bonds

	Term	2017 Group EUR'000	2017 Bank EUR'000	2016 Group EUR'000	2016 Bank EUR'000
USA government bonds with fixed income (S&P- AA+, Moody's – Aaa)	2017	-	-	3,825	3,825
Alfa Bank, Russian Federation (S&P – BB, Moody's – Ba2)	2017	-	-	1,945	1,945
Lithuanian government bonds with fixed income (S&P – A-, Moody's – Baa1)	2017	-	-	298	298
Lithuanian government bonds with fixed income (S&P – A-, Moody's – Baa1)	2018	302	302	308	308
Lithuanian government bonds with fixed income (S&P – A-, Moody's – Baa1)	2020	2,354	2,354	2,781	2,781
		2,656	**2,656**	**9,157**	**9,157**
Total held-to-maturity investments		**6,356**	**6,356**	**16,962**	**16,962**

9 AVAILABLE FOR SALE FINANCIAL INVESTMENTS

(a) Latvian government bonds with fixed income

	Term	2017 Group EUR'000	2017 Bank EUR'000	2016 Group EUR'000	2016 Bank EUR'000
Latvian government bonds with fixed income (S&P – A-, Moody's – A3)	2017	-	-	1,459	1,459
Latvian government bonds with fixed income (S&P – A-, Moody's – A3)	2021	1,708	1,708	1,642	1,642
		1,708	**1,708**	**3,101**	**3,101**

(b) Fixed income bonds

	Term	2017 Group EUR'000	2017 Bank EUR'000	2016 Group EUR'000	2016 Bank EUR'000
Lithuanian government bonds with fixed income (S&P – A, Moody's – Baa 1)	2017	-	-	2,965	2,965
USA government bonds with fixed income (S&P- AA, Moody's – Aaa)	2017	-	-	24,424	24,424
Croatian government bonds with fixed income (S&P – BB, Moody's – Baa 3)	2018	530	530	-	-
Slovenian government bonds with fixed income (S&P – A-, Moody's – Baa 3)	2018	849	849	1,982	1,982
USA government bonds with fixed income (S&P- AA, Moody's – Aaa)	2018	29,108	29,108	9,459	9,459
Romania government bonds with fixed income (S&P – BBB-, Moody's – Baa 3)	2018	-	-	3,401	3,401
Slovenian government bonds with fixed income (S&P – A-, Moody's – Baa 3)	2019	-	-	3,003	3,003
Polish government bonds with fixed income (S&P – A-, Moody's – A2)	2020	-	-	1,166	1,166
Polish government bonds with fixed income (S&P – A-, Moody's – BBB+)	2021	-	-	3,562	3,562
		30,487	**30,487**	**49,962**	**49,962**
Financial assets available-for-sale		**32,195**	**32,195**	**53,063**	**53,063**

10 LOANS AND TERM DEPOSITS DUE FROM CREDIT INSTITUTIONS

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Term deposits with credit institutions	1,175	1,175	8,589	8,589
Other balances due from credit institutions	709	709	806	806
Total loans and term deposits	**1,884**	**1,884**	**9,395**	**9,395**

As at 31 December 2017 the Bank and the Group had amounts due from credit institutions of EUR 709 thousand (2016: EUR 806 thousand) that secured collaterals for the guarantees issued by the Bank.

Geographical classification:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Residents of OECD countries	709	709	806	806
Residents of Latvia	1,175	1,175	6,660	6,660
Residents of non-OECD countries	-	-	1,929	1,929
Total loans and term deposits	**1,884**	**1,884**	**9,395**	**9,395**

11 LOANS TO CUSTOMERS

(a) Loans by groups are comprised as follows:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Individuals	14,402	12,893	16,166	14,240
Legal entities	84,808	105,176	95,829	116,034
Personnel of the Bank	434	434	468	468
Total loans, gross	**99,644**	**118,503**	**112,463**	**130,742**
Impairment allowance	(22,363)	(24,508)	(17,210)	(17,210)
Total loans, net	**77,281**	**93,995**	**95,253**	**113,532**

(b) Loans by type:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Loans and advances to customers	91,819	99,872	103,020	110,553
Credit lines	7,716	18,522	9,235	19,981
Overdrafts	109	109	208	208
Loans, gross	**99,644**	**118,503**	**112,463**	**130,742**
Impairment allowance*	(22,363)	(24,508)	(17,210)	(17,210)
Total loans, net	**77,281**	**93,995**	**95,253**	**113,532**

* As at 31 December 2017 The Bank and the Group impairment allowance include also EUR 1,790 thousand provisions for reducing credit risk concentration in accordance with regulatory requirements.

(c) Loans issued by industry, gross:

Legal entities	2017 Group		2017 Bank		2016 Group		2016 Bank	
Real estate property	30,928	36%	30,928	29%	35,194	36%	35,194	30%
Construction	5,972	7%	5,972	6%	6,583	7%	6,583	6%
Electricity	15,971	19%	15,971	15%	16,826	18%	16,826	15%
Wholesale and retailing	10,327	12%	10,327	10%	13,157	14%	12,914	11%
Industrial markets	8,729	10%	8,729	8%	9,880	10%	9,880	8%
Transport, warehousing and communications	1,807	2%	1,807	2%	1,696	2%	1,696	1%
Loans issued to financial intermediaries	-	-	27,649	26%	-	-	28,691	25%
Finance lease	7,281	9%	-	-	8,239	9%	-	-
Others	3,793	5%	3,793	4%	4,254	4%	4,250	4%
Total	**84,808**	**100%**	**105,176**	**100%**	**95,829**	**100%**	**116,034**	**100%**
Individuals and personnel of the Bank								
Consumer loans	242	2%	242	2%	284	2%	284	2%
Credit card commitments	347	2%	347	3%	406	2%	406	3%
Mortgage loans	7,158	48%	7,158	54%	7,622	46%	7,622	52%
Finance lease	1,509	10%	-	-	1,926	11%	-	-
Business loans	5,439	37%	5,439	40%	4,756	29%	4,756	32%
Others	141	1%	141	1%	1,640	10%	1,640	11%
Total	**14,836**	**100%**	**13,327**	**100%**	**16,634**	**100%**	**14,708**	**100%**

(d) Loans by geographical classification:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Residents of Latvia	94,515	113,374	103,937	122,216
Residents of OECD countries	3,232	3,232	7,296	7,296
Residents of non-OECD countries	1,897	1,897	1,230	1,230
Loans and receivables to non-banking customers, gross	**99,644**	**118,503**	**112,463**	**130,742**
Impairment allowance	(22,363)	(24,508)	(17,210)	(17,210)
Loans and receivables, net	**77,281**	**93,995**	**95,253**	**113,532**

(e) Movements in the impairment allowance:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Balance at the beginning of the year	**17,210**	**17,210**	**11,447**	**11,447**
Increase of impairmanet allowance	*5,848*	*7,993*	*7,450*	*7,450*
Provisions for reducing credit risk concentration	*1,790*	*1,790*	-	-
Recovery of prior period loan loss allowances	*(2,198)*	*(2,198)*	*(1,655)*	*(1,655)*
Changes in impairment allowance	5,440	7,585	5,795	5,795
Release of impairment allowances recognised in previous periods	(287)	(287)	(32)	(32)
Balance at the end of the reporting period	**22,363**	**24,508**	**17,210**	**17,210**

(f) Loans and accrued interest allocation, depending on delay of payments:

Group

EUR'000		Loans not overdue	Overdue loans					
Loans and advances to customers 31 December 2017			**Up to 30 days**	**30-60 days**	**61-90 days**	**91-180 days**	**181-360 days**	**More than 360 days**
Gross loans and advances to customers	**99,644**	62,752	10,637	4,987	571	10,700	5,628	4,369
Impairment allowance	**(22,363)**	(12,046)	(2,429)	(1,176)	(149)	(2,926)	(992)	(2,645)
As at 31 December 2016								
Gross loans and advances to customers	**112,463**	101,935	3,604	931	672	1,178	1,949	2,194
Impairment allowance	**(17,210)**	(14,251)	(254)	(8)	(15)	(498)	(794)	(1,390)

Bank

EUR'000		Loans not overdue	Overdue loans					
Loans and advances to customers 31 December 2017			**Up to 30 days**	**30-60 days**	**61-90 days**	**91-180 days**	**181-360 days**	**More than 360 days**
Gross loans and advances to customers	**118,503**	84,953	8,650	4,749	205	10,066	5,628	4,252
Impairment allowance	**(24,508)**	(14,191)	(2,429)	(1,176)	(149)	(2,926)	(992)	(2,645)
As at 31 December 2016								
Gross loans and advances to customers	**130,742**	123,979	1,589	783	184	1,061	1,191	1,955
Impairment allowance	**(17,210)**	(14,251)	(254)	(8)	(15)	(498)	(794)	(1,390)

(g) Allocation of loans by qualitative evaluation of collateral:

The table below shows separate loan groups by their carrying amount. The Bank and the Group hold collateral against loans and advances to customers in the form of mortgage interests over property, asset pledges and and guarantees. Loan quality by separate groups:

	2017 Group	**2017 Bank**	**2016 Group**	**2016 Bank**
Loans with collateral to corporate customers				
Loans without impairment allowances	30,187	30,187	53,648	53,648
Loans not overdue	*24,341*	*24,341*	*52,253*	*52,253*
Overdue by up to 90 days	*2,335*	*2,335*	*999*	*999*
Overdue by more than 90 days	*3,511*	*3,511*	*396*	*396*
Loans with impairment allowances	46,065	46,065	31,401	31,401
Loans not overdue	*22,831*	*22,831*	*30,474*	*30,474*
Overdue by up to 90 days	*9,924*	*9,924*	-	-
Overdue by more than 90 days	*13,310*	*13,310*	*927*	*927*
Impairment allowance	(17,486)	(17,486)	(13,726)	(13,726)
Total loans to corporate customers	**58,766**	**58,766**	**71,323**	**71,323**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

	2017 Group	2017 Bank	2016 Group	2016 Bank
Finance lease				
Leases	8,790	-	10,165	-
Leases not overdue	*4,848*	-	*7,158*	-
Leases overdue by up to 90 days	*3,191*	-	*2,650*	-
Leases overdue by more than 90 days	*751*	-	*357*	-
Impairment allowance	-	-	-	-
Total finance lease	**8,790**	**-**	**10,165**	**-**
Mortgage loans to individuals				
Loans without impairment allowances	8,290	8,290	8,723	8,723
Loans not overdue	*6,713*	*6,713*	*7,892*	*7,892*
Overdue by up to 90 days	*995*	*995*	*392*	*392*
Overdue by more than 90 days	*582*	*582*	*439*	*439*
Loans with impairment allowances	3,843	3,843	4,505	4,505
Loans not overdue	*2,601*	*2,601*	*2,708*	*2,708*
Overdue by up to 90 days	*168*	*168*	*966*	*966*
Overdue by more than 90 days	*1,074*	*1,074*	*831*	*831*
Impairment allowance	(1,379)	(1,379)	(1,247)	(1,247)
Total mortgage loans to individuals	**10,754**	**10,754**	**11,981**	**11,981**

	2017 Group	2017 Bank	2016 Group	2016 Bank
Loans to individuals secured by other type of collateral				
Loans without impairment allowances	194	194	252	252
Loans not overdue	*194*	*194*	*252*	*252*
Overdue by up to 90 days	-	-	-	-
Overdue by more than 90 days	-	-	-	-
Loans with impairment allowances	375	375	400	400
Loans not overdue	*4*	*4*	*51*	*51*
Overdue by up to 90 days	*183*	*183*	*185*	*185*
Overdue by more than 90 days	*188*	*188*	*164*	*164*
Impairment allowance	(361)	(361)	(384)	(384)
Total loans to individuals secured by other type of collateral	**208**	**208**	**268**	**268**

The amounts shown in the table represent the gross carrying amount of the loans by type of collateral and do not necessarily represent the fair value of the underlying collateral:

	31 December 2017				As at 31 December 2016			
	Group		Bank		Group		Bank	
	EUR'000	%	EUR'000	%	EUR'000	%	EUR'000	%
Commercial buildings	53,805	54%	53,805	46%	57,139	50%	57,139	44%
Commercial assets pledge	9,489	10%	9,489	8%	15,861	14%	15,861	12%
Land mortgage	3,670	4%	3,670	3%	4,185	4%	4,185	3%
Mortgage on residential properties	20,422	20%	20,422	17%	20,104	18%	20,104	16%
Guarantee	1,369	1%	1,369	1%	1,271	1%	1,271	1%
Lease and other	8,985	9%	195	-	10,532	10%	367	-
No collateral	1,904	2%	29,553	25%	3,371	3%	31,815	24%
Total	**99,644**	**100%**	**118,503**	**100%**	**112,463**	**100%**	**130,742**	**100%**

Significant credit risk concentration

As at 31 December 2017 and 2016, the Bank had 23 and 20 borrowers or groups of related borrowers, respectively, whose total loan liabilities exceeded 10% of the share capital of the Bank indicated in Note 37. The gross amount of the above loans as at 31 December 2017 and 31 December 2016 was EUR 67,834 thousand and EUR 71,263 thousand, respectively. An impairment allowance was recognised for the above loans as at 31 December 2017 and 31 December 2016 in the amount of EUR 16,931 thousand and EUR 6,807 thousand, respectively.

