SC "Citadele banka"

Public Financial Information

4th Quarter 2014

Citadele

Information disclosed in the report is prepared in accordance with the Financial and Capital Market Commission's regulations No. 145 „Regulations on Preparation of Public Quarterly Reports of Credit Institutions".

Financial results demonstrate stable growth

AS Citadele banka (Citadele Bank) grew in scale, quality and performance in 2014, as did the bank and its subsidiaries (Citadele Group). We are very proud of our achievements in 2014 and want to thank all the stakeholders who worked with us this past year.

Citadele sees change in its ownership structure

On 16 September 2014 and following a tender process, the Latvian government decided to sell its 75% stake in Citadele Bank to Ripplewood Advisors LLC (Ripplewood) and an international group of twelve investors. VAS Privatizācijas aģentūra (Privatisation Agency of the Republic of Latvia) signed the respective agreement on 5 November 2014.

The transaction is expected to close during the first quarter of 2015, following approvals by the Latvian Finance and Capital Markets Commission, as well as the banking regulators in Lithuania and Switzerland. The European Bank for Reconstruction and Development (EBRD) will retain its 25% stake in Citadele and become the single largest shareholder. On closing the deal, Ripplewood will own 22.4% of Citadele and the twelve co-investors a further 52.6% of the shares. None of the latter will hold a stake of more than 10% in the company. According to the terms of the deal, the new investors and the EBRD have committed to increase the capital of the bank.

Financial performance in 2014

In 2014, the **net interest income** of the Group increased by 13% to EUR 62.5 million (Bank: +15% to EUR 52.1 million). The main drivers of this development were an expansion of the lending volume, the improvement of customer portfolio quality and increased customer activity. For example, the number of cards increased by 3% and the share of purchases paid by cards increased from 40% to 42%. This was also supported by Latvia's conversion to the Euro as of 1 January 2014. Because of the positive development of the payment card business, **net commission and fee income** grew by 4% to EUR 33.4 million (Bank: +2% to EUR 24.4m).

Citadele Group's **net financial profit** increased by about 5% to EUR 109.3 million (Bank: +2% to EUR 88.6 million)

Despite the growing business, Citadele Group achieved a decrease in **administrative expenses** of 2% to EUR 61.3 million (Bank: -3% to EUR 45.2 million). The Group's **cost-to-income ratio** improved from 66% to 61% in 2014 (Bank: from 55% to 52%). There was a significant decrease in **impairment charges and reversals** from EUR -20.1 million in 2013 to EUR -8.0 million (Bank: from EUR 21.7 million to EUR 9.7 million).

In 2014, the Group's **unaudited net profit** surged 129% to EUR 31.1 million (Bank: +85% to EUR 28.3 million).

Citadele Group's **total assets** amounted to EUR 2.85 billion as of 31 December 2014, which corresponds to an increase of 12% (Bank: +9% to EUR 2.33 bilion). The **return on average assets** in 2014 was 1.2% compared to 0.6% in the previous year (Bank: 1.3% compared to 0.8%).

The loan book continued to improve, both in quality and average margin. The Group's volume of **loans to companies and private individuals** grew by 2% to EUR 1.08 billion (the Bank: +2% to EUR 941.3 million). The Group's **deposits from customers** also grew by a strong 12% to reach EUR 2.52 billion (Bank: +5% to EUR 1.95 billion). In 2014, the **loan-to-deposit ratio** of the Group decreased from 47% to 43% (Bank: from 50% to 48%).

As of 31 December 2014, **shareholders' equity** stood at EUR 175.4 million, which represents a 22% rise on the previous year (Bank: +20% to EUR 172.4m). The Group's **return on average equity** jumped from 9.8% in 2013 to 19.5% in 2014 (Bank: 11.1% to 17.9%).

The unaudited **tier 1 ratio** and **core equity tier 1 ratio** of Citadele Group as of 31 December 2014 was 8.3% (Bank: 9.6%). The Group's unaudited **capital adequacy ratio** as of 31 December 2014 was 10.1% (Bank: 11.5%). If 2014 unaudited profits were included in common equity Tier 1 capital and in operational risk charge calculation, Bank's and Group's **capital adequacy ratio** as at 31 December 2014 would be 12.3% and 10.9%, respectively; **common equity Tier 1 ratio** – 10.3% and 9.2%.

