

## **Risk management**

The Group activity is a subject to different risks occurred and the Group achievements depend on effective risk management, appropriate assessment and ongoing supervision. Risk strategy, approved by the Group, is based on conservative risk management system with moderate risk appetite and prudent risk management methods used. As result assets at risks should be diversified, market risk should be limited, operational risk should be minimal and liquidity risk should be controlled. To manage these risks, t.i. risk identification, assessment and control, the Group has worked out risk management policies in order to achieve by risk strategy set goals.

### **Risk management structure**

The Management Board is ultimately responsible for identifying and controlling risks.

#### *Supervisory Council*

The Supervisory Council reviews and approves policies for risk management.

#### *Management Board*

The Management Board is responsible for the overall risk management approach, for the establishment of risk management principles and structure as well as for the approval of the methodologies and procedures to ensure implementation of risk management policies. The Management Board sets limits on total portfolios and restrictions on large exposures.

#### *Assets and Liabilities Committee*

The Assets and Liabilities Committee is responsible for the assets and liabilities management monitoring and sets limits on counterparties within the limits and restrictions set by the Board.

#### *Risk Management Committee*

The Risk Management Committee is responsible for assessing the current quality of the Group's assets and off-balance sheet items, and for making decisions on provisions for and/or writing off impaired assets.

#### *Credit Committee*

The Credit Committee responsible for the approval of the exposure within its competence and credit portfolio quality analysis.

#### *Risk Management Department*

The Risk Management is responsible for the establishment of the Risk Management system: identification and assessment of risks inherent in the Bank's activity, preparation and submission of the risk reports. This unit also ensures the development of the Capital Adequacy Assessment Process.

#### *Treasury*

Treasury is responsible for managing assets and liabilities within set norms and limits, i.e. is charged with liquidity, funding and deposits pricing, foreign risks and foreign exchange operations, interest rate risks, cash management as well as the Bank's securities portfolio and repo/reverse repo portfolio management. It is also provides brokerage operations in financial markets.

#### *Internal Audit*

Risk Management processes are audited annually by the Internal Audit function that examines both the adequacy of the policies and procedures and the compliance with the internal and external requirements. Internal Audit discusses the results of inspections with the management, and submits reports on inspection results with necessary recommendations to the Supervisory Council, Managing Board and related units. Internal Audit performs follow-up engagements to check whether recommendations are followed and implemented.

To ensure control and management over financial risks, the Managing Board and Supervisory Council of the Group has approved Credit policy, Investment policy and Financial Risks Management and Control policy with regard to such significant risks as liquidity risk, credit risk and market risk, as well as other documents, that regulate financial risk management system created by the Group.

## Liquidity risk

Liquidity risk is the risk that the funds necessary to replace withdrawn deposits and other matured liabilities, and to fulfill the lending commitments could be insufficient, what can lead to unexpected losses.

Liquidity risk management goal is ensuring of adequate liquid assets to settle of creditors' legal claims at any time.

The Bank manages liquidity at the Group level and liquidity strategy is providing liquidity to the all subsidiaries included in the Group.

To ensure liquidity the Bank:

1. evaluates and plans the term structures of their assets and liabilities on a regular basis, sets internal limits on net positions and assets volumes,
2. maintains liquid assets no less than 40% of total current liabilities of the Bank, where current liabilities are demand liabilities and liabilities with a residual maturity of no more than 30 days, as opposed to the 30% required by the regulator FCMC;
3. analyses funding structure regularly;
4. creates threshold ratios system, that can help to identify liquidity positions weakness and necessity to attract additional funding;
5. assesses and controls assets, than could be used as collateral for borrowings in case of necessity;
6. performs liquidity stress testing to identify the potential sources of liquidity risk and liquidity reserve on regular basis;
7. works out and support the effective activity plan for getting over the possible liquidity crisis.

The Financial Risk Management and Control Policy determines Liquidity risk control and management, according to that the Management Board of the Bank and the Assets and Liabilities Committee state general liquidity risk management criteria by regulating the volumes, terms and directions of the activities, the Resource division (the Treasury) manages liquidity daily and Risk management department measures and monitors liquidity risk and submits reports.