According to regulatory requirements, the Bank is not allowed to have a credit exposure to one client or a group of related clients of more than 25% of the Bank's equity. The Bank was in excess of these requirements as at 31 December 2017 in ten instances (from 25.22% to 43,69%) and as at 31 December 2016 in two instances (26.96%, 29.39%). In order to reduce the credit risk concentration, provisions for individual exposures have been created in the amount of 1,790 thousand EUR. However, there is a risk that non-compliance with the regulator's requirements may result in corrective measures or fines. The risk will be eliminated by increasing capital and reducing the amount of risk exposures.

(h) Impaired loans:

Group

	2017 EUR'000	2016 EUR'000
Impaired loans, gross	51,631	38,829
Impairment allowance	(22,363)	(17,210)
Impaired loans and receivables, net:	**29,268**	**21,619**

Bank

	2017 EUR'000	2016 EUR'000
Impaired loans, gross	65,040	38,829
Impairment allowance	(24,508)	(17,210)
Impaired loans and receivables, net:	**40,532**	**21,619**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

(i) Finance lease receivables:

Loans and advances to customers include the following finance lease receivables for leases of certain fixed assets where the Group is lessor:

EUR'000	2017	2016
Gross investment in finance leases, receivable with maturity:		
Less than one year	3,289	3,639
Between one and five years	4,896	5,871
More than 5 years	1,368	1,749
Total gross investment in finance leases, receivables	**9,553**	**11,259**
Unearned interest income	(763)	(1,094)
Net investment in finance lease	**8,790**	**10,165**
Net investments in finance leases with maturity:		
Less than one year	3,030	3,309
Between one and five years	4,506	5,282
More than 5 years	1,254	1,574
	8,790	**10,165**

12 PROPERTY AND EQUIPMENT

Group property and equipment

EUR'000	Buildings	Vehicles	Office equipment	Leasehold improvements	Total
Cost					
As at 31 December 2015	**708**	**134**	**841**	**244**	**1,927**
Additions	-	20	338	-	358
Disposals	-	-	-	(76)	(76)
Disposals	-	(51)	(151)	-	(202)
As at 31 December 2016	**708**	**103**	**1,028**	**168**	**2,007**
Additions	-	11	295	-	306
Disposals	-	-	(25)	-	(25)
Disposals	-	-	(90)	(100)	(190)
31 December 2017	**708**	**114**	**1,208**	**68**	**2,098**
Accumulated depreciation					
As at 31 December 2015	**245**	**119**	**474**	**-**	**838**
Depreciation for the reporting year	34	15	211	-	260
Depreciation of disposed fixed assets	-	(51)	(151)	-	(202)
As at 31 December 2016	**279**	**83**	**534**	**-**	**896**
Depreciation for the reporting year	34	7	269	-	310
Depreciation of disposed fixed assets	-	-	(90)	-	(90)
31 December 2017	**313**	**90**	**713**	**-**	**1,116**
Balance					
As at 31 December 2015	**463**	**15**	**367**	**244**	**1,089**
As at 31 December 2016	**429**	**20**	**494**	**168**	**1,111**
31 December 2017	**395**	**24**	**495**	**68**	**982**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

Bank property and equipment

EUR'000	Buildings	Vehicles	Office equipment	Leasehold improvements	Total
Cost					
At 31 December 2015	**708**	**51**	**841**	**244**	**1,844**
Additions	-	20	338	-	358
Disposals	-	-	-	(76)	(76)
Disposals	-	(51)	(151)	-	(202)
As at 31 December 2016	**708**	**20**	**1,028**	**168**	**1,924**
Additions	-	2	295	-	297
Reclassified	-	-	(25)	-	(25)
Disposals	-	-	(90)	(100)	(190)
31 December 2017	**708**	**22**	**1,208**	**68**	**2,006**
Accumulated depreciation					
At 31 December 2015	**245**	**51**	**474**	**-**	**770**
Depreciation for the reporting year	34	2	211	-	247
Depreciation of disposed fixed assets	-	(51)	(151)	-	(202)
As at 31 December 2016	**279**	**2**	**534**	**-**	**815**
Depreciation for the reporting year	34	4	269	-	307
Depreciation of disposed fixed assets	-	-	(90)	-	(90)
31 December 2017	**313**	**6**	**713**	**-**	**1,032**
Balance					
As at 31 December 2015	**463**	**-**	**367**	**244**	**1,074**
As at 31 December 2016	**429**	**18**	**494**	**168**	**1,109**
31 December 2017	**395**	**16**	**495**	**68**	**974**

13 INVESTMENT PROPERTY

The Group's investment property

	Land	Buildings	Total
Cost			
At 31 December 2015	**4,327**	**8,130**	**12,457**
Disposals	(180)	-	(180)
Acquired	34	4,575	4,609
As at 31 December 2016	**4,181**	**12,705**	**16,886**
Disposals	-	(2,175)	(2,175)
Acquired	2,166		2,166
31 December 2017	**6,347**	**10,530**	**16,877**
Change in fair value			
As at 31 December 2015	**-**	**696**	**696**
Revaluation impact	-	280	280
As at 31 December 2016	**-**	**976**	**976**
Revaluation impact	-	705	705
31 December 2017	**-**	**1,681**	**1,681**
Balance			
At 31 December 2015	**4,327**	**7,434**	**11,761**
As at 31 December 2016	**4,181**	**11,729**	**15,910**
31 December 2017	**6,347**	**8,849**	**15,196**

Income from lease of investment property in 2017 amounted to EUR 332 thousand (2016: EUR 264 thousand) and respectively maintenance expenses in 2017 amounted to EUR 118 thousand (2016: EUR 121 thousand).

Investment property consists of land, residential properties and commercial properties. In 2016, the measurement of investment properties was changed from the cost basis to the fair value basis. The management of the subsidiary believes that the fair value reflects the value of investment property more objectively.

The fair value measurement for investment property has been categorised as a Level 3 in the fair value hierarchy.

Group	2017 Fair value EUR'000	2016 Fair value EUR'000	Key assumption
Residential real estate, Salaspils region	1,690	1,690	Determined based on comparable market transactions method and income method (50% and 50% respectively). Discount rate 9%.
Sand and gravel deposit, Talsi region	4,225	4,460	Discount rate of 15.12%. Cash flow period of 10 years Income based on sale of various quality of extracted sand and gravel.
Residential real estate, Riga	1,366	1,366	Land and building value determined based on comparable transactions. Price is EUR 2,651 per m^2
Commercial real estate, Daugavpils	628	519	Discount rate of 11,32%. Cash flow period of 6 years Occupancy rate of 80% to 95%. Rent ranging on average EUR 2,5 to EUR 10,38 per m^2

14 OTHER ASSETS

Other assets are as follows:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Financial assets:				
Funds in transit	6,817	6,817	2,844	2,844
Receivables	2,364	30	1,791	30
Credit card transactions in transit	598	598	449	449
Other financial assets	1,730	1,730	655	655
	11,509	**9,175**	**5,739**	**3,978**
Non-financial assets:				
Deferred expenses and accrued income	163	138	155	151
Other non-financial assets	1	-	362	-
	164	**138**	**517**	**151**
Total	**11,673**	**9,313**	**6,256**	**4,129**

15 DUE TO CREDIT INSTITUTIONS ON DEMAND

Due to credit institutions are comprised as follows:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Credit institutions registered in OECD countries	-	-	5	5
Total demand deposits	**-**	**-**	**5**	**5**

As at 31 December 2017 the Bank did not have accounts in correspondent banks (31 December 2016: 1).

16 DEPOSITS

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Sector profile:				
Non-banking deposits				
Legal entities	126,864	126,865	137,342	137,342
Individuals	120,238	120,239	117,796	117,796
State institutions	2,320	2,320	14,980	14,980
Total non-banking deposits:	**249,422**	**249,424**	**270,118**	**270,118**
Total deposits	**249,422**	**249,424**	**270,118**	**270,118**
Geographical profile:				
Residents	92,833	92,835	91,581	91,581
Non-residents	156,589	156,589	178,537	178,537
Residents of OECD countries	*59,545*	*59,545*	*57,723*	*57,723*
Residents of non-OECD countries	*97,044*	*97,044*	*120,814*	*120,814*
Total deposits	**249,422**	**249,424**	**270,118**	**270,118**

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Demand deposits				
Legal entities	120,416	120,417	132,242	132,242
Private individuals	76,794	76,794	74,265	74,265
State institutions	2,320	2,320	14,980	14,980
Total demand deposits	**199,530**	**199,531**	**221,487**	**221,487**
Term deposits				
Legal entities	6,448	6,448	5,100	5,100
Private individuals	43,444	43,445	43,531	43,531
Total term deposits	**49,892**	**49,893**	**48,631**	**48,631**
Total current accounts and deposits from non-banking customers	**249,422**	**249,424**	**270,118**	**270,118**

As at 31 December 2017, the Bank maintained customer deposit balances of EUR 531 thousand (2016: EUR 563 thousand) which were blocked by the Bank as collateral for loans and other contingent liabilities granted by the Bank.

Concentrations of current accounts and customer deposits

As at 31 December 2017 and 31 December 2016 the Bank had no customers whose balances exceeded 10% of total customer deposits.

17 SUBORDINATED DEBT

Subordinated liabilities as at 31 December 2017 comprise loans received from 8 natural persons and 1 legal entity (31 December 2016: 10 natural and 1 legal person).

	Maturity	Interest rate	31 December 2017, EUR'000		31 December 2016, EUR'000	
			Group	Bank	Group	Bank
Loan No. 1	02.09.2017	4%	-	-	284	284
Loan No. 2	02.09.2017	4%	-	-	427	427
Loan No. 3	02.09.2017	4%	-	-	285	285
Loan No. 4	28.12.2017	4%	-	-	427	427
Loan No. 5	26.04.2025	4%	427	427	427	427
Loan No. 6 (related party)	01.01.2017	3,5%	-	-	500	500
Loan No. 7	25.11.2018	3.6%	1,300	1,300	1,300	1,300
Loan No. 8	22.03.2019	3.6%	1,500	1,500	1,500	1,500
Loan No. 9	30.10.2017	3,5%	-	-	300	300
Loan No. 10	29.04.2018	2%	284	284	284	284
Loan No. 11	09.07.2018	4.25%	300	300	300	300
Loan No. 12	08.09.2018	3.75%	300	300	300	300
Loan No. 13	05.04.2023	4%	280	280	280	280
Loan No. 14	02.09.2022	4%	427	427	-	-
Loan No. 15	01.09.2022	4%	285	285	-	-
Loan No. 16	31.03.2022	3.5%	280	280	-	-
Total			**5,383**	**5,383**	**6,614**	**6,614**

Subordinated loans are to be satisfied after the claims of all other creditors of the Bank, but before claims of shareholders of the Bank in case of liquidation of the Bank.

18 OTHER LIABILITIES

Other liabilities are as follows:

EUR'000	**2017 Group**	**2017 Bank**	**2016 Group**	**2016 Bank**
Financial liabilities				
Funds in transit	2,161	2,161	3,021	3,021
Unmatched funds	90	90	5,283	5,283
Other financial liabilities	1,286	1,286	1,247	1,247
	3,537	**3,537**	**9,551**	**9,551**
Non-financial liabilities				
Accrued expenses and deferred income	927	893	-	-
Other liabilities	282	70	726	36
	1,209	**963**	**726**	**36**
Total	**4,746**	**4,500**	**10,277**	**9,587**

Cash in transit includes amounts requested by clients for payment with a value date of 2 January 2018 and 2017, respectively.

Unmatched funds include amounts for which the Bank has not matched incoming funds to its client accounts. Unmatched accounts are matched within ten working days after they are received.

19 PROVISIONS

Provisions include provisions for unused vacations and amount to EUR 171 thousand for the Group purposes and EUR 168 thousand for the Bank purposes (2016: EUR 154 thousand and EUR 152 thousand, respectively).

20 SHARE CAPITAL

		31 December 2017		As at 31 December 2016	
	Nominal value (EUR)	**Number of shares**	**Share capital, EUR'000**	**Number of shares**	**Share capital, EUR'000**
Ordinary shares	71.10	233,451	16,598	220,124	15,651

Shareholders

	2017		2016	
	Number of shares	**%**	**Number of shares**	**%**
Private individuals	210,339	90.10	205,635	93.42
Legal entities	23,112	9.90	14,489	6.58
Total	**233,451**	**100**	**220,124**	**100**

The Bank's capital is registered and fully paid. Ordinary shares rank equally with respect to dividends, as may be declared, and entitle all holders to equal voting rights at the shareholders' meeting. All shares rank equal with respect to residual assets. As at 31 December 2017, there were 6 shareholders – 1 legal person and 5 individuals (As at 31 December 2016: 7 – 1 legal person and 6 individuals).

Upon privatization of the Bank in accordance with statutory requirements in force as at the date of privatization a reserve capital of EUR 149 thousand was created. In May 2014, the previous shareholder dispossessed the shares without any claim and transferred it to the Bank. In November 2014, the Bank sold these shares for EUR 4,006 thousand and starting from 31 December 2014, this investment is recognized as reserve capital.

The use of share premium is defined by applicable Latvian legislation.