Citadele would like to thank all its customers and partners for their support in 2014. We would also like to express our gratitude to our employees for their high standards of professionalism and commitment to achieving Citadele's goals.

We shall continue developing Citadele to make it the most valuable local financial group in the Baltics. We optimistically look to the future at Citadele Group and platform we have built together to develop exciting new growth opportunities.

The report has been approved by the Management Board of the Bank on 24 February 2015.

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Balance Sheets as at 31 December 2014 and 2013

EUR 000’s

	31.12.2014. *Unaudited* Group	**31.12.2013. *Audited** Group**	**31.12.2014. *Unaudited* Bank**	**31.12.2013. *Audited** Bank**
Cash and demand deposits with central banks	225,399	361,485	142,650	312,525
Demand deposits with credit institutions	349,719	133,680	315,918	104,740
Financial assets held for trading	29,880	31,466	5,963	3,665
Financial assets designated at fair value through profit and loss	97,449	62,336	-	-
Available-for-sale financial assets	558,196	401,738	444,418	331,930
Loans and receivables to customers:				
Loans to credit institutions	159,685	137,501	148,354	114,488
Loans to companies and private individuals	1,075,701	1,055,922	941,268	924,914
Held-to-maturity investments	229,252	244,423	192,977	224,462
Change in the fair value of the portfolio hedged against interest rate risk	-	-	-	-
Prepayments and accrued income	3,016	2,440	1,725	1,876
Property and equipment	42,892	42,826	3,651	3,402
Investment property	408	748	-	-
Intangible assets	2,065	1,845	1,456	1,350
Investments in subsidiaries	-	-	62,625	62,841
Income tax assets	28,445	32,875	26,879	31,700
Other assets	51,145	32,237	41,881	23,335
Total assets	**2,853,252**	**2,541,522**	**2,329,765**	**2,141,228**
Due to central banks	5	5	5	5
Demand liabilities to credit institutions	14,971	8,506	70,657	20,748
Financial liabilities held for trading	1,647	4,062	3,567	4,599
Financial liabilities designated at fair value through profit and loss	24,594	16,626	-	-
Financial liabilities measured at amortised cost:				
Loans from credit institutions	10,060	17,244	46,335	34,533
Deposits from customers	2,517,107	2,246,912	1,948,751	1,851,348
Subordinated liabilities	73,596	73,575	73,596	73,575
Other financial liabilities	12,235	8,315	-	-
Amounts payable under repurchase agreements	-	-	-	-
Change in the fair value of the portfolio hedged against interest rate risk	-	-	-	-
Accrued expenses and deferred income	12,049	12,193	9,129	8,804
Provisions	695	-	-	-
Income tax liabilities	239	-	-	-
Other liabilities	10,646	10,636	5,325	4,020
Total liabilities	**2,677,844**	**2,398,074**	**2,157,365**	**1,997,632**
Shareholders’ equity	175,408	143,448	172,400	143,596
Total liabilities and shareholders’ equity	**2,853,252**	**2,541,522**	**2,329,765**	**2,141,228**
Memorandum items				
Contingent liabilities	58,217	101,909	54,544	96,566
Financial commitments	168,575	186,737	192,406	192,561

* Auditor: SIA “KPMG Baltics”.

On 1 January 2014 the Republic of Latvia adopted Euro as the national currency. From 1 January 2014 the Bank’s and the Group's presentation currency is Euro (“EUR”). The comparative amounts presented in these financial statements are converted from Lats to Euros at the official exchange rate of 0.702804 LVL/1 EUR.