## Credit risk

Credit risk is the potential that the Bank or the Group borrower or counterparty will fail or refuse to meet its obligations in accordance with agreed terms. Both the Group and the Bank manage the credit risk, including the country risk in accordance with the Financial Risk Management and Control Policy, Policy for the Country Risk Management and Credit Policy.

The Group's and the Bank's Mission and Strategy of credit risk management are the following:

- 1) Operate in compliance with the conservative credit policy with the objective to fully cover the Bank risks,
- 2) Maintain acceptable risk to income ratio, project a stable Bank's image in financial sphere,
- 3) Allocate credit risks through decreasing the amount of credits with high risk level,
- 4) Grant credit to trustworthy borrowers,
- 5) Deal with reliable partners.

Bank Mission and Strategic goals related to credit risk are reflected and described in detail in:

- Bank Credit Policy that regulates the Bank lending process as well as ensures creation of the qualitative and profitable credit portfolio;
- Bank Investment policy that regulates development and management of the investment portfolio, its revaluation, as well as investment management organizational structure, measures for risk limitation and control.

When managing credit risk Bank ensures its measurement assessment and supervision.

Credit risk monitoring system established by the Bank is based on the following key elements:

- **1<sup>st</sup> element – Availability of risk measurement method.** The Bank has developed and consistently applies methods for assessing creditworthiness of the Borrowers.
- **2<sup>nd</sup> element - Decision making procedure for granting a credit.** Decisions on granting a credit are made jointly and the limits of authority are distributed across various levels in accordance with respective competence levels.
- **3<sup>rd</sup> element – Diversification of the Credit Portfolio, i.e. establishment of limits and restrictions.** Setting limits and restrictions is regarded as a tool for minimization of credit risk and elimination of potential losses.
- **4<sup>th</sup> element. Monitoring of compliance to established limits and restrictions,**
- **5<sup>th</sup> element. Creation of adequate loan loss provisions** to cover losses that might appear in the course of credit transactions. Created provisions are regarded an instrument that would allow the Bank to cover future expected losses resulting from credit transaction risks; thus protecting the Bank financial stability from any negative impact.

The credit risk management practice includes the approvals methods of the credit risk measurement of the borrowers, counter-parties or issuers as well as the regular assessment of the off-balance sheet activities.

The Group and the Bank identify and control the credit risk by establishing the concentrations limits for individual borrowers and groups of connected clients; economic sectors; different types of exposures; types of collateral. The exposure limits are established in The Credit Policy and the Policy of Control over Large Exposures. Those limits are being regularly supervised and are revised by the Board annually, at least.

The Credit risk is managed by the Board and Credit Committee.

The Board approves the internal bank's regulations required to implement the credit policy, considers and accepts new credit exposures, approves the measures for mitigating the risk related to the Loan Portfolio, exercises control over the Credit Committee.

The Credit Committee is authorised to approve the exposure within the set limits. It analyses the quality of the Loan Portfolio or individual loan and in case of deterioration accepts the measures for mitigating the credit risk. The Board approves the Credit Committee's decisions when the exposure exceeds 5% of the 1<sup>st</sup> and 2<sup>nd</sup> tier capital.

The Group and the Bank determines the following key principles for credit granting:

1. Conformity to Bank credit risk strategy and Credit policy;
2. Sound credit purpose;
3. Credit granting decision is based on thorough analysis, with consideration of the inner credit rating of the Borrower;
4. Credit amount should comply with creditworthiness of the Borrower ;
5. Credit repayment source is cash flow from economic activities of the Borrower, wage and other similar types of income;
6. Credit collateral is regarded a credit risk mitigating factor with the appropriate liquidity and sufficient in terms of content and value;
7. Borrower ensures participation in financing of a project in conformity with the risk level;
8. Credit price should cover the credit risk taken on by the Bank.

The Credit and Investment Supervision Department is managing the credit risk on a daily basis. The Credit and Investment Supervision Department is responsible for Credit Policy implementation and supervision over its fulfillment. The Credit and Investment Supervision Department also is in charge for exposure concentration analysis, for control over the set limits, for monitoring the loans portfolio, preparing the surveys on loan portfolio and their submission to the Management Board. All breaches revealed by the Credit and Investment Supervision Department are reported to the Management Board.