21 INTEREST INCOME

EUR'000	**2017 Group**	**2017 Bank**	**2016 Group**	**2016 Bank**
Interest income on loans and receivables				
Loans and receivables	2,880	2,978	3,444	3,738
Loans and receivables from banks	404	404	456	456
Held-to-maturity investments	221	221	443	443
Available-for-sale securities	417	417	1,122	1,122
Total	**3,922**	**4,020**	**5,465**	**5,759**

Interest recognized from impaired loans during the year ended 31 December 2017 amounts to EUR 399 thousand (31 December 2016: EUR 556 thousand).

22 INTEREST EXPENSE

EUR'000	**2017 Group**	**2017 Bank**	**2016 Group**	**2016 Bank**
Interest expenses on liabilities at amortized cost:				
Current accounts and deposits of customers	1,587	1,587	1,427	1,427
Total	**1,587**	**1,587**	**1,427**	**1,427**

23 FEE AND COMMISSION INCOME

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Commissions from money transfers, cash operations and servicing accounts	4,365	4,365	3,738	3,738
Fees from cards services	1,903	1,903	1,084	1,084
Commissions from guarantees	82	82	174	166
Brokerage fees	122	122	118	118
Others	181	179	182	182
Total	**6,653**	**6,651**	**5,296**	**5,288**

24 FEE AND COMMISSION EXPENSE

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Commissions paid to correspondent banks	319	319	353	353
Commissions for transactions with payment cards	1,451	1,451	1,054	1,054
Fees for operations with securities	78	78	122	122
Others	218	218	221	221
Total	**2,066**	**2,066**	**1,750**	**1,750**

25 GAIN ON TRADING WITH FINANCIAL INSTRUMENTS, NET

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Profit from foreign currency transactions	2,531	2,531	1,179	1,179
Profit / (loss) from revaluation of foreign exchange	97	89	(3)	19
Profit/(loss) from transactions with fixed income securities	24	24	(431)	(431)
Profit/(loss) from transactions with non-fixed income securities	-	-	1,480	1,480
Profit/(loss) from revaluation of investments	1	1	1	1
Total	**2,653**	**2,645**	**2,226**	**2,248**

The acquisition of shares of VISA Europe Limited was announced by VISA Inc. in 2015 and completed in 2016.

This transaction in June 2016 generated for the Bank a cash payment of EUR 1,176 thousand and a deferred payment of EUR 101 thousand, which was recognised as income from the sales of available-for-sale financial instruments. In addition, 5943.552 preference shares were received. According to VISA Inc., preference shares rank to ordinary shares of VISA Inc. as 1:13.952. As preference shares are not quoted on an active market and they will be exchanged for regular shares over a long period of time, the value of these preference shares is set by the Bank using Bloomberg quotes for regular shares adjusted by a 50% markdown. Preference shares are revalued on a regular basis by reference to Bloomberg quotes for regular shares.

26 ADMINISTRATIVE EXPENSES

Salaries, wages and related social security contributions represent the basic remuneration of the employees, social security contributions as well as other personnel expense. During the years ended 31 December 2017 and 2016, the Bank and the Group employed on average 228 and 250 employees, respectively. Administrative expenses are as follows:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Personnel salaries and wages	3,989	3,960	3,771	3,740
Rent of premises and other maintenance expenses	943	943	1,112	1,112
State compulsory social insurance contributions	1,025	1,019	954	948
Professional services	1,207	1,207	1,677	1,677
Depreciation of property and equipment and investments in rented property and equipment	311	307	540	247
Salaries to members of the Council and the Board	415	415	330	330
Office supplies	35	35	37	37
Advertising and marketing	31	31	29	29
Others	1,424	1,286	526	369
Total	**9,380**	**9,203**	**8,976**	**8,489**

The administrative expenses for 2017 include a provision of EUR 889 thousand for the fine imposed by the Financial andCapital Market Commission. The fine was paid in 2018.

Total audit expenses are included in the professional services item:

	2017 Group	2017 Bank	2016 Group	2016 Bank
Annual and interim audit fees	87	84	52	49
Other audit fees and similar expenses	10	10	574	574

Total personnel expenses are included in the following profit or loss caption:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Administrative expenses	5,429	5,394	5,055	5,018
Total	**5,429**	**5,394**	**5,055**	**5,018**

Total depreciation of property and equipment and leasehold improvements is included in the following profit or loss caption:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Administrative expenses	311	307	540	247
Total	**311**	**307**	**540**	**247**

27 TAXES

(a) Corporate Income Tax

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Corporate Income Tax	-	-	-	-
Corporate Income Tax	**-**	**-**	**-**	**-**

In the reporting year

Current tax for the reporting year is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. See below for information on changes effective as of 1 January 2018.

Changes to the calculation of Corporate Income Tax as of 1 January 2018

As of 1 January 2018, the new Law on Enterprise Income Tax of the Republic of Latvia comes into effect setting out a conceptually new regime for paying taxes. As of the date, the tax rate will be 20% instead of the current 15%, the taxation period will be one month instead of a year and the taxable base will include:

- distributed profit (dividends calculated, payments equalled to dividends, conditional dividends) and
- conditionally or theoretically distributed profit (non-operating expenses, doubtful debts, excessive interest payments, loans to related parties, decrease of income or excessive expenses which are incurred by entering transactions at prices other than those on the market that should be calculated using the methodology determined by the Cabinet of Ministers, benefits bestowed by the non-resident upon its staff or board (council members) regardless of whether the receiving party is a resident or a non-resident, if they relate to the operation of a permanent establishment in Latvia, liquidation quota).

The use of tax losses carried forward from previous periods is limited: it will be possible to utilise these losses to decrease the amount of tax calculated on dividends in the reporting period by not more than 50%. It will be possible to carry forward unused tax losses and utilise them in the previously described manner only until 2022.

(b) Reconciliation of effective tax rate:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Loss before tax	(5,677)	(7,212)	(4,818)	(4,211)
Expected tax charge applying current tax rate of 15%	(852)	(1,082)	(723)	(632)
Non-deductible expenses and non-taxable income	(12)	10	(237)	(328)
Effect of changes in unrecognized deferred tax asset	864	1,072	960	960
Corporate income tax	-	-	-	-

In accordance with the Annual Reports and Consolidated Annual Reports Law of the Republic of Latvia, companies are permitted to recognise deferred tax supported by justified reasons. In such cases, deferred tax should be recognised, assessed and disclosed in the financial statements in line with the International Financial Reporting Standards (IFRS) as adopted by the EU. Under IAS 12 *Income taxes*, deferred tax assets and liabilities should be recognised by applying a rate expected to be applied to retained earnings.

According to the new Law on Enterprise Income Tax of the Republic of Latvia adopted on 28 July 2017, and effective as of 1 January 2018, a 20% rate is only applied to distributed profit, while a 0% rate is expected to be applied to undistributed profits. Therefore, deferred tax assets and liabilities are recognisable as nil. This principle has been applied in the Bank's and Group's financial statements for the year ended 31 December 2017.

28 CASH AND CASH EQUIVALENTS

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Cash	4,125	4,125	4,110	4,110
Current placements with the Bank of Latvia	99,421	99,421	67,516	67,516
Demand deposits and term deposits with other credit institutions with initial maturity of less than three months	22,604	22,604	41,729	41,729
Due to credit institutions with maturity of less than three months	-	-	(5)	(5)
Total	**126,150**	**126,150**	**113,350**	**113,350**

29 INVESTMENTS IN SUBSIDIARIES

(a) Investments in subsidiaries (Group)

	Share %	
Name of subsidiary	**2017**	**2016**
MTB Finance AS	100%	100%

EUR'000	31 December 2017	31 December 2016
Investments in subsidiaries	44	44
Impairment allowance	(44)	(44)
Investment in subsidiary, net	-	-

EUR'000	Current assets	Long-term assets	Total Assets	Current liabilities	Non-current liabilities	Total liabilities	Net assets
31 December 2017	5,358	20,997	26,355	21,227	6,868	28,095	(1,740)
As at 31 December 2016	7,714	20,738	28,452	20,927	8,604	29,531	(1,079)

	Income	Expenses	Net loss
31 December 2017	1,410	(2,072)	(662)
As at 31 December 2016	733	(1,118)	(385)

On 29 December 2016, AS MTB Finance acquired the shares of MULT YATIRIM VE DANISMANLIK EMLAK TURIZM INSAAT ITHALAT IHRACAT SANAYI TICARET LIMITED SIRKETI (Company), registration No. 52424, AS MTB Finance became the sole shareholder of the company. The deal was registered on 26 January 2017. The shares were acquired in order to obtain unlimited control over the assets of the company, including 6 real estate properties located in Turkey, Antalya district, Kumluca region, Karaoz micro region, Jenica village. The control will ensure transparent and high quality maintenance and subsequent sale of these properties.

AS MTB Finance acquired the shares of the Company for TRY 10,000 by making a cash payment. In acquiring the shares, the Group incurred transaction costs of EUR 2,708 in 2017. In acquiring the shares, AS MTB Finance incurred transaction costs in 2016 of EUR 35,722.

Had the acquisition of the subsidiary taken place on 1 January 2016 the Group's operating financial results would not change significantly.

The net assets of the acquired subsidiary were as follows at the date of acquisition:

'000 EUR	Pre-acquisition carrying amount on a comparable IFRS basis	Fair value adjustment	Recognised fair value on acquisition
Assets			
Cash and due from central banks	1	1	1
Investment property	708	708	708
Other assets	24	24	24
Liabilities			
Other loans	854	854	854
Other liabilities	102	102	102
Net identifiable assets and liabilities	**(223)**	**(223)**	**(223)**
Cash (acquired)/disposed of	2	2	2
Net cash outflow/(inflow)	2	2	2

30 RELATED PARTY TRANSACTIONS

(a) Control relationships

Related parties are defined as shareholders of the Bank who have a significant holding in the Bank and spouses, parents and children of the shareholders who are natural persons, members of the Council and the Board, head of the Internal Audit Service, CRO, compliance controller and public controller, the spouses, parents and children of these persons, and companies in which they have a controlling interest. In line with Section 43 of the Credit Institution Law, risk transactions with related parties must not exceed 15% of the Bank's equity, applicable to limiting large exposures according to Regulation No 575/2013. As at 31 December 2017, the Bank did not observe this requirement and its risk transactions with related parties amounted to 20% (taking into account provision for credit risk reduction, refer to Note 11). During the reporting period, the Bank performed measures to prevent this violations, and as at the date of these financial statements, the Bank complies with the restriction.

During 2017 and 2016, all related party transactions were performed on an arm's length basis.

Subordinated liabilities to related parties as at 31 December 2017 amount to nil (2016: EUR 500 thousand). Refer to Note 17 for detailed information.

The transactions carried out with AS MTB Finance (Latvia) in the year ended 31 December 2017 were as follows:

EUR'000	2017 Bank	Average weighted rate	2016 Bank	Average weighted rate
Loans issued to AS MTB Finance	27,649	1.53%	28,691	1.59%
Deposits from AS MTB Finance	2	-	-	-

The Bank's and the Group's assets and liabilities from transactions with related parties:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Credit exposures to Other related parties, net				
Loans to customers, net				
- Management	106	106	153	153
- Consolidated subsidiaries	-	25,503	-	28,691
- Entities related to the shareholders	3,985	3,985	1,162	1,162
Credit exposures to related parties, net	**4,091**	**29,594**	**1,315**	**30,006**

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Liabilities to Other related parties				
Deposits				
- Management	730	730	1,265	1,265
- Consolidated subsidiaries	-	2	-	-
- Others	704	704	1,553	1,553
Subordinated liabilities	-	-	500	500
Trade payables to related parties	**1,434**	**1,436**	**3,318**	**3,318**

The Bank's and the Group's operating income and expenses from transactions with related parties:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Interest income				
- Management and companies related to the shareholders	18	18	16	16
- Consolidated subsidiaries	-	406	-	690
Interest expenses				
- Management	(9)	(9)	(9)	(9)
- Subordinated liabilities	-	-	(17)	(17)

The total amount of related party loans and deposits at the year end:

EUR'000	2017 Bank	Average weighted rate	2016 Bank	Average weighted rate
Deposits from AS MTB Finance and other related parties	**1,434**	**1.11%**	**3,318**	**0.57%**
Loans to other related parties				
Opening balance	1,315		1,370	
Issued loans in current year	3,013		165	
Matured loans in current year	(237)		(220)	
Loans closing balance	**4,091**	**2.30%**	**1,315**	**2.61%**

Remuneration to the Council and the Board:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Remuneration to the Council and the Board	415	415	330	330
Total	**415**	**415**	**330**	**330**

Transactions with related parties carried out in the year:

EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Interest income	18	406	16	706
Interest expenses	(9)	(9)	(26)	(26)
Total	**9**	**397**	**(10)**	**680**

31 ASSETS AND LIABILITIES UNDER TRUST MANAGEMENT

Assets EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Fiduciary loan	2,084	2,084	13,100	13,100
Total	**2,084**	**2,084**	**13,100**	**13,100**

Liabilities EUR'000	2017 Group	2017 Bank	2016 Group	2016 Bank
Funds received from individuals	500	500	500	500
Funds received from corporate customers	1,584	1,584	12,500	12,500
Total	**2,084**	**2,084**	**13,000**	**13,000**

Liabilities under trust management consist of funds of non-resident clients in the total amount of EUR 1,584 thousand and the funds of resident clients in the total amount of EUR 500 thousand.