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Statements of Income
for the year ended 31 December 2014 and 2013

EUR 000's

	01.01.2014.- 31.12.2014. *Unaudited* Group	01.01.2013.- 31.12.2013. *Audited** Group	01.01.2014.- 31.12.2014. *Unaudited* Bank	01.01.2013.- 31.12.2013. *Audited** Bank
Interest income	80,706	74,810	67,462	62,746
Interest expense	(18,241)	(19,520)	(15,359)	(17,274)
Dividends received	1	-	1,691	3,754
Commission and fee income	47,796	45,099	36,423	34,582
Commission and fee expense	(14,413)	(12,930)	(11,984)	(10,669)
Net gain/ (loss) on financial assets and financial liabilities measured at amortised cost	(91)	-	-	-
Net gain/ (loss) on available for sale financial assets and financial liabilities	3,106	4,612	1,288	2,467
Net gain/ (loss) on held for trading financial assets and financial liabilities	95	(985)	7	5
Net gain/ (loss) on financial assets or financial liabilities designated at fair value though profit and loss	(396)	(874)	-	-
Fair value change in the hedge accounting	-	-	-	-
Gain/ (loss) from foreign exchange trading and revaluation of open positions	10,757	14,388	9,109	11,513
Net financial profit	**109,320**	**104,600**	**88,637**	**87,124**
Net gain/ (loss) on disposal of property, plant and equipment, investment property and intangible assets	49	174	-	-
Other income	2,588	2,737	1,492	1,261
Other expense	(1,384)	(2,021)	(521)	(592)
Administrative expense	(61,327)	(62,550)	(45,233)	(46,553)
Amortisation and depreciation charge	(5,204)	(5,857)	(1,361)	(1,376)
Impairment charge and reversals, net	(7,962)	(20,144)	(9,659)	(21,696)
Profit before taxation	**36,080**	**16,939**	**33,355**	**18,168**
Corporate income tax	(4,971)	(3,342)	(5,007)	(2,877)
Profit for the reporting period	**31,109**	**13,597**	**28,348**	**15,291**

Statements of Comprehensive Income:

EUR 000's

	01.01.2014.- 31.12.2014. *Unaudited* Group	01.01.2013.- 31.12.2013. *Audited** Group	01.01.2014.- 31.12.2014. *Unaudited* Bank	01.01.2013.- 31.12.2013. *Audited** Bank
Net change in fair value revaluation reserve of securities and other reserves	851	(5,123)	456	(2,612)
Other comprehensive income for the period	**851**	**(5,123)**	**456**	**(2,612)**
Total comprehensive income for the period	**31,960**	**8,474**	**28,804**	**12,679**

* Auditor: SIA "KPMG Baltics".

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Performance Ratios of the Group and the Bank

	01.01.2014.-31.12.2014. Group	01.01.2013.-31.12.2013. Group	01.01.2014.-31.12.2014. Bank	01.01.2013.-31.12.2013. Bank
Return on equity (ROE) (%)*	19.51%	9.77%	17.94%	11.14%
Return on assets (ROA) (%)*	1.15%	0.56%	1.27%	0.76%

* Average value is calculated as the arithmetic mean of the balance sheet assets or residual capital and reserves at the beginning of the reporting period and at the end of the reporting period.

Ratings Assigned by Rating Agencies

	Long-term rating	Short-term rating	Financial strength rating	Rating’s outlook	Rating revision date
Moody's Investors Service	B2	Not Prime	E+	Negative	29.05.2014.
Moody's Investors Service	B2	Not Prime	E+	Stable	23.08.2013.
Moody's Investors Service	B2	Not Prime	E+	Negative	16.12.2011.
Moody's Investors Service	Ba3	Not Prime	E+	Under Review	06.10.2011.
Moody's Investors Service	Ba3	Not Prime	E+	Stable	06.10.2010.

Detailed information about ratings can be found on the web site of the rating agency: www.moodys.com

Investments in Securities by Issuer’s Country

	Group			
	31.12.2014. ***Unaudited***		**31.12.2013.** ***Audited***	
	Government bonds	Other securities	Government bonds	Other securities
Latvia	253,751	37,978	290,350	37,714
Lithuania	86,375	-	74,015	-
Finland	13,246	16,312	17,735	8,002
United States	12,358	77,321	-	32,023
Netherlands	10,080	53,734	10,447	28,697
Sweden	5,376	21,342	-	7,291
Canada	3,308	24,023	3,745	19,834
Australia	693	32,946	-	17,854
Norway	-	26,638	-	13,999
Germany	-	24,479	1,150	24,866
Singapore	-	24,368	7,319	4,031
Other countries**	26,521	157,999	29,756	107,179
Total securities, net	**411,708**	**497,140**	**434,517**	**301,490**

