

SC "Citadele banka"

Public Financial Information

2nd Quarter 2014



Citadele

Management Report

Citadele group's results for the first six months of 2014 demonstrated solid stable growth in main lines of its business. The balanced business strategy and disciplined execution yielded positive results and we believe positions us for continued growth, stability and profitability as a strong competitor in the financial market of the Baltics.

The group completed the first six months of the year with a profit of 14.4 million euros, a 74% increase in comparison with the first six months of 2013, and 6% more than the entire fiscal year of 2013.

Financial Results Demonstrate Solid Growth

Management concentrated on increasing return on capital by delivering both; growth through client-focused competitive services for the market, and cost efficiency by improving the cost-to-income ratio for the group to 63.3% in the first half of 2014. The loan portfolio quality is gradually improving, thereby positively affecting the impairment charges in the first half of this year, whereas the impairment level in the comparative period of 2013 are mostly driven by the charges related to a few legacy cases, which are already prudently provided at the moment. Further to that, the Bank's restructuring approach resulted in the reversal of impairments for some larger loans.

The group's total assets grew to 2.56 billion euros (the bank's – 2.08 billion euros) as of 30 June 2014. The group's loan portfolio was 1.09 billion euros (the bank's – 0.96 billion euros), a 3.6% increase for the group (3.3% for the bank) since year end.

The group's capital and reserve level as of 30 June 2014 was 160 million euros (the bank's – 159 million euros) and the deposit portfolio reached 2.23 billion euros (the bank's – 1.77 billion euros). Additionally the group's capital adequacy ratio was 10.1% and the Bank's – 11.5%. The Bank's liquidity ratio was 50%.

The group's growth model delivered a net interest income increase of 10.5% (13.2% for the bank) during the first half of this year as opposed to the same period last year. ROE (return on average equity) was a healthy 19.0% for the group and 18.7% for the bank while ROA (return on average assets) was 1.13% for the group and 1.34% for the bank.

Management believes that a high level of customer service supported an increase in client activity for both Baltic and foreign clients which drove an operating income increase of 1.9% for the first half of this year over the prior year's first half.

Maintaining High Liquidity Management Standards

Loan volume continued to grow for both retail and corporate clients while the group ensured financial stability through maintaining high liquidity. During the first six months of 2014 the loans to deposits ratio remained conservatively low – 49% for the group (54% for the Bank). In relation to the deposit product offering, the aim of management is to deliver a differentiated product offering with competitive terms to targeted markets. The bank's Lithuanian subsidiary was especially successful as it increased its term deposit portfolio by 44% during the first half of 2014.

Diversified Offers Form the Basis of Citadele's Business Development

Three key business areas drive the group's strategy: services for retail clients, corporate clients and private capital management clients.

Diversification of products, services and the client base are the cornerstone of our business development, maximizing opportunities while reducing Citadele's exposure to risks created by certain product or client groups.

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“.

Citadele Bank is the exclusive cooperation partner of American Express® in Latvia and Lithuania, entitling it to issue American Express payment cards. In order to ensure the most extensive network for using these cards, new sales points are being added continuously: American Express card holders can use their cards in a total of 11,800 sales points in Latvia and 14,900 sales points in Lithuania as of June 2014.

The demand for loans to retail clients increased in Latvia year over year. Loan originations increased by 105% and consumer credit card limits outstanding increased by 54% during the first six months of 2014 compared to the same period last year.

Similarly, helping entrepreneurs' achieve their business goals, our SME loan portfolio increased by 49% during the period compared to the first six months of 2013. The SME portfolio is distributed to participants in the following sectors: agricultural (33%), service (34%) and trade (10%).

The group's subsidiary IPAS "Citadele Asset Management" increased the total amount of assets under management by 7.8% during the first half of 2014, reaching 599 million euros.

Additionally, in banking services, Citadele is the only market participant in Latvia who offers cash collection services. During the first half of 2014 the number of clients in this segment increased by 30% and locations served increased by 44%.

Group subsidiary JSC "Citadele Life" offers savings products for retail and corporate clients, life and personal accident insurance, as well as life insurance agreements to borrowers. During the first half of 2014 "Citadele Life" increased its market share of underwritten premiums from 11% to 13%.

Electronic Services Are Increasingly Used by Clients

Clients now perform 80% of all of their bank payments via the internet bank. As the trend of clients using remote banking services increases, Citadele's client services centres are gradually being reshaped into financial consultation centres.

Citadele's data on payment cards suggest the introduction of the euro in Latvia is altering people's habits of settling accounts: the frequency of using payment cards increased by 30% during the first half of this year.