A fiduciary loan is a transaction whereby the Bank and Group have attracted a fiduciary deposit that has been issued to a borrower specified by those depositors on behalf of the depositors and at the depositor's risk. The property owned by clients is kept under management separately from the property of the Bank and Group and is kept in separate accounts at credit institutions through which the funds are invested. Assets under management often represent a securities portfolio separated from the Bank's and the Group's assets, which is treated as a joint management object with its own structure, liquidity degree, sources of resources, yield and common risk. The Group and Bank is engaged in securities purchase and sales on behalf of their clients. Such securities are not recognized on statement of financial position of the Bank and the Group.

32 CONTINGENT LIABILITIES

At any time the Bank has outstanding commitments to extend credit. These commitments take the form of approved loans, credit card limits and overdraft facilities.

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to ten years. The Bank also provides guarantees by acting as settlement agent in securities borrowing and lending transactions

The contractual amounts of commitments are set out in the following table by category. The amounts reflected in the table for commitments assume that amounts are fully advanced. The amounts reflected in the table for guarantees and letters of credit represent the maximum exposure that would be recognised in the statement of comprehensive income if counterparties failed to honour their contracted liabilities to any extent.

	2017	2017	2016	2016
EUR'000	**Group**	**Bank**	**Group**	**Bank**
Loans and credit line liabilities	4,354	4,354	2,092	2,092
Guarantees and letters of credit	756	756	937	937
Total	**5,110**	**5,110**	**3,029**	**3,029**

33 GEOGRAPHICAL CONCENTRATION OF ASSETS, LIABILITIES, EQUITY AND CONTINGENT LIABILITIES

The geographical segmentation of the Bank's and the Group's assets, liabilities and contingent liabilities as at 31 December 2017 was as follows:

Group

31 December 2017	Latvia	OECD countries	CIS countries	Other countries	Total
Assets EUR'000					
Cash and balances due from the Bank of Latvia	102,636	-	-	910	103,546
Held-to-maturity investments	3,700	-	-	2,656	6,356
Available-for-sale financial assets	1,708	30,240	-	530	32,478
Demand deposits with credit institutions	12,292	8,326	588	223	21,429
Loans and term deposits due from credit institutions	1,175	709	-	-	1,884
Loans and advances to customers	73,873	1,511	884	1,013	77,281
Held-for-trading financial assets:	3	-	-	-	3
Intangible assets	28	-	-	-	28
Property and equipment	970	-	-	12	982
Investment properties	15,068	128	-	-	15,196
Other assets	2,602	2,318	3,052	3,701	11,673
Total assets	**214,055**	**43,232**	**4,524**	**9,045**	**270,856**

31 December 2017	Latvia	OECD countries	CIS countries	Other countries	Total
Liabilities EUR'000					
Deposits	92,833	59,545	22,571	74,473	249,422
Subordinated liabilities	-	-	3,883	1,500	5,383
Other liabilities	4,730	-	-	16	4,746
Provisions	158	-	-	13	171
Capital and reserves	11,134	-	-	-	11,134
Total equity, reserves and liabilities	**108,855**	**59,545**	**26,454**	**76,002**	**270,856**
Forecasted and contingent liabilities	**5,104**	**-**	**-**	**6**	**5,110**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

33 GEOGRAPHICAL CONCENTRATION OF ASSETS, LIABILITIES, EQUITY AND CONTINGENT LIABILITIES (CONTINUED)

Bank

31 December 2017	Latvia	OECD countries	CIS countries	Other countries	Total
Assets EUR'000					
Cash and balances due from the Bank of Latvia	102,636	-	-	910	103,546
Held-to-maturity investments	3,700	-	-	2,656	6,356
Available-for-sale financial assets	1,708	30,240	-	530	32,478
Demand deposits with credit institutions	12,292	8,326	588	223	21,429
Loans and term deposits due from credit institutions	1,175	709	-	-	1,884
Loans and advances to customers	90,587	1,511	884	1,013	93,995
Held-for-trading financial assets:	3	-	-	-	3
Intangible assets	28	-	-	-	28
Property and equipment	962	-	-	12	974
Other assets	845	1,715	3,052	3,701	9,313
Total assets	**213,936**	**42,501**	**4,524**	**9,045**	**270,006**

31 December 2017	Latvia	OECD countries	CIS countries	Other countries	Total
Liabilities EUR'000					
Deposits	92,835	59,545	22,571	74,473	249,424
Subordinated liabilities	-	-	3,883	1,500	5,383
Other liabilities	4,484	-	-	16	4,500
Provisions	155	-	-	13	168
Capital and reserves	10,531	-	-	-	10,531
Total equity, reserves and liabilities	**108,005**	**59,545**	**26,454**	**76,002**	**270,006**
Forecasted and contingent liabilities	**5,104**	**-**	**-**	**6**	**5,110**

33 GEOGRAPHICAL CONCENTRATION OF ASSETS, LIABILITIES, EQUITY AND CONTINGENT LIABILITIES (CONTINUED)

The geographical segmentation of the Bank's and the Group's assets, liabilities and contingent liabilities as at 31 December 2016 was as follows:

Group

As at 31 December 2016	Latvia	OECD countries	CIS countries	Other countries	Total
Assets EUR'000					
Cash and balances due from the Bank of Latvia	71,112	-	-	514	71,626
Held-to-maturity investments	7,805	3,825	1,945	3,387	16,962
Available-for-sale financial assets	3,101	43,816	-	6,366	53,283
Demand deposits with credit institutions	22,456	6,901	3,650	133	33,140
Loans and term deposits due from credit institutions	6,660	806	1,929	-	9,395
Loans and advances to customers	88,720	5,303	1,050	180	95,253
Held-for-trading financial assets:	2	-	-	-	2
Property and equipment	1,093	-	-	18	1,111
Investment property	15,910	-	-	-	15,910
Other assets	2,434	641	2	3,179	6,256
Total assets	**219,293**	**61,292**	**8,576**	**13,777**	**302,938**

As at 31 December 2016	Latvia	OECD countries	CIS countries	Other countries	Total
Liabilities EUR'000					
Demand deposits with credit institutions	-	5	-	-	5
Deposits	91,581	57,622	34,239	86,676	270,118
Subordinated liabilities	500	-	4,614	1,500	6,614
Other liabilities	9,973	-	-	304	10,277
Provisions	141	-	-	13	154
Deferred tax liabilities	34	-	-	-	34
Capital and reserves	15,736	-	-	-	15,736
Total equity, reserves and liabilities	**117,965**	**57,627**	**38,853**	**88,493**	**302,938**
Contingent liabilities and commitments	**2,972**	**-**	**48**	**8**	**3,028**

33 GEOGRAPHICAL CONCENTRATION OF ASSETS, LIABILITIES, EQUITY AND CONTINGENT LIABILITIES (CONTINUED)

Bank

As at 31 December 2016	Latvia	OECD countries	CIS countries	Other countries	Total
Assets EUR'000					
Cash and balances due from the Bank of Latvia	71,112	-	-	514	71,626
Held-to-maturity investments	7,805	3,825	1,945	3,387	16,962
Available-for-sale financial assets	3,101	43,816	-	6,366	53,283
Demand deposits with credit institutions	22,456	6,901	3,650	133	33,140
Loans and term deposits due from credit institutions	6,660	806	1,929	-	9,395
Loans and advances to customers	106,999	5,303	1,050	180	113,532
Held-for-trading financial assets:	2	-	-	-	2
Property and equipment	1,091	-	-	18	1,109
Other assets	307	641	2	3,179	4,129
Total assets	**219,533**	**61,292**	**8,576**	**13,777**	**303,178**

As at 31 December 2016	Latvia	OECD countries	CIS countries	Other countries	Total
Liabilities EUR'000					
Demand deposits with credit institutions	-	5	-	-	5
Deposits	91,581	57,622	34,239	86,676	270,118
Subordinated liabilities	500	-	4,614	1,500	6,614
Other liabilities	9,283	-	-	304	9,587
Provisions	139	-	-	13	152
Deferred tax liabilities	34	-	-	-	34
Capital and reserves	16,668	-	-	-	16,668
Total equity, reserves and liabilities	**118,205**	**57,627**	**38,853**	**88,493**	**303,178**
Contingent liabilities and commitments	**2,972**	**-**	**48**	**8**	**3,028**

34 INTEREST RATE REPRICING ANALYSIS

The interest rate repricing analysis of the Bank's and the Group's assets and liabilities as at 31 December 2017 was as follows:

Group

EUR'000	Less than 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Not sensitive to changes in interest rates	Total
Financial assets								
Cash and balances due from the Bank of Latvia	99,421	-	-	-	-	-	4,125	103,546
Demand deposits with credit institutions	21,429	-	-	-	-	-	-	21,429
Held-to-maturity assets	-	2,412	-	-	3,944	-	-	6,356
Available-for-sale financial assets	-	8,352	21,605	530	1,708	-	283	32,478
Loans and advances to customers	10,370	9,268	27,699	16,129	13,533	258	4	77,281
Loans and term deposits due from credit institutions	758	417	709	-	-	-	-	1,884
Held-for-trading securities	-	-	-	-	-	-	3	3
Other financial assets	-	-	-	-	-	-	11,509	11,509
Total financial assets	**131,978**	**20,449**	**50,013**	**16,659**	**19,205**	**258**	**15,924**	**254,486**
Financial liabilities								
Deposits	204,832	4,852	8,371	16,546	14,821	-	-	249,422
Subordinated liabilities	-	-	285	1,900	2,491	707	-	5,383
Other financial liabilities	-	-	-	-	-	-	3,537	3,537
Total financial liabilities	**204,832**	**4,852**	**8,656**	**18,446**	**17,312**	**707**	**3,537**	**258,342**
Interest rate risk	**(72,854)**	**15,597**	**41,357**	**(1,787)**	**1,893**	**(449)**	**12,387**	**(3,856)**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

34 INTEREST RATE REPRICING ANALYSIS (CONTINUED)

Bank

EUR'000	Less than 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Not sensitive to changes in interest rates	Total
Financial assets								
Cash and balances due from the Bank of Latvia	99,421	-	-	-	-	-	4,125	103,546
Demand deposits with credit institutions	21,429	-	-	-	-	-	-	21,429
Held-to-maturity assets	-	2,412	-	-	3,944	-	-	6,356
Available-for-sale financial assets	-	8,352	21,605	530	1,708	-	283	32,478
Loans and advances to customers	10,136	10,711	27,205	30,089	13,233	2,621	-	93,995
Loans and term deposits due from credit institutions	758	417	709	-	-	-	-	1,884
Held-for-trading securities	-	-	-	-	-	-	3	3
Other financial assets	-	-	-	-	-	-	9,175	9,175
Total financial assets	**131,744**	**21,892**	**49,519**	**30,619**	**18,885**	**2,621**	**13,586**	**268,866**
Financial liabilities								
Deposits	204,834	4,852	8,371	16,546	14,821	-	-	249,424
Subordinated liabilities	-	-	285	1,900	2,491	707	-	5,383
Other financial liabilities	-	-	-	-	-	-	3,537	3,537
Total financial liabilities	**204,834**	**4,852**	**8,656**	**18,446**	**17,312**	**707**	**3,537**	**258,344**
Interest rate risk	**(73,090)**	**17,040**	**40,863**	**12,173**	**1,573**	**1,914**	**10,049**	**10,522**

34 INTEREST RATE REPRICING ANALYSIS (CONTINUED)

The interest rate repricing analysis of the Group's and the Bank's assets and liabilities as at 31 December 2016 was as follows:

Group

EUR'000	Less than 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Not sensitive to changes in interest rates	Total
Financial assets								
Cash and balances due from the Bank of Latvia	67,516	-	-	-	-	-	4,110	71,626
Demand deposits with credit institutions	33,140	-	-	-	-	-	-	33,140
Held-to-maturity assets	-	5,829	297	3,826	7,010	-	-	16,962
Available-for-sale financial assets	-	1,459	-	27,389	24,215	-	220	53,283
Loans (adjusted)	4,304	16,423	27,906	16,439	25,645	4,536	-	95,253
Loans and term deposits due from credit institutions	8,115	474	806	-	-	-	-	9,395
Held-for-trading securities	-	-	-	-	-	-	2	2
Other financial assets	-	-	-	-	-	-	5,739	5,739
Total financial assets	**113,075**	**24,185**	**29,009**	**47,654**	**56,870**	**4,536**	**10,071**	**285,400**
Financial liabilities								
Demand deposits with credit institutions	5	-	-	-	-	-		5
Deposits	217,981	4,438	6,574	14,973	14,560	-	11,592	270,118
Subordinated liabilities	500	-	-	1,722	4,112	280	-	6,614
Other financial liabilities	-	-	-	-	-	-	9,551	9,551
Total financial liabilities	**218,486**	**4,438**	**6,574**	**16,695**	**18,672**	**280**	**21,143**	**286,288**
Interest rate risk	**(105,411)**	**19,747**	**22,435**	**30,959**	**38,198**	**4,256**	**(11,072)**	**(888)**

34 INTEREST RATE REPRICING ANALYSIS (CONTINUED)

Bank

EUR'000	Less than 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 5 years	Over 5 years	Not sensitive to changes in interest rates	Total
Financial assets								
Cash and balances due from the Bank of Latvia	67,516	-	-	-	-	-	4,110	71,626
Demand deposits with credit institutions	33,140	-	-	-	-	-	-	33,140
Held-to-maturity assets	-	5,829	297	3,826	7,010	-	-	16,962
Available-for-sale financial assets	-	1,459	-	27,389	24,215	-	220	53,283
Loans (adjusted)	4,244	18,012	27,324	29,483	28,961	5,508	-	113,532
Loans and term deposits due from credit institutions	8,115	474	806	-	-	-	-	9,395
Held-for-trading securities	-	-	-	-	-	-	2	2
Other financial assets	-	-	-	-	-	-	3,978	3,978
Total financial assets	**113,015**	**25,774**	**28,427**	**60,698**	**60,186**	**5,508**	**8,310**	**301,918**
Financial liabilities								
Demand deposits with credit institutions	5	-	-	-	-	-	-	5
Deposits	217,981	4,438	6,574	14,973	14,560	-	11,592	270,118
Subordinated liabilities	500	-	-	1,722	4,112	280	-	6,614
Other financial liabilities	-	-	-	-	-	-	9,551	9,551
Total financial liabilities	**218,486**	**4,438**	**6,574**	**16,695**	**18,672**	**280**	**21,143**	**286,288**
Interest rate risk	**(105,471)**	**21,336**	**21,853**	**44,003**	**41,514**	**5,228**	**(12,833)**	**15,630**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

34 INTEREST RATE REPRICING ANALYSIS (CONTINUED)

Sensitivity analysis

The following demonstrates the sensitivity to reasonably possible changes in interest rates of the Bank's statement of comprehensive income. The analysis assumes that all other variables, in particular foreign currency rates, remain constant.