The collateral is considered as an element of mitigating the credit risk. The acceptable types of collateral and the methods of evaluation are established in the Credit Policy and the Procedure for the Supervision over the Loans. The main acceptable types of collateral are: the real estate mortgage, vessel mortgage, commercial pledge of the assets of the companies, incl. fixed assets, inventory and accounts receivable.

According the requirements of the Credit Policy the maximum portion of the credits with the similar type of collateral should be limited up to 45% of the Credit Portfolio.

The unsecured exposures (they mainly are the consumer and card loans) are considered as a group of loans with the same purpose and similar credit risk that has been analysed, assessed and accepted while implementing the respective credit instrument. Strengthen the limit on concentration of unsecured loans to 15 percent of the total Loan portfolio.

The Bank is stress testing the Loan portfolio at least once in half-year aiming to identify the effect of possible events to the Bank's and Group's capital adequacy.

The detailed information on the Maximum credit risk exposure concentration, segregation on assets types, geographical segmentation, as well as industrial sectors of financial assets and loan type's analysis could be found in Consolidated and Separate Financial statements 2011 appendix 3 "RISK MANAGEMENT. Credit risk" and also appendix 15 "LOANS AND RECEIVABLES FROM CUSTOMERS".

The Group and the Bank are constantly monitoring the creditworthiness of the borrowers and adequacy of the collateral and calculating of its fair value.

The Bank classifies the loans on the quarter basis or every time when it receives the information about the substantial deterioration of the quality of any loan. The classification is made with the aim to assess the quality and risk grade of the issued loans and guarantees as well to measure the adequate amount of special provisions and potential losses.

The loan evaluation is made by the Credit Committee and the Risk management Committee. Both committees in its considerations and estimations observe the principles of conservatism and discretion, i.e. not to decrease the amount of assets and earnings or not to increase the amount of liabilities and costs so that the financial report is reliable.

The Risk Management Committee decides on making the provisions.

The assessment of the loan quality is made by assessing of each loan, i.e. individually, or collectively by pooling the loans with similar credit risk characteristics.

The detailed information on loans and receivables quality could be found in Consolidated and Separate Financial statements 2011 appendix 3 "RISK MANAGEMENT. Credit risk" and information about the provisions made against bad debts is in appendix 16 "IMPAIRMENT LOSSES ON FINANCIAL ASSETS".

## Market risk

Market risk is a risk of losses resulting from revaluation of balance sheet items and off-balance sheet items, connected with changes in market prices of financial instruments, commodities and commodities derivatives, that arise from changes in exchange rates, interest rates and other factors, therefore, the Bank determines the market risk as the aggregate of the following risks:

- **foreign currency risk** is a risk of losses arising from revaluation of assets and off-balance liabilities, denominated in foreign currencies, due to exchange rate changes;
- **interest rate risk** - is a risk of the net interest income (or net interest margin) decreasing in short term period or the bank's equity decreasing in long term period due to changes of interest rate changes,
- **price risks** is a risk of losses resulting from revaluation of balance sheet items and off-balance sheet items due to changes in market price of the Trade Portfolio and derivatives;
- **counterparty risk** - a risk of losses that may arise if a counterparty to a transaction with the Trade Portfolio does not fulfill or does not adequately fulfill his liabilities;
- **settlement risk** is a risk of losses resulting from uncompleted settlements on transactions with the Trade Portfolio's instruments;

To limit **foreign currency risk** there are the restriction on open foreign currency positions set by the Law on Credit institutions paragraph N.49 and its should not be more than:

- a) net open positions in single foreign currency – 10 per cent of equity;
- b) total open positions in all foreign currencies – 20 per cent of equity

In order to minimise foreign currency risk, the Management Board sets stronger limits on the level of open long or short positions in single currencies and total open position. It may also set such limits for the Bank's subsidiaries, despite it is not required by FCMC.

The Board of the Bank sets also maximum stop-loss limits for a day and/or a month in order to constrain a speculative management of an open position.