Employees Account for the Group's Success

It was great teamwork that delivered the above mentioned growth in Citadele's performance this past six months. Management would like to express our gratitude to our employees for their high level of professionalism and contribution in achieving Citadele's goals.

A total of 1,604 employees worked for the Citadele group as of June 2014. During the first half of the year 106 new employees joined our team; the vast majority of our new team members replaced employees who continued pursuing their careers in Citadele group. Management believes strongly in our Vision of providing employees a good work environment as well as a dynamic, challenging atmosphere that supports individual achievements. We are proud that approximately 60% of our employees have been part of our team for more than five years.

We will continue developing Citadele in order to ensure that it is the most valuable local financial group in the Baltic States and that the attraction of a private investor will enable us to create new and greater growth prospects and opportunities in the future.

The report has been approved by the Management Board of the Bank on 26 August 2014.

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Balance Sheets as at 30 June 2014 and 31 December 2013

EUR 000's

	30.06.2014. <i>Audited*</i>	31.12.2013. <i>Audited*</i>	30.06.2014. <i>Audited*</i>	31.12.2013. <i>Audited*</i>
	Group	Group	Bank	Bank
Cash and demand deposits with central banks	162,172	361,485	93,647	312,525
Demand deposits with credit institutions	218,442	133,680	192,824	104,740
Financial assets held for trading	28,849	31,466	1,757	3,665
Financial assets designated at fair value through profit and loss	89,201	62,336	-	-
Available-for-sale financial assets	435,772	401,738	343,005	331,930
<i>Loans and receivables to customers:</i>				
Loans to credit institutions	168,286	137,501	150,823	114,488
Loans to companies and private individuals	1,093,699	1,055,922	955,231	924,914
Held-to-maturity investments	250,523	244,423	220,588	224,462
Change in the fair value of the portfolio hedged against interest rate risk	-	-	-	-
Prepayments and accrued income	2,969	2,440	1,820	1,876
Property and equipment	41,207	42,826	3,627	3,402
Investment property	722	748	-	-
Intangible assets	1,866	1,845	1,285	1,350
Investments in subsidiaries	-	-	61,600	62,841
Income tax assets	30,866	32,875	29,374	31,700
Other assets	31,085	32,237	20,054	23,335
Total assets	2,555,659	2,541,522	2,075,635	2,141,228
Due to central banks	5	5	5	5
Demand liabilities to credit institutions	34,101	8,506	41,224	20,748
Financial liabilities held for trading	785	4,062	1,001	4,599
Financial liabilities designated at fair value through profit and loss	20,456	16,626	-	-
<i>Financial liabilities measured at amortised cost:</i>				
Loans from credit institutions	3,153	17,244	18,433	34,533
Deposits from customers	2,226,230	2,246,912	1,767,018	1,851,348
Subordinated liabilities	73,556	73,575	73,556	73,575
Other financial liabilities	9,090	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	11,023	12,193	8,577	8,804
Provisions	-	-	-	-
Income tax liabilities	171	-	-	-
Other liabilities	17,353	10,636	6,544	4,020
Total liabilities	2,395,923	2,398,074	1,916,358	1,997,632
Shareholders' equity	159,736	143,448	159,277	143,596
Total liabilities and shareholders' equity	2,555,659	2,541,522	2,075,635	2,141,228
Memorandum items				
Contingent liabilities	37,421	101,909	33,637	96,566
Financial commitments	331,780	186,737	369,167	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/EUR.

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Statements of Income for the 6 month period ended 30 June 2014 and 2013