	Bank			
	31.12.2014. ***Unaudited***		**31.12.2013.** ***Audited***	
	Government bonds	Other securities	Government bonds	Other securities
Latvia	241,007	36,955	288,417	36,734
United States	12,358	38,612	-	17,440
Finland	10,549	16,312	15,695	8,002
Netherlands	10,080	34,351	10,447	17,092
Canada	3,308	19,356	3,745	17,349
Australia	693	24,792	-	15,106
Singapore	-	22,820	7,319	4,031
Norway	-	19,788	-	11,097
Other countries**	28,030	118,383	25,143	78,775
Total securities, net	**306,025**	**331,369**	**350,766**	**205,626**

** Each country’s issuers’ total exposure is less than 10% from the eligible capital used for capital adequacy calculation purposes. Investments in managed funds are included in line "Other countries".

As at the period end the Bank and the Group has not recognised any impairment allowance for held-to-maturity investments (2013: nil). Market value of the total Bank’s and Group’s held-to-maturity securities as at 31 December 2014 is EUR 197,188 thousand (2013: EUR 229,353 thousand) and EUR 234,260 thousand (2013: EUR 249,724 thousand), respectively. During the reporting period the Bank and the Group has recognised net provisions of EUR 520 thousand for available for sale securities (2013: recognised provisions of EUR 130 thousand); total recognised impairment allowance for available for sale securities as at the period end is EUR 7,062 thousand (2013: EUR 8,256 thousand).

Bank’s Business Strategy and Objectives

Information about Citadele’s strategy is available in “Business Strategy” section of the Bank’s web page, about Bank’s objectives – in “Vision, mission, values” section.

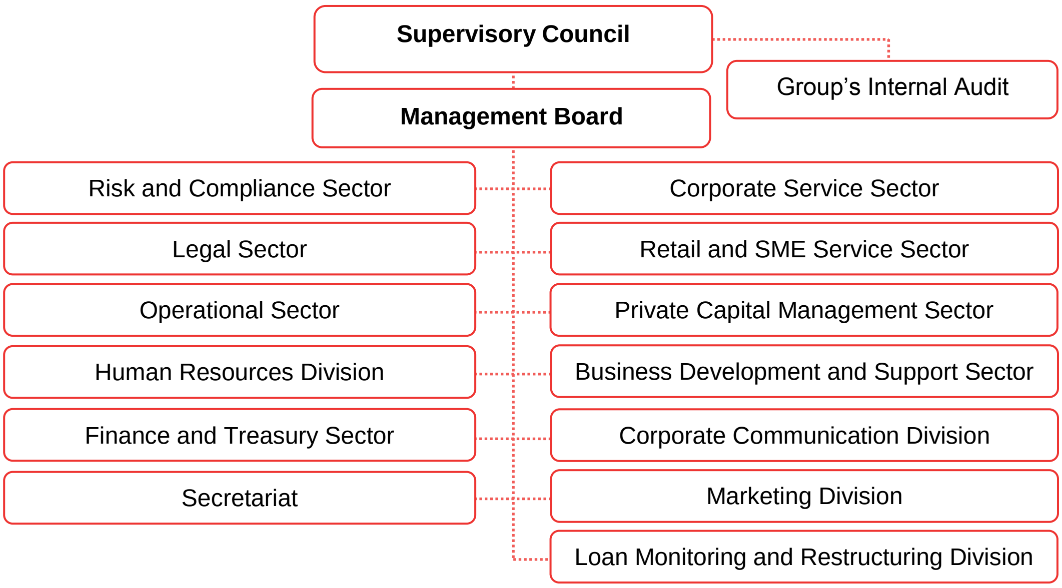
Issued Share Capital as at 31 December 2014

Shareholders	Nominal value (EUR)	Number of shares	Paid-in share capital (EUR)	Voting rights	Paid-in share capital (%)
VAS “Privatizācijas Aģentūra"	1	109,916,846	109,916,846	109,916,846	75% minus 1 share
EBRD	1	36,638,950	36,638,950	36,638,950	25% plus 1 share
Total		**146,555,796**	**146,555,796**	**146,555,796**	**100%**

Due to Euro adoption, on 8 April 2014 amendments to the statutes of AS Citadele Banka were registered, changing nominal value of one share from LVL 1 to EUR 1. The total number of shares and voting rights increased to 146,555,796 (2013: 103,000,000). Shareholder structure did not change.