The *Resources Department (the Treasury)* manages and supervises the total net position of the Bank's foreign currencies daily and the Risk management Department controls set limits compliance.

## Interest rate risk

Interest rate risk management is conducted using the following methods:

- a) float interest rate usage ( especially on long-term assets);
- b) assets and liabilities management:
  - spread and interest margin management,
  - GAP analysis and duration analysis.

Managing the assets and liabilities:

- 1) The Bank calculates and analyses:
  - a) spreads, t.i. a result of interest earning assets and interest bearing liabilities;
  - b) net interest margin by the Bank's activities and conducts yield matching.
- 2) conducts GAP analysis regularly, calculating interest rate risk net positions to define the Bank's sensitivity to interest rate changes, and if it is necessary, decides on balancing of assets and liabilities or hedging instruments usage.

To manage and limit interest rate risk the Bank set the following limits:

- a) total limits on assets volumes: Loan portfolio, Trade portfolio and Available-for-sale portfolio;
- b) limits on interest rate total and net positions;
- c) limit on Trade portfolio duration.

The Treasury manages the interest rate risk within set policies and limits and the Risk Management Department controls set limits compliance.

The detailed information on foreign currency risk and interest rate risk as well as the Bank's sensitivity analysis of these risks could be found in Consolidated and Separate Financial statements 2011 appendix 3 "RISK MANAGEMENT. Market risk"

## Price Risk

Management of **the price risk**, which the Trade Portfolio's financial instruments are exposed to, is based on the Bank's Investment policy that is aimed at gaining maximal profit by investing in financial instruments, and simultaneously ensuring an adequate safeguard of invested funds, with the purpose of safeguarding the Bank's capital and ensuring safety of the Bank's funds, i.e. reducing (managing) risks. To limit this risk the Bank sets limits on financial instruments types, volumes and issuers.

**Counterparty risk** arises dealing with financial instruments. Before the deals the Bank assesses counterparty's creditworthiness according to the Bank's methodology.

To reduce the counterparty risk the Bank:

- 1) sets the limits on deals type, terms and volumes, made with the counterparty,
- 2) can take a collateral.

The Bank controls the correspondence of counterparty exposures and set limits constantly.

When counterparty is a client of the Bank, than dealing with derivatives with value date more than 2 days, the Bank requires collateral from the clients and the collateral size depends on deal type and maturity.

**Settlement risk** consists of:

- 1) settlement/ delivery risk, when both sides have not been done settlement and delivery at value date;
- 2) unpaid delivery risk, when the bank fulfilled its liabilities (for example: paid for securities or foreign exchange or delivered them) but counterparty has not fulfilled theirs liabilities.

To mitigate settlement risk the Bank sets limits on daily settlements to each counterparty and within these limits the Bank may first fulfill its liabilities. If counterparty are the clients of the Bank, than settlements and delivery are made simultaneously.

The settlements on securities purchase or sales are done on DVP (delivery vs payment) terms.

The Bank controls settlement risk constantly.

Making deals with financial instruments appropriate business units (Front office) comply with set requirements and limits, booking departments (Back office) control them, and Risk management Department supervises compliance with set limits of financial instrument types, volumes, issuers and counterparties.

## Operational risk

Operational risk – a risk of direct or indirect losses that may arise as a result of incorrectly established business processes, as well as due to inefficiency of internal control procedures, technological failures, activity unauthorised by the personnel or as a result of consequences of external influence.

The operational risk management and control system consists of the following elements:

- creation of operational risk management area, which allows to identify, assess, supervise, control and mitigate operational risk;
- establishig of Business Continuity Plan.