The sensitivity of statement of comprehensive income is the effect of the assumed changes in the interest rates on the net interest income for one year, following the reporting period end date, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2017 and 31 December 2016.

Sensitivity of the Group's profit and loss to changes in interest rates is not disclosed separately as it does not differ significantly from that of the Bank.

An increase and decrease of interest rates by 100 basis points would result in the following change to the statement of comprehensive income and equity:

EUR'000	2017		2016	
	Profit or loss	Shareholders' equity	Profit or loss	Shareholders' equity
Increase in interest rates	(253)	(156)	(231)	(626)
Decrease in interest rates	253	158	231	644
Increase in USD interest rates	(116)	(153)	(47)	(347)
Decrease in USD interest rates	116	155	47	347

35 FINANCIAL ASSETS AND LIABILITIES BY TYPES

Group 31 December 2017

EUR'000	Held-to-maturity investments	Financial assets and liabilities designated at fair value through profit or loss	Financial assets and liabilities designated at fair value through other comprehensive income	Loans and receivables	Liabilities measured at amortised cost	Total
Financial assets						
Cash and balances due from the Bank of Latvia	-	-	-	103,546	-	**103,546**
Demand deposits with credit institutions	-	-	-	21,429	-	**21,429**
Held-to-maturity investments	6,356	-	-	-	-	**6,356**
Available-for-sale financial assets	-	-	32,478	-	-	**32,478**
Loans and receivables	-	-	-	79,165		**79,165**
Held-for-trading securities	-	3	-	-	-	**3**
Other financial assets	-	-	-	11,509	-	**11,509**
Total financial assets	**6,356**	**3**	**32,478**	**215,649**	**-**	**254,486**
Financial liabilities						
Deposits	-	-	-	-	249,422	**249,422**
Subordinated liabilities	-	-	-	-	5,383	**5,383**
Other financial liabilities	-	-	-	-	3,537	**3,537**
Total financial liabilities	**-**	**-**	**-**	**-**	**258,342**	**258,342**

35 FINANCIAL ASSETS AND LIABILITIES BY TYPES (CONTINUED)

Bank 31 December 2017

EUR'000	Held-to-maturity investments	Financial assets and liabilities designated at fair value through profit or loss	Financial assets and liabilities designated at fair value through other comprehensive income	Loans and receivables	Liabilities measured at amortised cost	Total
Financial assets						
Cash and balances due from the Bank of Latvia	-	-	-	103,546	-	**103,546**
Demand deposits with credit institutions	-	-	-	21,429	-	**21,429**
Held-to-maturity investments	6,356	-	-	-	-	**6,356**
Available-for-sale financial assets	-	-	32,478	-	-	**32,478**
Loans and receivables	-	-	-	95,879		**95,879**
Held-for-trading securities	-	3	-	-	-	**3**
Other financial assets	-	-	-	9,175	-	**9,175**
Total financial assets	**6,356**	**3**	**32,478**	**230,029**	**-**	**268,866**
Financial liabilities						
Deposits	-	-	-	-	249,424	**249,424**
Subordinated liabilities	-	-	-	-	5,383	**5,383**
Other financial liabilities	-	-	-	-	3,537	**3,537**
Total financial liabilities	**-**	**-**	**-**	**-**	**258,344**	**258,344**

35 FINANCIAL ASSETS AND LIABILITIES BY TYPES (CONTINUED)

Group 31 December 2016

EUR'000	Held-to-maturity investments	Financial assets and liabilities designated at fair value through profit or loss	Financial assets and liabilities designated at fair value through other comprehensive income	Loans and receivables	Liabilities measured at amortised cost	Total
Financial assets						
Cash and balances due from the Bank of Latvia	-	-	-	71,626	-	**71,626**
Demand deposits with credit institutions	-	-	-	33,140	-	**33,140**
Held-to-maturity investments	16,962	-	-	-	-	**16,962**
Available-for-sale financial assets	-	-	53,283	-	-	**53,283**
Loans and receivables	-	-	-	104,648		**104,648**
Held-for-trading financial assets:	-	2	-	-	-	**2**
Other financial assets	-	-	-	5,739	-	**5,739**
Total financial assets	**16,962**	**2**	**53,283**	**215,153**	**-**	**285,400**
Financial liabilities						
Demand deposits with credit institutions	-	-	-	-	5	**5**
Deposits	-	-	-	-	270,118	**270,118**
Subordinated liabilities	-	-	-	-	6,614	**6,614**
Other financial liabilities	-	-	-	-	9,551	**9,551**
Total financial liabilities	**-**	**-**	**-**	**-**	**286,288**	**286,288**

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

35 FINANCIAL ASSETS AND LIABILITIES BY TYPES (CONTINUED)

Bank 31 December 2016

EUR'000	Held-to-maturity investments	Financial assets and liabilities designated at fair value through profit or loss	Financial assets and liabilities designated at fair value through other comprehensive income	Loans and receivables	Liabilities measured at amortised cost	Total
Financial assets						
Cash and balances due from the Bank of Latvia	-	-	-	71,626	-	**71,626**
Demand deposits with credit institutions	-	-	-	33,140	-	**33,140**
Held-to-maturity investments	16,962	-	-	-	-	**16,962**
Available-for-sale financial assets	-	-	53,283	-	-	**53,283**
Held-for-trading financial assets:	-	-	-	122,927		**122,927**
Loans and receivables	-	2	-	-	-	**2**
Other financial assets	-	-	-	3,978	-	**3,978**
Total financial assets	**16,962**	**2**	**53,283**	**231,671**	**-**	**301,918**
Financial liabilities						
Demand deposits with credit institutions	-	-	-	-	5	**5**
Deposits	-	-	-	-	270,118	**270,118**
Subordinated liabilities	-	-	-	-	6,614	**6,614**
Other financial liabilities	-	-	-	-	9,551	**9,551**
Total financial liabilities	**-**	**-**	**-**	**-**	**286,288**	**286,288**

36 CURRENCY ANALYSIS

The Bank and the Group actively controls foreign exchange open positions. The Bank operates based on the Law on Credit Institutions stating that the open position in any currency should not exceed 10% of shareholders' equity and that the total open position should not exceed 20% of the shareholders' equity.

The currency analysis of the Group's and the Bank's expected and contingent liabilities as at 31 December 2017 was as follows:

Group

	EUR	USD	Others	Total
31 December 2017	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**
Financial assets				
Cash and balances due from the Bank of Latvia	102,636	495	415	103,546
Demand deposits with credit institutions	2,826	15,561	3,042	21,429
Held-to-maturity investments	3,168	3,188	-	6,356
Available-for-sale financial assets	530	31,948	-	32,478
Loans and advances to customers	74,386	2,895	-	77,281
Loans and term deposits due from credit institutions	-	1,884	-	1,884
Held-for-trading financial assets:	3	-	-	3
Other financial assets	10,646	809	54	11,509
Total financial assets	**194,195**	**56,780**	**3,511**	**254,486**
Financial liabilities				
Deposits	162,069	80,743	6,610	249,422
Subordinated liabilities	5,383	-	-	5,383
Other financial liabilities	2,668	710	159	3,537
Total financial liabilities	**170,120**	**81,453**	**6,769**	**258,342**
Net open position in the statement of financial position	24,075	(24,673)	(3,258)	(3,856)
Net position arising from currency exchange transactions	(27,447)	23,997	3,450	-
Total net open position	**(3,372)**	**(676)**	**192**	**(3,856)**

36 CURRENCY ANALYSIS (CONTINUED)

Bank

31 December 2017	EUR EUR'000	USD EUR'000	Others EUR'000	Total EUR'000
Financial assets				
Cash and balances due from the Bank of Latvia	102,636	495	415	103,546
Demand deposits with credit institutions	2,826	15,561	3,042	21,429
Held-to-maturity investments	3,168	3,188	-	6,356
Available-for-sale financial assets	530	31,948	-	32,478
Loans and advances to customers	90,588	3,407	-	93,995
Loans and term deposits due from credit institutions	-	1,884	-	1,884
Held-for-trading financial assets:	3	-	-	3
Other financial assets	8,312	809	54	9,175
Total financial assets	**208,063**	**57,292**	**3,511**	**268,866**
Financial liabilities				
Deposits	162,071	80,743	6,610	249,424
Subordinated liabilities	5,383	-	-	5,383
Other financial liabilities	2,668	710	159	3,537
Total financial liabilities	**170,122**	**81,453**	**6,769**	**258,344**
Net open position in the statement of financial position	37,941	(24,161)	(3,258)	10,522
Net position arising from currency exchange transactions	(27,447)	23,997	3,450	-
Total net open position	**10,494**	**(164)**	**192**	**10,522**

The geographical segmentation of the Bank's and the Group's assets, liabilities and contingent liabilities as at 31 December 2016 was as follows:

Group

As at 31 December 2016	EUR EUR'000	USD EUR'000	Others EUR'000	Total EUR'000
Financial assets				
Cash and balances due from the Bank of Latvia	70,322	1,007	297	71,626
Demand deposits with credit institutions	1,157	29,028	2,955	33,140
Held-to-maturity investments	3,577	13,385	-	16,962
Available-for-sale financial assets	9,771	43,512	-	53,283
Loans and advances to customers	88,286	6,967	-	95,253
Loans and term deposits due from credit institutions	-	1,992	7,403	9,395
Held-for-trading financial assets:	2	-	-	2
Other financial assets	4,909	725	105	5,739
Total financial assets	**178,024**	**96,616**	**10,760**	**285,400**
Financial liabilities				
Demand deposits with credit institutions	5	-	-	5
Deposits	167,766	91,952	10,400	270,118
Subordinated liabilities	6,614	-	-	6,614
Other financial liabilities	3,337	6,173	41	9,551
Total financial liabilities	**177,722**	**98,125**	**10,441**	**286,288**
Net open position in the statement of financial position	302	(1,509)	319	(888)
Net position arising from currency exchange transactions	(272)	288	(16)	-
Total net open position	**30**	**(1,221)**	**303**	**(888)**

36 CURRENCY ANALYSIS (CONTINUED)

Bank

As at 31 December 2016	EUR EUR'000	USD EUR'000	Others EUR'000	Total EUR'000
Financial assets				
Cash and balances due from the Bank of Latvia	70,322	1,007	297	71,626
Demand deposits with credit institutions	1,157	29,028	2,955	33,140
Held-to-maturity investments	3,577	13,385	-	16,962
Available-for-sale financial assets	9,771	43,512	-	53,283
Loans and advances to customers	105,904	7,628	-	113,532
Loans and term deposits due from credit institutions	-	1,992	7,403	9,395
Held-for-trading financial assets:	2	-	-	2
Other financial assets	3,148	725	105	3,978
Total financial assets	**193,881**	**97,277**	**10,760**	**301,918**
Financial liabilities				
Demand deposits with credit institutions	5	-	-	5
Deposits	167,766	91,952	10,400	270,118
Subordinated liabilities	6,614	-	-	6,614
Other financial liabilities	3,337	6,173	41	9,551
Total financial liabilities	**177,722**	**98,125**	**10,441**	**286,288**
Net open position in the statement of financial position	16,159	(848)	319	15,630
Net position arising from currency exchange transactions	(272)	288	(16)	-
Total net open position	**15,887**	**(560)**	**303**	**15,630**

An analysis of sensitivity of the Group's and Bank's net income for the year and equity to changes in the foreign currency exchange rates based on positions existing as at 31 December 2017 and 2016 and a simplified scenario of a 10% change in USD to EUR exchange rates is as follows:

Group

EUR'000	2017 Net profit	2016 Net profit
10% appreciation of USD against EUR	1	(136)
10% depreciation of USD against EUR	(1)	136

Bank

EUR'000	2017 Net profit	2016 Net profit
10% appreciation of USD against EUR	5	(62)
10% depreciation of USD against EUR	(5)	62

37 MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The below amounts represent the assets and liabilities grouped by residual maturity.