Information about Citadele Bank’s Organizational Structure

As at 31 December 2014 the Bank was operating a total of 20 branches (including 1 foreign branches), 18 mid-size client service centres (including 1 foreign) and 2 representative offices. Information about Citadele's branches and client service centres is available in the Bank's web page's section “Klientu apkalpošanas centri un filiāles”, about ATM – in section “Bankomāti”.



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Consolidation Group

No.	Name of company	Registration number	Registration address	Country of domicile	Company type*	% of total paid-in share capital	% of total voting rights	Basis for inclusion in the group**
1	AS “Citadele banka"	LV-40103303559	Latvia, Riga LV-1010, Republikas laukums 2A	LV	BNK	100	100	MAS
2	IPAS “CBL Asset Management"	LV-40003577500	Latvia, Riga LV-1010, Republikas laukums 2A	LV	IPS	100	100	MS
3	AB “Citadele”	LT-112021619	Lithuania, Vilnius LT-03107, K. Kalinausko 13	LT	BNK	100	100	MS
4	SIA “Citadele Express Kredīts"	LV-40003238125	Latvia, Riga LV-1010, Republikas laukums 2A	LV	CFI	100	100	MS
5	AS “CBL atklātais pensiju fonds"	LV-40003397312	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PFO	100	100	MS
6	AAS “CBL Life"	LV-40003786859	Latvia, Riga LV-1010, Republikas laukums 2A	LV	APS	100	100	MMS
7	OU “Citadele Leasing & Factoring"	EE-10925733	Estonia, Tallinn 10119, Roosikrantsi 2	EE	LIZ	100	100	MS
8	OOO “Citadele Asset Management Ukraina”	UA-32984601	Ukraine, Kiev 03150, Gorkovo 172	UA	IBS	100	100	MMS
9	SIA “E & P Baltic Properties"	LV-40003754637	Latvia, Riga LV-1010, Republikas laukums 2A	LV	IPS	50	50	MMS
10	UAB “Citadele faktoringas ir lizingas"	LT-126233315	Lithuania, Vilnius LT03107, K.Kalinausko 13	LT	LIZ	100	100	MMS
11	UAB “Citadele investiciju valdymas"	LT-111829843	Lithuania, Vilnius LT01109, Gyneju 16	LT	IBS	100	100	MMS
12	“AP Anlage & Privatbank” AG	CH-130.0.007.738-0	Switzerland, Limmatquai 4, CH-8001, Zurich	CH	BNK	100	100	MS
13	Calenia Investments Limited	CY-HE156501	Cyprus, Nicosia 1075, 58 Arch. Makarios III Avenue, Iris Tower, 6th floor, office 602	CY	PLS	100	100	MS
14	SIA “Citadele līzings un faktorings"	LV-50003760921	Latvia, Riga LV-1010, Republikas laukums 2A	LV	LIZ	100	100	MS
15	SIA “Rīgas pirmā garāža"	LV-40003397543	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
16	SIA “RPG interjers"	LV-40103157899	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
17	SIA “PR Speciālie projekti"	LV-40103195231	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MMS
18	SIA “Hortus Commercial"	LV-40103460641	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
19	SIA “Hortus Land"	LV-40103460961	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
20	SIA “Hortus TC"	LV-50103460681	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
21	SIA “Hortus Residental"	LV-40103460622	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
22	SIA “Hortus LH”	LV-40103721581	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
23	SIA “Hortus MD”	LV-40103724840	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
24	SIA “Hortus JU”	LV-40103724855	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
25	SIA “Hortus RE”	LV-40103752416	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS

Consolidation Group (Continued)

No.	Name of company	Registration number	Registration address	Country of domicile	Company type*	% of total paid-in share capital	% of total voting rights	Basis for inclusion in the group**
26	SIA “Hortus BR”	LV-50103752441	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS
27	SIA “Hortus NI”	LV-40103752435	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PLS	100	100	MS

*BNK – bank, IBS – investment brokerage company, IPS – investment management company, PFO – pension fund, CFI – other financial institution, LIZ – leasing company, PLS – company providing various support services, APS – insurance company. ** MS – subsidiary company, MMS – subsidiary of the subsidiary company, MAS – parent company.