EUR 000's

	01.01.2014.- 30.06.2014. <i>Audited*</i>	01.01.2013.- 30.06.2013. <i>Audited*</i>	01.01.2014.- 30.06.2014. <i>Audited*</i>	01.01.2013.- 30.06.2013. <i>Audited*</i>
	Group	Group	Bank	Bank
Interest income	38,585	37,363	32,286	31,269
Interest expense	(9,058)	(10,642)	(7,634)	(9,487)
Dividends received	-	-	1,690	3,754
Commission and fee income	22,956	21,312	17,453	16,153
Commission and fee expense	(6,722)	(5,622)	(5,647)	(4,876)
Net gain/ (loss) on financial assets and financial liabilities measured at amortised cost	(90)	-	-	-
Net gain/ (loss) on available for sale financial assets and financial liabilities	1,654	3,726	696	1,583
Net gain/ (loss) on held for trading financial assets and financial liabilities	222	(716)	1	3
Net gain/ (loss) on financial assets or financial liabilities designated at fair value through profit and loss	17	(479)	-	-
Fair value change in the hedge accounting	-	-	-	-
Gain/ (loss) from foreign exchange trading and revaluation of open positions	5,097	6,814	4,868	5,580
Net financial profit	52,661	51,756	43,713	43,979
Net gain/ (loss) on disposal of property, plant and equipment, investment property and intangible assets	(15)	223	-	-
Other income	1,351	1,014	805	642
Other expense	(569)	(427)	(235)	(296)
Administrative expense	(30,766)	(28,973)	(22,990)	(21,585)
Amortisation and depreciation charge	(2,828)	(2,957)	(645)	(715)
Impairment charge and reversals, net	(2,843)	(10,992)	(4,070)	(10,485)
Profit before taxation	16,991	9,644	16,578	11,540
Corporate income tax	(2,553)	(1,329)	(2,442)	(1,457)
Profit for the reporting period	14,438	8,315	14,136	10,083

Statements of Comprehensive Income:

EUR 000's

	01.01.2014.- 30.06.2014. <i>Audited*</i>	01.01.2013.- 30.06.2013. <i>Audited*</i>	01.01.2014.- 30.06.2014. <i>Audited*</i>	01.01.2013.- 30.06.2013. <i>Audited*</i>
	Group	Group	Bank	Bank
Net change in fair value revaluation reserve of securities and other reserves	1,850	(5,946)	1,545	(3,183)
Other comprehensive income for the period	1,850	(5,946)	1,545	(3,183)
Total comprehensive income for the period	16,288	2,369	15,681	6,900

* 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/EUR.

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Performance Ratios of the Group and the Bank

	01.01.2014.- 30.06.2014.	01.01.2013.- 30.06.2013.	01.01.2014.- 30.06.2014.	01.01.2013.- 30.06.2013.
	Group	Group	Bank	Bank
Return on equity (ROE) (%)*	19.05%	12.21%	18.67%	15.01%
Return on assets (ROA) (%)*	1.13%	0.73%	1.34%	1.04%

* 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.moody.com

Investments in Securities by Issuer's Country

	Group			
	30.06.2014.		31.12.2013.	
	Government bonds	Other securities	Government bonds	Other securities
Latvia	286,726	50,628	290,350	49,422
Lithuania	98,497	-	74,015	-
Finland	17,752	4,760	17,735	8,002
Netherlands	10,322	37,859	10,447	28,697
Singapore	7,426	10,017	7,319	4,031
Canada	3,703	22,290	3,745	19,834
Germany	-	21,060	1,150	24,929
United States	1,463	53,045	-	32,213
Australia	-	19,569	-	17,854
Other countries**	31,707	126,003	29,756	116,508
Total securities, net	457,596	345,231	434,517	301,490

	Bank			
	30.06.2014.		31.12.2013.	
	Government bonds	Other securities	Government bonds	Other securities
Latvia	277,670	43,402	288,417	43,360
Finland	15,701	4,760	15,695	8,002
Netherlands	10,322	19,128	10,447	17,092
Canada	3,703	17,880	3,745	17,349
United States	1,463	27,879	-	17,440
Other countries**	29,374	112,311	32,462	102,383
Total securities, net	338,233	225,360	350,766	205,626

** Each country's issuers' total exposure is less than 10% from the eligible capital used for capital adequacy calculation purposes.

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As at the period end the Bank and the Group has not recognized 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 30 June 2014 is EUR 225,783 thousand (2013: EUR 229,353 thousand) and EUR 256,391 thousand (2013: EUR 249,724 thousand), respectively. During the reporting period the Bank and the Group has recognized net provisions of EUR 255 thousand for available for sale securities (2013: recognized provisions of EUR 236 thousand); total recognized impairment allowance for available for sale securities as at the period end is EUR 7,287 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.