The Finance Operation Department based on its liquidity management policy manages liquidity risk. All departments whose operations affect the liquidity of the Bank and the Groupare involved in liquidity management. The structure of assets/liabilities and the difference between them are calculated in order to carry out liquidity control. Liquidity is largely managed by using monetary instruments.

The Bank is active in managing its net liquidity position by means of:

- reducing maturities of assets, including by maintaining large balances on correspondent accounts or interbank overnight deposits and by investing funds in highly liquid debt securities in the available-for-sale portfolio or in highly liquid debt securities in the held-to-maturity portfolio, which are accepted as collateral by the ECB or other market players.
- increasing maturities of liabilities by attracting term deposits.

The Bank approves limits on net liquidity positions in general, as well as in EUR and USD.

As at 31 December 2017 and 31 December 2016 the individual liquidity coverage ratio for the Bank was 661% and 936%, respectively, and for the Group it was 658% and 896%, respectively.

The maturity analysis of the Bank's and the Group's assets and liabilities as at 31 December 2017 was as follows:

Group

31 December 2017	Up to 1 month including EUR'000	1 to 3 months EUR'000	3 to 6 months EUR'000	6 to 12 months EUR'000	More than 1 year EUR'000	Over 5 years or not determined EUR'000	Total EUR'000
Financial assets							
Cash and balances due from the Bank of Latvia	103,546	-	-	-	-	-	103,546
Demand deposits with credit institutions	21,429	-	-	-	-	-	21,429
Held-to-maturity investments	-	2,412	-	-	3,944	-	6,356
Available-for-sale financial assets	32,195	-	-	-	-	283	32,478
Loans and term deposits due from credit institutions	758	417	-	-	709	-	1,884
Loans and advances to customers	5,186	3,214	11,649	20,424	24,282	12,526	77,281
Held-for-trading financial assets:	-	-	-	-	-	3	3
Other financial assets	11,509	-	-	-	-	-	11,509
Total financial assets	**174,623**	**6,043**	**11,649**	**20,424**	**28,935**	**12,812**	**254,486**
Financial liabilities							
Deposits	193,238	4,923	8,381	16,572	14,982	11,326	249,422
Subordinated liabilities	-	-	285	1,900	2,491	707	5,383
Other financial liabilities	3,496	-	-	-	41	-	3,537
Total financial liabilities	**196,734**	**4,923**	**8,666**	**18,472**	**17,514**	**12,033**	**258,342**
Liquidity risk	**(22,111)**	**1,120**	**2,983**	**1,952**	**11,421**	**779**	**(3,856)**

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37 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

Bank

31 December 2017	Up to 1 month including EUR'000	1 to 3 months EUR'000	3 to 6 months EUR'000	6 to 12 months EUR'000	More than 1 year EUR'000	Over 5 years or not determined EUR'000	Total EUR'000
Financial assets							
Cash and balances due from the Bank of Latvia	103,546	-	-	-	-	-	103,546
Demand deposits with credit institutions	21,429	-	-	-	-	-	21,429
Held-to-maturity investments	-	2,412	-	-	3,944	-	6,356
Investments classified as available for sale	32,195	-	-	-	-	283	32,478
Loans and term deposits due from credit institutions	758	417	-	-	709	-	1,884
Loans and advances to customers	5,544	4,654	11,265	35,046	24,962	12,524	93,995
Held-for-trading financial assets:	-	-	-	-	-	3	3
Other financial assets	9,175	-	-	-	-	-	9,175
Total financial assets	**172,647**	**7,483**	**11,265**	**35,046**	**29,615**	**12,810**	**268,866**
Financial liabilities							
Deposits	193,240	4,923	8,381	16,572	14,982	11,326	249,424
Subordinated liabilities	-	-	285	1,900	2,491	707	5,383
Other financial liabilities	3,496	-	-	-	41	-	3,537
Total financial liabilities	**196,736**	**4,923**	**8,666**	**18,472**	**17,514**	**12,033**	**258,344**
Liquidity risk	**(24,089)**	**2,560**	**2,599**	**16,574**	**12,101**	**777**	**10,522**

37 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

The maturity analysis of the Bank's assets and liabilities as at 31 December 2016 was as follows:

Group

	Up to 1 month including	1 to 3 months	3 to 6 months	6 to 12 months	More than 1 year	Over 5 years or not determined	Total
As at 31 December 2016	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**
Financial assets							
Cash and balances due from the Bank of Latvia	71,626	-	-	-	-	-	71,626
Demand deposits with credit institutions	33,140	-	-	-	-	-	33,140
Held-to-maturity investments	-	5,829	297	3,826	7,010	-	16,962
Available-for-sale financial assets	53,063	-	-	-	-	220	53,283
Loans and term deposits due from credit institutions	8,115	474	806	-	-	-	9,395
Loans and advances to customers	2,865	4,469	5,663	25,474	47,356	9,426	95,253
Held-for-trading financial assets:	-	-	-	-	-	2	2
Other financial assets	3,519	-	-	-	2,220	-	5,739
Total financial assets	**172,328**	**10,772**	**6,766**	**29,300**	**56,586**	**9,648**	**285,400**
Financial liabilities							
Demand deposits with credit institutions	5	-	-	-	-	-	5
Deposits	217,981	4,438	6,574	14,973	14,560	11,592	270,118
Subordinated liabilities	500	-	-	1,722	4,112	280	6,614
Other financial liabilities	9,551	-	-	-	-	-	9,551
Total financial liabilities	**228,037**	**4,438**	**6,574**	**16,695**	**18,672**	**11,872**	**286,288**
Liquidity risk	**(55,709)**	**6,334**	**192**	**12,605**	**37,914**	**(2,224)**	**(888)**

37 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

Bank

	Up to 1 month including	1 to 3 months	3 to 6 months	6 to 12 months	More than 1 year	Over 5 years or not determined	Total
As at 31 December 2016	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**	**EUR'000**
Financial assets							
Cash and balances due from the Bank of Latvia	71,626	-	-	-	-	-	71,626
Demand deposits with credit institutions	33,140	-	-	-	-	-	33,140
Held-to-maturity investments	-	5,829	297	3,826	7,010	-	16,962
Available-for-sale financial assets	53,063	-	-	-	-	220	53,283
Loans and term deposits due from credit institutions	8,115	474	806	-	-	-	9,395
Loans and advances to customers	2,809	5,057	5,080	42,942	45,960	11,684	113,532
Held-for-trading financial assets:	-	-	-	-	-	2	2
Other financial assets	3,978	-	-	-	-	-	3,978
Total financial assets	**172,731**	**11,360**	**6,183**	**46,768**	**52,970**	**11,906**	**301,918**
Financial liabilities							
Demand deposits with credit institutions	5	-	-	-	-	-	5
Deposits	217,981	4,438	6,574	14,973	14,560	11,592	270,118
Subordinated liabilities	500	-	-	1,722	4,112	280	6,614
Other financial liabilities	9,551	-	-	-	-	-	9,551
Total financial liabilities	**228,037**	**4,438**	**6,574**	**16,695**	**18,672**	**11,872**	**286,288**
Liquidity risk	**(55,306)**	**6,922**	**(391)**	**30,073**	**34,298**	**34**	**15,630**

37 MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

Analysis of financial liabilities' contractual undiscounted cash flows.

The table below presents the cash flows payable by the Bank under both non-derivative and derivative financial liabilities by remaining contractual maturities as at 31 December 2017 and 2016.

The amounts disclosed in the table are the contractual undiscounted cash flows in comparison with carrying amounts of financial liabilities, comprising discounted cash flows as at the reporting date.

The Group analysis of financial liabilities' contractual undiscounted cash flows has not been presented as the differences to the Bank analysis are insignificant.

31 December 2017	Carrying amount	Gross nominal out flow	Less than 1 month	1 – 3 months	3 months to 1 year	1-5 years	Over 5 years
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Deposits	(249,424)	(250,744)	(208,894)	(4,989)	(27,537)	(9,324)	-
Subordinated liabilities	(5,383)	(5,383)	-	-	(2,185)	(2,491)	(707)
Other financial liabilities	(3,537)	(3,537)	(3,537)	-	-	-	-
Total non-derivative financial liabilities	**(258,344)**	**(259,664)**	**(212,431)**	**(4,989)**	**(29,722)**	**(11,815)**	**(707)**
Loans and credit line liabilities	(4,354)	(4,354)	(4,354)	-	-	-	-
Guarantees and letters of credit	(756)	(756)	(6)	-	(709)	(41)	-
Total financial liabilities	**(263,454)**	**(264,774)**	**(216,791)**	**(4,989)**	**(30,431)**	**(11,856)**	**(707)**

As at 31 December 2016	Carrying amount	Gross nominal inflow / (outflow)	Less than 1 month	1 – 3 months	3 months to 1 year	1-5 years	Over 5 years
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Non-derivative financial liabilities							
Demand deposits with credit institutions	(5)	(5)	(5)	-	-	-	-
Deposits	(270,118)	(271,274)	(225,974)	(4,407)	(21,923)	(18,970)	-
Subordinated liabilities	(6,614)	(7,539)	(505)	(65)	(1,905)	(4,769)	(295)
Other financial liabilities	(9,551)	(9,551)	(9,551)	-	-	-	-
Total non-derivative financial liabilities	**(286,288)**	**(288,369)**	**(236,035)**	**(4,472)**	**(23,828)**	**(23,739)**	**(295)**
Loans and credit line liabilities	(2,091)	(2,091)	(2,091)	-	-	-	-
Guarantees and letters of credit	(937)	(937)	-	(15)	(116)	(806)	-
Total financial liabilities	**(289,316)**	**(291,397)**	**(238,126)**	**(4,487)**	**(23,944)**	**(24,545)**	**(295)**

38 CAPITAL ADEQUACY

The capital requirement for the Bank and the Group is set and monitored by the Financial and Capital Market Commission.

Capital is defined by the Bank and the Group as items defined by statutory regulation as capital. Under the current capital requirements set by Financial and Capital Market Commission, banks must maintain a ratio of capital to risk weighted assets ("statutory capital ratio") above the prescribed minimum level. Furthermore, according to Section 35.25 of the Credit Institution Law, the Bank is required to ensure that its Tier 1 basic capital is sufficient to meet the total capital buffer requirement which given the provisions of Section 35.3(1) of the Credit Institution Law is comprised of a capital conservation buffer of 2.5% of total exposures calculated according to Article 92(3) of the Regulation and, as required in Section 35.4(1) of the Credit Institutions Law, of the specific countercyclical capital buffer (CCyB) calculated by multiplying the total value of exposures as required by Article 92(3) of the Regulation and the CCyB rate specific for the particular credit institution.

As at 31 December 2017 the individual minimum level is 10.2% which is increased by the total capital buffer requirement of 2.5% calculated as the sum of the capital buffer and the countercyclical capital buffer specific for the particular credit institution (31 December 2016: 10.2% which is increased by the total capital buffer requirement of 2.5% calculated as the sum of the capital buffer and the countercyclical capital buffer specific for the particular credit institution).

In the reporting year ended 31 December 2017, the actual capital adequacy ratio of the Bank and the Group was below the individual capital adequacy ratio set by the FCMC. In the reporting years ended 31 December 2016, the actual capital adequacy ratio of the Bank and the Group was above the individual capital adequacy ratio set by the FCMC, excluding capital conservation buffer.

In order to achieve compliance with the total capital reserve requirements under Sections 35.26 to 35.32 of the Credit Institution Law the Bank takes measures to strenghthen capital as described in Note 43.