On 22 December 2014 legal names of IPAS „CBL Asset Management" (former legal name IPAS „Citadele Asset Management"), AS „CBL atklātais pensiju fonds" (former legal name AS „Citadele atklātais pensiju fonds"), and AAS „CBL Life" (former legal name AAS „Citadele Life") were changed. The purpose of the new name is to strengthen the companies’ international reputation while maintaining links to the Citadele Bank and its name. “CBL” is an abbreviation of “Citadele Bank Latvia”.

Management of the Bank as at 31 December 2014

Supervisory Council of the Bank

Name	Position
Klāvs Vasks	Chairman of the Supervisory Council
Geoffrey Richard Dunn	Deputy chairman of the Supervisory Council
Baiba Anda Rubesa	Member of the Supervisory Council
Aldis Greitāns	Member of the Supervisory Council

Management Board of the Bank

Name	Position
Guntis Beļavskis	Chairman of the Management Board, p.p.
Valters Ābele	Member of the Management Board, p.p.
Kaspars Cikmačs	Member of the Management Board
Santa Purgaile	Member of the Management Board
Aldis Paegle	Member of the Management Board

On 1 January 2014 Aldis Paegle was appointed to the Management Board as Chief Financial Officer. On 1 November 2014 Member of the Supervisory Council Laurence Philip Adams resigned.

Liquidity Ratio Calculation as at 31 December 2014

EUR 000’s

		31.12.2014. *Unaudited* Bank
1	**Liquid assets (1.1.+1.2.+1.3.+1.4.)**	**1,115,000**
1.1	Cash	57,728
1.2	Due from Bank of Latvia	84,593
1.3	Due from with solvent credit institutions	460,838
1.4	Liquid securities	511,841
2	**Liabilities (with remaining maturity up to 30 days) (2.1.+2.2.+2.3.+2.4.+2.5.+2.6.)**	**1,884,387**
2.1	Due to credit institutions	104,612
2.2	Deposits	1,532,200
2.3	Issued debt securities	-
2.4	Cash in transit	46,640
2.5	Other current liabilities	16,655
2.6	Off balance sheet liabilities	184,280
3	**Liquidity ratio (1.:2.) (%)**	**59%**
4	**Minimum liquidity ratio**	**30%**

Bank’s individual minimum liquidity ratio allowed by FCMC is 40%.

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Capital Adequacy Reports as at 31 December 2014