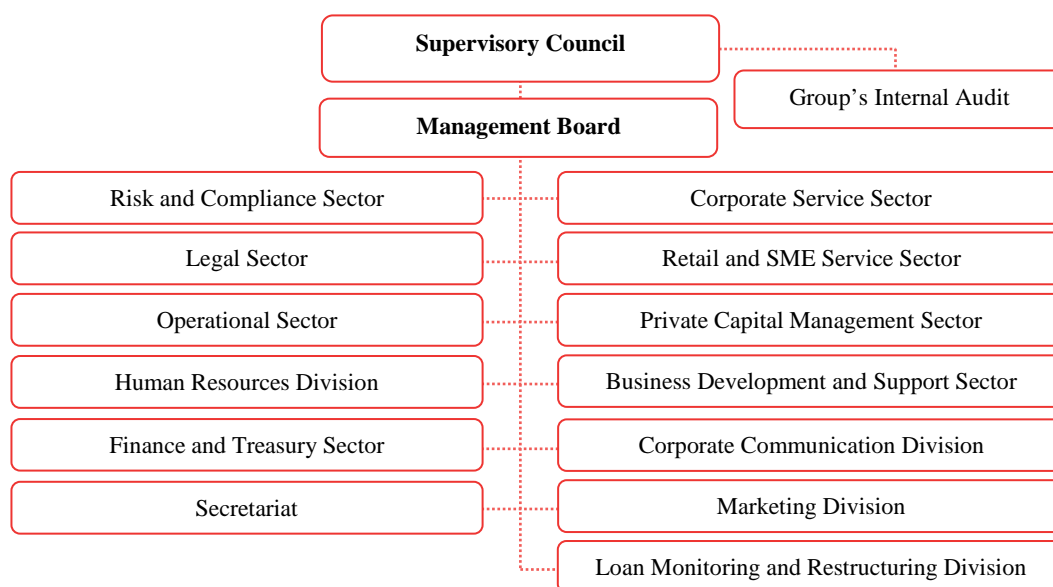
Issued Share Capital as at 30 June 2014

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 30 June 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](#)".



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 "Citadele 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 "Citadele atklātais pensiju fonds"	LV-40003397312	Latvia, Riga LV-1010, Republikas laukums 2A	LV	PFO	100	100	MS
6	AAS "Citadele 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 faktoringas"	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 Residential"	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

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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.

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Management of the Bank as at 30 June 2014

Supervisory Council of the Bank

Name	Position
Klāvs Vasks	Chairman of the Supervisory Council
Geoffrey Richard Dunn	Deputy chairman of the Supervisory Council
Laurence Philip Adams	Member 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 Belavskis	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.

Liquidity Ratio Calculation as at 30 June 2014

EUR 000's

	30.06.2014. Bank
1 Liquid assets (1.1.+1.2.+1.3.+1.4.)	884,210
1.1 Cash	54,038
1.2 Due from Bank of Latvia	25,549
1.3 Due from with solvent credit institutions	346,215
1.4 Liquid securities	458,408
2 Liabilities (with remaining maturity up to 30 days) (2.1.+2.2.+2.3.+2.4.+2.5.+2.6.)	1,767,276
2.1 Due to credit institutions	46,327
2.2 Deposits	1,339,526
2.3 Issued debt securities	-
2.4 Cash in transit	30,910
2.5 Other current liabilities	16,322
2.6 Off balance sheet liabilities	334,191
3 Liquidity ratio (1.:2.) (%)	50%
4 Minimum liquidity ratio	30%

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

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Capital Adequacy Reports as at 30 June 2014

EUR 000's

	30.06.2014. <i>Audited</i> Group	30.06.2014. <i>Audited</i> Bank
1 Own funds	173,537	177,333
1.1 Tier 1 capital	136,399	140,208
1.1.1 Common equity Tier 1 capital	136,399	140,208
1.1.2 Additional Tier 1 capital	136,399	-
1.2 Tier 2 capital	37,138	37,125
2 Total risk exposure amount (2.1.+2.2.+2.3.+2.4.+2.5.+2.6.+2.7.)	1,713,203	1,539,192
2.1 Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	1,500,003	1,388,799
2.2 Total risk exposure amount for settlement/delivery	-	-
2.3 Total risk exposure amount for position, foreign exchange and commodities risks	33,518	7,789
2.4 Total risk exposure amount for operational risk	179,347	142,269
2.5 Total risk exposure amount for credit valuation adjustment	335	335
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)	8.0%	9.1%
3.2 Surplus (+)/ deficit (-) of Common equity Tier 1 capital (1.1.1.-2.*4.5%)	59,304	70,944
3.3 Tier 1 capital ratio (1.1./2.*100)	8.0%	9.1%
3.4 Surplus (+)/ Deficit (-) of Tier 1 capital (1.1.-2.*6%)	33,606	47,856
3.5 Total capital ratio (1./2*100)	10.1%	11.5%
3.6 Surplus (+)/ Deficit (-) of total capital (1.-2.*8%)	36,481	54,197
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	8.0%	9.1%
5.3 Tier 1 capital ratio including line 5.1 adjustments	8.0%	9.1%
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.

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.

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“.

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.