The following table shows the composition of the Group's capital position as at 31 December 2017 and 31 December 2016:

	31 December 2017 EUR'000	31 December 2016 EUR'000
Tier 1		
Share capital	15,651	15,651
Share premium	260	260
Reserve capital	4,155	4,155
Retained earnings/(accumulated loss) carried forward from previous years	(4,237)	581
Profit/ (loss) for the reporting year	(5,677)	(4,818)
Revaluation reserve of AFS other financial assets	18	(103)
Additional value adjustment	(1)	(2)
Intangible assets	(28)	-
Total Tier 1 capital	**10,141**	**15,724**
Tier 2 capital		
Subordinated capital (unamortised part)	2,290	2,096
Total Tier 2 capital	**2,290**	**2,096**
Statutory deductions from Tier 1 and Tier 2 capital	**(320)**	**(712)**
Total shareholders' equity	**12,111**	**17,108**
Risk weighted value of exposures to credit risk, counterparty credit risk, impairment of recoverable amounts and unpaid deliveries risk	109,143	133,047
Total exposure to position risk, foreign currency risk and commodity risk	927	317
Total exposure to operational risk	17,134	15,863
Total risk exposure	**127,204**	**149,227**
Total capital adequacy ratio	**9.52%**	**11.46%**
Minimum capital adequacy ratio set by the FCMC	**10.20%**	**10.20%**
Minimum capital adequacy ratio set by the FCMC including the total reserve requirement	**12.70%**	**12.70%**

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The following table shows the composition of the Bank's capital position as at 31 December 2017 and 31 December 2016:

	31 December 2017 EUR'000	31 December 2016 EUR'000
Tier 1		
Share capital	15,651	15,651
Share premium	260	260
Reserve capital	4,155	4,155
Retained earnings of the previous years	(3,305)	906
Profit/ (loss) for the reporting year	(7,212)	(4,211)
Revaluation reserve of AFS other financial assets	17	(103)
Additional value adjustment	(1)	(2)
Intangible assets	(28)	
Total Tier 1 capital	**9,537**	**16,656**
Tier 2 capital		
Subordinated capital (unamortised part)	2290	2,096
Total Tier 2 capital	**2290**	**2,096**
Statutory deductions from Tier 1 and Tier 2 capital	**(320)**	**(712)**
Total shareholders' equity	**11,507**	**18,040**
Risk weighted value of exposures to credit risk, counterparty credit risk, impairment of recoverable amounts and unpaid deliveries risk	107,927	132,403
Total exposure to position risk, foreign currency risk and commodity risk	298	317
Total exposure to operational risk	17,055	15,761
Total risk exposure	**125,280**	**148,481**
Total capital adequacy ratio	**9.18%**	**12.15%**
Minimum capital adequacy ratio set by the FCMC	**10.20%**	**10.20%**
Minimum capital adequacy ratio set by the FCMC including the total reserve requirement	**12.70%**	**12.70%**

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses. The additional value adjustment was calculated according to the simplified approach based on Commission Delegated Regulation (EU) 2016/101.

Capital adequacy ratio fully loaded by the Bank and the Group (i.e., without applying transitional regulations):

	31 December 2017 EUR'000	31 December 2017 EUR'000
	Bank	**Group**
Tier 1 capital, fully loaded	7,638	8,242
Tier 2 capital	2,290	2,290
Statutory deductions from Tier 1 and Tier 2 capital	(320)	(320)
Total capital, fully loaded	**9,608**	**10,212**
Total risk exposure amount, fully loaded	**123,539**	**125,463**
Capital adequacy ratio, fully loaded	**7,78%**	**8,14%**

39 MAXIMUM CREDIT RISK EXPOSURE

The table below shows the maximum credit risk for the components of the statement of the financial position, including derivatives. Credit risk exposure is disclosed based on subjected to credit risk net carrying amount of statement of financial position items less doubtful loans and receivables.

The maximum credit exposures are shown gross, i.e. without taking into account any pledges and collaterals. Detailed information on the type and amount of collateral is presented in the respective notes.

The maximum credit risk exposure for the Group is not disclosed as it does not differ significantly from that of the Bank.

	Maximum credit exposure	
	2017	**2016**
Balances with the Bank of Latvia	99,421	67,516
Demand deposits with credit institutions	21,429	33,140
Held-to-maturity investments	6,356	16,962
Investments classified as available for sale	32,478	53,283
Loans and term deposits due from credit institutions	1,884	9,395
Loans and advances to customers	93,995	113,532
Held-for-trading financial assets:	3	2
Other financial assets	9,175	3,978
Total items of the statement of financial position subjected to credit risk	**264,741**	**297,808**
Loans and credit line liabilities	4,354	2,091
Guarantees and letters of credit	756	937
Forecasted and contingent liabilities	**5,110**	**3,028**
Total maximum credit risk exposure	**269,851**	**300,836**

As it is shown above, 35 % from total gross maximum credit risk amount refers to loans and receivables (2016: 38%).

40 FAIR VALUE OF FINANCIAL INSTRUMENTS

(a) Financial instruments measured at fair value

The table below analyses the financial instruments of the Bank and the Group measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised.

2017	Level 1: EUR'000	Level 2: EUR'000	Level 3: EUR'000	Total EUR'000
Investments classified as available for sale	32,478	-	-	32,478
Held-for-trading financial assets	3	-	-	3
Total	**32,481**	-	-	**32,481**
2016				
Financial assets				
Investments classified as available for sale	53,283	-	-	53,283
Held-for-trading financial assets	2	-	-	2
	53,285	-	-	**53,285**

(b) Financial instruments not measured at fair value

The table below analyses the fair values of the financial instruments of the Bank other than measured at fair value by the level in the fair value hierarchy into which each fair value measurement is categorised. The fair values of the financial instruments of the Group other than measured at fair value are not disclosed as they do not differ significantly from those of the Bank.

31 December 2017	Level 1: EUR'000	Level 2: EUR'000	Level 3: EUR'000	Total fair value EUR'000	Total carrying amount EUR'000
Financial assets					
Cash and due from central banks	-	-	-	103,546	103,546
Demand deposits with credit institutions	-	-	21,429	21,429	21,429
Loans and advances to customers	-	-	95,879	95,879	95,879
Held to maturity financial instruments	6,597	-	-	6,597	6,356
Other financial assets	-	-	9,175	9,175	9,175
Financial liabilities					
Deposits	-	-	249,424	249,424	249,424
Other loans	-	-	5,383	5,383	5,383
Other liabilities	-	-	3,537	3,537	3,537
As at 31 December 2016					
Financial assets					
Cash and due from central banks	-	-	-	71,626	71,626
Demand deposits with credit institutions	-	-	33,140	33,140	33,140
Loans and advances to customers	-	-	122,927	122,927	122,927
Held to maturity financial instruments	17,345	-	-	17,345	16,962
Other financial assets	-	-	3,978	3,978	3,978
Financial liabilities					
Deposits and balances due to financial institutions	-	-	-	5	5
Deposits	-	-	270,118	270,118	270,118
Other loans	-	-	6,614	6,614	6,614
Other liabilities	-	-	9,551	9,551	9,551

42 LITIGATION

In the ordinary course of business the Bank and the Group are subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints, will not have a material adverse effect on the financial conditions of the results of future operations of the Group or the Bank.

43 GOING CONCERN

As disclosed in Note 38, in the year ended 31 December 2017, the Bank and the Group were not in compliance with the individual capital adequacy ratio set by the regulator. Also, the situation as at the end of the period made the Group's and the Bank's capital adequacy ratio substantially sensitive to any possible additional decrease in capital.

According to Note 44, events in the Latvian financial market resulting in the termination of operation of one of the largest Latvian banks provoked wide response and adversely affected reputation of the Latvian financial sector. In the 2nd quarter of 2018, amendments were introduced in regulations to prohibit servicing the so-call 'shell arrangements' where the legal person is not related to any actual business activity and the activity of the legal person involves little or no economic activity. The above events significantly affect the Bank's and Group's vision regarding the future business development model.

The Bank prepared its development strategy for the period until 2021. The strategy includes the change of business model with the following directions:

- Strengthening of capital base;
- Strengthening the corporate governance and management team;
- Optimisation of expenses;
- Continuing to reduce client base risk;
- New areas of strategic development;
- Recovery of assets.

Within the business model, the shareholders of the Bank have made a decision to attract a strategic investor for the Bank's capital by cooperating with a professional external consultant. In December 2018, changes were made to the Bank's shareholding structure: A new minority shareholder joined the Bank. By the end of February 2019, following a respective decision by the shareholders' meeting, the plan is to increase the Bank's share capital by investing cash of EUR 1 million. The major part of funds for the increase in the share capital is deposed in the current account with a notary. Also, actions have been taken to attract additional subordinated capital. As at the moment of these financial statements, subordinated loan in the amount of EUR 1.5 million from a Latvian-registered company has been restructured and extended. The Bank awaits the evaluation result from the FCMC to include this loan in the calculation of capital adequacy. In addition, following the evaluation by the FCMC of the new subordinated loan received, in Q1 2019 it is planned to attract another subordinated loan amounting to EUR 1 million from the same Latvian-registered company.

In line with the measures set out in the Development strategy, one of the key priorities is strengthening the corporate governance beginning at the top level of corporate governance in the Bank. On 10 December 2018, in an extraordinary shareholders' meeting the Council of the Bank in a new constitution was appointed, setting 27 December 2018 as the first day of the authority of the new council. Jurijs Adamovičs, Ivars Grunte and Goča Tutberidze were appointed as Council members. The new constitution of the Council will ensure the best combination of individual competencies and suitability. Mr Adamovičs is a competent and internationally renowned professional specialising in the field of restructurization, recovery of companies and change management, setting the preparation of the Bank for the attraction of a strategic investor as his key priority. The appointment of Mr Grunte, the lead partner at TGS Baltics and a Member of the Latvian Collegium of Sworn Advocates, to a members of the Council is a clear signal to the market players of the Bank's intent to strengthen its internal corporate governance process and ensure the operation of the principle and system of the prevention of independent conflicts of interests. The key role of Mr Tutberidze as the member of the Council is to ensure succession of changes to be implemented within the restructurization of the Bank, monitoring of the management of specific risks pertaining to the Bank's operation and demonstrate stability to the Bank's long-term partners and customer base. Also, changes to the Board are expected, expanding it to 5 members.

Within the optimisation of costs, the Bank intends to reduce the number of employees and the number of service centres, thus decreasing the administrative expenses in 2019 by at least 20% compared to 2017, net of sanctions allowances.

In 2018, the Bank gradually terminated cooperation with 'shell arrangements'. As at 31 August 2018, the Bank closed 668 accounts of customers who matched the definition of the new AML/TF law. However, the Bank preserved such depositors who do not match several features as included in the laws and regulations of the Republic of Latvia. The proportion of such deposits in 2018 is lower than 10% and the Bank plans to sever ties with the majority by the end of June 2019. As a result of these measures, a one-off increase in income from commission and transactions with foreign currency in 2018 could be observed (up to the forecast EUR 10 million and EUR 2.5 million, respectively), however the amount of this income for 2019 is expected considerably lower.

Among the priorities that the Bank has set for further operations is the development of cooperation with providers of e-commerce services and promotion of trade finance services. Also, the Bank expected to use 20% of the funds currently invested with the Bank of Latvia (as at 31 December 2017 total deposit amounted to EUR 99 421) in addition to the acquisition of bonds with fixed income. The new business model of the Group and the Bank is focused on servicing customers from Latvia and Lithuania and relies on an advanced customer base and sales channels for services.

Finally, the Bank plans to improve the quality of its loan portfolio, incl. recovery and sale, as well as realise investment property owned by the Group's subsidiary, investing the free funds in higher quality loan products.

Following these measures the Bank and the Group plan to recover its profitability as of 2019. Also the Bank expects to be able to comply with the total capital buffer requirement established by the FCMC from the mid-2019.

Thus the management of the Group and the Bank has prepared these separate and consolidated financial statements for 2017 on a going concern basis. These financial statements do not include amendments that would be necessary in case the Bank loses its ability to continue as a going concern. The management admits that there is a material uncertainty with regard to the outcome of future events, that conversely affects the assumptions and estimates described in these financial statements used by the management in preparing financial plans for 2018 and subsequent years, and making decisions on the appropriateness of the application of the going concern principle. The key sources of uncertainty include:

- Potential future results of the reviews and regulatory reviews at the Bank in the field of AML/CTF, including the potential amount of the sanction fines, considering reviews carried out by the FCMC in the banking sector since 2015;
- The possible sanctions arising from the Bank's inability to comply with the regulatory requirements of the maximum credit risk concentration with one customer or a group of related customers as at 31 December 2017.
- the amount of the overall current and future regulatory changes affecting the financial sector of the Republic of Latvia, as well as the Bank's and Group's ability to implement measures and agree upon them with the FCMC to mitigate regulatory, compliance and reputational risk in the corresponding period. As great uncertainty governs the regulatory environment, the extended amount of limitations in relation to the provision of services to certain international customer categories may cause further adverse consequences to the Bank's and Group's operation. Should the regulatory environment change differently from the original initiatives, the Bank has to review its strategy.
- The Bank's and Group's ability to implement the new business model, develop the customer base with acceptable risk profile, generate profit and maintain the regulatory capital adequacy in the transition period. Financial success will depend on the Bank's ability to implement changes in corporate governance and management, as well as on the Bank's and Group's current and potential shareholders' ability to invest the necessary additional share capital for the maintenance of future operations.

44 SUBSEQUENT EVENTS

On 13 February 2018 the Financial Crimes Enforcement Network ("FinCEN") under the US Department of the Treasury issued a finding and notice of proposed rulemaking (NPRM), pursuant to Section 311 of the USA PATRIOT Act, against one of the largest banks in Latvia. On 19 February 2018, following an outflow of deposits from this institution, the European Central Bank instructed the Financial and Capital Market Commission to impose a prohibition to make outgoing payments from the bank. On 12 June 2018, in the extraordinary meeting the council of the Financial and Capital Market Commission accepted the decision on the initiation of the bank's self-liquidation process. On 17 February 2018, the Corruption Prevention and Combating Bureau of Latvia apprehended a high ranking government official on charges related to bribery. These events have a significantly adverse impact on the Latvian banking sector and its international reputation. The regulatory environment in the area of AML/CFT has become even stricter, making the Latvian financial institutions rapidly reduce risks arising from foreign customers. Regulatory requirements are adopted to prohibit servicing the so-call 'shell arrangements' where the legal person is not related to any actual business activity and the activity of the legal person generates little or no economic value.