EUR 000’s

		31.12.2014. *Unaudited* Group	31.12.2014. *Unaudited* Bank
1	**Own funds**	**182,222**	**185,486**
1.1	Tier 1 capital	150,654	153,918
1.1.1	*Common equity Tier 1 capital*	*150,654*	*153,918*
1.1.2	*Additional Tier 1 capital*	-	-
1.2	Tier 2 capital	31,568	31,568
2	**Total risk exposure amount (2.1.+2.2.+2.3.+2.4.+2.5.+2.6.+2.7.)**	**1,805,262**	**1,611,703**
2.1	Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	1,607,038	1,464,225
2.2	Total risk exposure amount for settlement/delivery	-	-
2.3	Total risk exposure amount for position, foreign exchange and commodities risks	17,734	4,074
2.4	Total risk exposure amount for operational risk	179,347	142,269
2.5	Total risk exposure amount for credit valuation adjustment	1,142	1,135
2.6	Total risk exposure amount related to large exposures in the trading book	-	-
2.7	Other risk exposure amounts	-	-
3	**Capital adequacy ratios**		
3.1	Common equity Tier 1 capital ratio (1.1.1./2.*100)	8.3%	9.6%
3.2	Surplus (+)/ deficit (-) of Common equity Tier 1 capital (1.1.1.-2.*4.5%)	69,417	81,391
3.3	Tier 1 capital ratio (1.1./2.*100)	8.3%	9.6%
3.4	Surplus (+)/ Deficit (-) of Tier 1 capital (1.1.-2.*6%)	42,338	57,216
3.5	Total capital ratio (1./2*100)	10.1%	11.5%
3.6	Surplus (+)/ Deficit (-) of total capital (1.-2.*8%)	37,801	56,550
4	**Combined buffer requirements (4.1.+4.2.+4.3.+4.4.+4.5.)**	**2.5%**	**2.5%**
4.1	Capital conservation buffer (%)	2.5%	2.5%
4.2	Institution specific countercyclical buffer (%)	-	-
4.3	Systemic risk buffer (%)	-	-
4.4	Systemically important institution buffer (%)	-	-
4.5	Other systemically important institution buffer (%)	-	-
5	**Capital adequacy ratios, including adjustments**		
5.1	Impairment or asset value adjustments for capital adequacy ratio purposes	-	-
5.2	Common equity tier 1 capital ratio including line 5.1 adjustments	8.3%	9.6%
5.3	Tie 1 capital ratio including line 5.1 adjustments	8.3%	9.6%
5.4	Total capital ratio including line 5.1 adjustments	10.1%	11.5%

Capital adequacy ratios in these financial statements are calculated in accordance with the CRD IV package which transposes – via a regulation (575/2013) and a directive (2013/36/EU) – the new global standards on bank capital (the Basel III agreement) into EU law.

Bank’s individual minimum total capital adequacy ratio allowed by FCMC is 10.9%. If 2014 unaudited profit was included in common equity Tier 1 capital and in operational risk charge calculation, Bank’s and Group’s total capital ratio as at 31 December 2014 would be 12.3% and 10.9%, respectively; common equity Tier 1 capital ratio – 10.3% and 9.2%.

Risk Management

Risk management principles are set out in Group’s Risk Management Policy. The Group adheres to the following key risk management principles:

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

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

The Group is exposed to the following main risks: credit risk, market risk, interest rate risk, liquidity risk, currency risk and operational risk. The Group has approved risk management policies for each of these risks, which are briefly summarised below. More detailed information about risk management is available in “Risk management” note of AS “Citadele Banka” annual report, which is published in the Bank’s web page’s section “Annual reports”.

Credit Risk

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

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

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

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

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

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

Market Risk

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

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

The Group manages market risk by developing investment guidelines for every significant portfolio, as well as by setting individual limits to issuers and financial instruments, ensuring that maximum limit volumes are closely linked to the results of risk assessment. The Group puts a large emphasis on concentration risk applying a framework, where limits are set based on risk weighted exposures for every country and sector combination. To assess position risk the Group uses sensitivity analysis and scenario analysis, which identifies and quantifies negative impact of adverse events on portfolio of the Group taking into consideration regional, sector and credit rating profile.

Interest Rate Risk

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

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

The Group manages interest rate risk by using the gap analysis of the risk sensitive assets and liabilities, duration analysis and sensitivity analysis of assets and liabilities as well as stress testing of interest rate risk. The Group sets limits for impact of interest rate shock on economic value, net interest income and revaluation reserve. Based on the market analysis and the Group’s financing structure, ALCO sets customer deposit interest rates.

Liquidity Risk

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

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

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

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

Currency Risk

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

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

Day-to-day currency risk management is the responsibility of Treasury Sector, while risk monitoring and reporting is the responsibility of Risk and Compliance Sector. The Group has set a limit for open currency positions in each currency at 10% of its equity, and the limit for the total open currency position at 20% of its equity. The limits are in compliance with the requirements of Latvian legislation. In assessing its currency risk the Group also makes use of several widely applied methodologies: value at risk, expected shortfall and scenario analysis.

Operational Risk

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

The Group does not accept operational risks with potential impact exceeding 10% of the Group’s net annual revenues and with probability of occurrence at least once per ten years or risks with unquantifiable impact which are unmanageable, irrespective of the financial gains this could bring (i.e., the Group does not perform business activities incurring such operational risks).

The Group applies following approaches for operational risk management:

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