Although the Bank implemented a range of measures for the reduction of ML/FT risks in 2016 and 2017, as disclosed under Note 4, following the review of 2017, the Financial and Capital Market Commission expressed further remarks and suggestions for the improvement of the Bank's internal control system. In 2018, the Financial and Capital Market Commission has concluded an administrative agreement with the Bank, establishing legal obligations and imposing a fine of EUR 456 thousand. The fine imposed by the Financial and Capital Markets Commission has no impact on the Bank's daily work and servicing of clients. As described under Note 4, the Bank developed a set of measures for the implementation of more effective control system and continues to implement and introduce these measures, and organise independent expert reviews.

NOTES TO THE BANK SEPARATE AND GROUP CONSOLIDATED FINANCIAL STATEMENTS

Together with external consultants, the Bank prepared its development strategy until 2021. The change of business model included in the strategy together with the capital strengthening measures is based on the strengthening of corporate governance, management team, continuance of expense optimisation, further reduction of customer base risk, determination of target customer groups, development of non-performing assets, effective use of free resources, focusing on separate business areas and establishment of individual 'niche'. By reducing the client base risk and implementing a strategy focused on domestic customers, in 11 months of 2018, proportion of the Latvian and Lithuanian deposits in the Bank's deposit portfolio exceed a half and reached 56%.

In December 2018, changes were made to the Bank's shareholding structure: A new minority shareholder joined the Bank. In line with the measured set by the Development Plan, one of the key priorities is strengthening of corporate governance beginning at the top level of corporate governance in the Bank. On 10 December 2018, in an extraordinary shareholders' meeting the Council of the Bank in a new constitution was appointed, setting 27 December 2018 as the first day of the authority of the new council. Jurijs Adamovičs, Ivars Grunte and Goča Tutberidze were appointed as Council members. The new constitution of the Council will ensure the best combination of individual competencies and suitability. Mr Adamovičs is a competent and internationally renowned professional specialising in the field of restructurization, recovery of companies and change management, setting the preparation of the Bank for the attraction of a strategic investor as his key priority. The appointment of Mr Grunte, the lead partner at TGS Baltics and a Member of the Latvian Collegium of Sworn Advocates, to a members of the Council is a clear signal to the market players of the Bank's intent to strengthen its internal corporate governance process and ensure the operation of the principle and system of the prevention of independent conflicts of interests. The key role of Mr Tutberidze as the member of the Council is to ensure succession of changes to be implemented within the restructurization of the Bank, monitoring of the management of specific risks pertaining to the Bank's operation and demonstrate stability to the Bank's long-term partners and customer base.

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Independent Auditors' Report

To the shareholders of JSC "Meridian Trade Bank"

Report on the Audit of the Separate and Consolidated Financial Statements

Our Opinion on the Separate and Consolidated Financial Statements

We have audited the accompanying separate financial statements of JSC "Meridian Trade Bank" ("the Bank") and consolidated financial statements of the Bank and its subsidiary (collectively, "the Group") set out on pages 9 to 79 of the accompanying separate and consolidated annual report, which comprise:

- the separate and consolidated statements of financial position as at 31 December 2017,
- the separate and consolidated statements of profit or loss and other comprehensive income for the year then ended,
- the separate and consolidated statements of changes in shareholders' equity for the year then ended,
- the separate and consolidated statements of cash flows for the year then ended, and
- notes to the separate and consolidated financial statements, which include a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying separate and consolidated financial statements give a true and fair view of the unconsolidated and consolidated financial position of the Bank and the Group, respectively, as at 31 December 2017, and of their respective unconsolidated and consolidated financial performance and their unconsolidated and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for Opinion

Pursuant to the 'Law on Audit Services' of the Republic of Latvia 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 *Auditors' Responsibilities for the Audit of the Separate and Consolidated Financial Statements* section of our report.

We are independent of the Bank and the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the independence requirements included in the 'Law on Audit Services' of the Republic of Latvia that are relevant to our audit of the separate and consolidated financial statements in the Republic of Latvia. We have also fulfilled our other professional ethics responsibilities and objectivity requirements in accordance with the IESBA Code and the 'Law on Audit Services' of the Republic of Latvia.

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 44 of the separate and consolidated financial statements, which describes recent developments in the financial sector of the Republic of Latvia. Following these developments, in March 2018, the government of the Republic of Latvia expressed its intent to strengthen the country's legal and regulatory framework for the sector. As part of the above, among other things, amendments were introduced to the country's anti-money-laundering/combatting the financing of terrorism (AML/CFT) and financial sector legislation in April 2018, aimed specifically at introducing a prohibition to conduct business with shell companies, considered to be companies without real substance as measured by certain criteria set out in law.

The potential impact of the above changes on the Bank and the Group is discussed in detail in Note 43 of the separate and consolidated financial statements, which also describes key judgements and assumptions related to future events underlying the management's conclusion on the appropriateness of the application of the going concern basis in the preparation of these separate and consolidated financial statements. Any future regulatory penalties and sanctions, including those in the credit risk area and AML/CFT area, as described in Note 11 and Note 43, respectively, and the changing regulatory and legislative landscape may all have adverse consequences on the Bank's and the Group's operations and profitability, and on their respective compliance with capital adequacy requirements set by Financial Capital and Market Commission, necessitating further adjustments to their business models. In addition, the Bank and the Group are in the process of defining their new strategy, aimed at financial recovery from net losses generated in 2016 and 2017, the resulting erosion of their respective capital positions below the minimum regulatory total capital reserve requirements, and the attraction of new financial and strategic investors. Continued financial support from the existing shareholders, ability to attract a new investor and to implement a viable new strategy are key assumptions underlying management's judgement about the Bank's and the Group's ability to continue as a going concern.

As stated in Note 43, the above events and conditions, along with other matters as set forth in Note 43 and Note 44, indicate that a material uncertainty exists that may cast significant doubt on the Bank's and the Group'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 separate and consolidated financial statements of the current period. These matters were addressed in the context of our audit of the separate and consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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In addition to the matters described in the *Material Uncertainty Related to Going Concern* sections, above, we have determined the matters described below to be the key audit matters to be communicated in our report.

Impairment of loans (consolidated and separate financial statements)	
Key audit matter	*Our response*
The carrying amount of loans in the consolidated financial statements as at 31 December 2017: EUR 77 million; change in impairment allowance recognised in 2017: EUR 5,4 million; total impairment allowance as at 31 December 2017: EUR 22,4 million. The carrying amount of loans in the separate financial statements as at 31 December 2017: EUR 94 million; change in impairment allowance recognised in 2017: EUR 7,6 million; total impairment allowance as at 31 December 2017: EUR 24,5 million. *We refer to the separate and consolidated financial statements: Note 3 (information on principal accounting policies), Note 11 (financial disclosures).* The Bank offers a variety of loan products issued to corporate clients and individuals. Relative share of the loan receivables in total assets has decreased during 2017 as the Bank did not actively issue new loans, but rather implemented maintenance and improvement processes to the existing loan portfolio. Impairment allowances represent the Management Board's best estimate of the losses incurred within the loan portfolios at the reporting date. We identified this area as a significant risk during our audit because recognition of allowances for loan impairment is associated with significant estimation uncertainty as it requires the Management Board to exercise judgment and develop complex and subjective assumptions about both the timing of recognition and the amounts of such impairment. Individual impairment allowances recognized by the Bank and the Group mostly relate to large, individually monitored, exposures to corporates clients. The assessment is therefore based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. The Bank has a highly concentrated loan portfolio, with individually significant exposures constituting	Our audit procedures included, among others: • testing of controls over the approval, recording and monitoring of loans. • for a sample of individually significant loans as well as loans with higher risk characteristics, such as watchlist - included or restructured exposures, those in respect of borrowers in foreign jurisdictions and loans with repayment delays, critically assessing, by reference to the underlying loan files, and through inquiries of the responsible loan officers, the existence of any impairment triggers; • where impairment triggers had been identified, through inspection of the underlying loan documentation and corroborating inquiries of the responsible loan officers, assessing the forecasts of future cash flows used in the Bank's and the Group's loan impairment calculations, which included evaluating key assumptions applied, such as discount rates, collateral values (assisted by our own valuation specialists), forecasted business performance as well as, where applicable, collateral sales costs and sales periods used in the forecasts; • based on the effects of the preceding procedures, assessing the accuracy and completeness of the impairment losses recognized by the Bank and the Group as at the reporting date; assessing the accuracy and completeness of the financial instruments disclosures, specifically in respect of loans and receivables' category, including in respect of the related impairment, against the requirements of the relevant financial reporting standards.

a high proportion of the total portfolio. As a consequence, the Bank's Management Board focuses on individual impairment assessment as in their view it covers substantially all of the loan portfolio's credit risk and as such provides the appropriate basis for determination of impairment allowances.	

Impairment of investment property (consolidated financial statements)	
Key audit matter	***Our response***
The carrying amount of Investment properties in the consolidated financial statements as at 31 December 2017: EUR 15,2 million. *We refer to the financial statements: Note 3 (accounting policy), Notes13 (financial disclosures).* Investment property is held either to earn rental income or for capital appreciation or for both. The Group's investment property is represented by repossessed real estate, which it measures at its fair value, with all changes therein recorded in profit or loss. The valuation of the Group's investment properties requires the Management Board to apply significant judgement and produce complex estimates, using the input obtained from the external contracted appraisers, particularly in relation to the key assumptions, being those relating to discount rates, cash flow projections and comparable market transactions. Due to the above factors, we considered this area to be our key audit matter.	Our procedures included, among others: • Based on our updated understanding of the Group's approach to the valuation of investment property, assessing the valuation methodology applied by the Group against the requirements of the relevant financial reporting standards and market practice; • Tracing the fair values determined by the Group's external appraisers to the Group's accounting records and, involving our own valuation specialists, challenging, on a sample basis, the valuation methods and key assumptions applied by the Group's appraisers, including those in respect of discount rates, reversionary cap rates, cash flow projections and comparable market transactions; • Performing a sensitivity analysis in respect of the above key assumptions to evaluate the effects of their potential changes on the investment property fair values. • Considering the adequacy of the Group's disclosures related to the assumptions and significant judgements used at estimating fair values of investment properties.

Reporting on Other Information

The Bank's and the Group's management are responsible for the other information. The other information comprises:

- the Bank's and the Group's Management Report, as set out on pages 3 to 4 of the accompanying Annual Report,
- the Composition of the Supervisory Council and Management Board, as set out on page 5 of the Annual Report, and

- the Statement of Management's Responsibility, as set out on page 6 of the accompanying Annual Report, and

Our opinion on the separate and consolidated financial statements does not cover the other information included in the Annual Report, and we do not express any form of assurance conclusion thereon, except as explicitly stated 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 separate and consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate and consolidated 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 Bank, the Group 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

In addition, in accordance with the 'Law on Audit Services' of the Republic of Latvia with respect to the Management Report, our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Financial and Capital Market Commission of the Republic of Latvia's Regulation No. 46 'Regulations on the Preparation of Annual Reports and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies' ("Regulation No. 46").

Based solely on the work required to be undertaken in the course of our audit of the separate and consolidated financial statements, in our opinion:

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

- the Management Report has been prepared in accordance with the requirements of Regulation No. 46.

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

Management is responsible for the preparation of the separate and consolidated financial statements that give a true and fair view in accordance with IFRSs as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of the separate and consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate and consolidated financial statements, management is responsible for assessing the Bank's and the Group'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 Bank and / or the Group or to cease operations, or has no realistic alternative but to do so.

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

Auditors' Responsibility for the Audit of the Separate and Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the separate and consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 separate and consolidated 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 separate and consolidated 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 Bank's and the Group'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 Bank's and/or the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the separate and consolidated 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 auditors' report. However, future events or conditions may cause the Bank and/or the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the separate and consolidated financial statements, including the disclosures, and whether the separate and consolidated financial statements represent the underlying transactions and events in a manner that achieves a 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 objectivity, 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 separate and consolidated 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.

Report on Other Legal and Regulatory Requirements

Other Reporting Responsibilities and Confirmations Required by the Legislation of the Republic of Latvia and the European Union when Providing Audit Services to Public Interest Entities

We were appointed by the annual shareholders' meeting on 21 September 2017 to audit the separate and consolidated financial statements of JSC Meridian Trade Bank for the year ended 31 December 2017. Our total uninterrupted period of engagement is 13 years, covering the periods ended 31 December 2005 to 31 December 2017.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Chairman of the Council of the Bank and the Group;
- as referred to in the paragraph 37.6 of the 'Law on Audit Services' of the Republic of Latvia, we have not provided to the Bank and the Group the prohibited non-audit services (NASs) referred to of EU Regulation (EU) No 537/2014, paragraph 5 point 1. We also remained independent of the audited entity (the Bank) and the Group in conducting the audit.

For the period to which our statutory audit relates, in addition to the audit, we have not provided to the Bank and the Group and its controlled entities any services which are not disclosed in the Management Report, or in the separate and consolidated financial statements of the Bank and the Group.

KPMG Baltics SIA
License No 55

Armine Movsisjana
Chairperson of the Board
Sworn Auditor
Certificate No 178
Riga, Latvia
21 December 2018