. The main methods used to manage its operational risk include:

- a) Clearly described and defined procedures and job descriptions of the Bank's employees and precise observance thereof;
- b) Segregation of authority of the Bank's employees, in the process of fulfilment of their functional duties;
- c) Organisation of training for the Bank's personnel, incl. seminars in which mistakes and errors most often committed by employees are analysed and methods for correcting these errors are explained;
- d) Availability of the Bank's information systems security policy and control over its observance;
- e) Informing the Bank's employees with the most significant terms and conditions of the Bank's information systems security policy;
- f) Implementation of requirements of the Internal Control system in the Bank's internal regulatory documents, that describe the main directions of the Bank's activity and processes (e.g. controllers' job in the Bank's organisational units, who are dealing with operational control; availability of control functions in the information systems being used; verification of various type of data against source documents, the Bank's assets value control on a regular basis, distribution of the employees' authority, etc.);
- g) Daily control over operations conducted by the Bank's employees (checking of operations conducted by employees against source documents);
- h) Control of observance of limits that are set for various products of the Bank, directions of the activity, conclusion of transactions, custody of assets (limits for storing cash in settlement groups and branch offices), as well as control over observance of limits set for counterparties; taking an inventory of the Bank's fixed assets and property, etc.;
- i) Involvement of controllers in the operations conduct scheme, in order to reduce the number of errors committed by personnel, simultaneously improving also the methods of controls (double entering, setting

- of operational limits, distribution of authority, limiting of access possibilities, data comparison, determining personal responsibility for each operation, control over corrections made, etc.);
- j) Insurance against of revealed risks – measures to be taken in order not to allow certain types of operational risk to occur (possible losses due to internal or external fraudulent activity, etc.);
  - k) Strict observance of the Bank's anti-money laundering policy;
  - l) Regular internal and external checks of the Bank's organisational units, supervision of the internal control system, detection of shortcomings and elimination thereof;
  - m) Availability of a detailed plan for continuous operation of the Bank's information systems (as an integral part of the Business Continuity Plan) and regular testing checks of this plan.

The same operational risk management methods are used by Bank's subsidiaries.

**Reputation risk** – is a risk, the Bank/the Group clients, counterparties, shareholders, regulatory and other stakeholders can have low perception of the Bank and it could negatively reflect on the Bank's ability to support relationships or create the new ones with the clients and counterparties, and also it can negatively affect on the Bank's funding accessibility.

The Bank\ the Group creates a good reputation and constantly protects it by:

1. complying during its activity with the normative acts of the RL, with the standards set by the self-regulating bodies connected to the activity of the Bank (e.g., Association of Latvian Commercial Banks), codes of the professional act and ethics and other standards of good practice connected with the activity of the Bank; paying a special attention to the complying with the Banking Act, Law on the market of financial instruments, Law on protection of consumer rights, Law on prohibition of ill commercial practice, other normative acts which define the terms of providing the financial services to the consumers;
2. timely executing its obligations;
3. executing the requirements of regulating and supervisory bodies;
4. improving the quality of its products and services;
5. perfecting the processes of its basic activity.

To prevent the reputation risk, the Bank:

- 1) works out and improves the Bank's internal documents, that regulates the Bank's activities, in compliance with Latvian legislation, standards, professional behavior and ethics norms, other best practice standards and avoids interest conflict;
- 2) sets quality requirements to employees, including to the heads of business units, in order to avoid incompetent and baseless activities;
- 3) performs potential employees verification;
- 4) sets the rules of professional ethics principles;
- 5) develops effective internal control system:
  - a) in the area of prevention of money laundering and terrorism financing in order to diminish all possible risks and losses at most that can have a negative impact on the activity and reputation of the Bank\ the Group and to develop knowledge and understanding of the Bank's\ the Group's employees in the area of compliance of clients and financial transactions, prevention of money laundering and terrorism financing;
  - b) in the area of the Bank's\ the Group's activity compliance supervision in order to diminish at most all possible risks that Bank\ the Group can suffer losses or legal duties or sanctions can be imposed on it or its reputation can degrade, because the Bank\ the Group does not observe with laws on compliance, rules and standards;
  - c) in the process of execution of the Bank's operations and other transactions that allows to control the fulfilment of obligations and claims of the Bank\the Group;
- 6) ensures Clients information confidentiality and security;
- 7) sets information disclosure about the Bank;
- 8) sets up adequate and appropriate risk management system;
- 9) developing new products and services and working out the Bank's normative documents, follows the rules to be in compliance with all necessary requirements to avoid reputation risk

## Capital and capital requirements

Bank/Group maintain effective capital basis to ensure the high level of return on equity using capital structure and volume, at the same time to ensure the compliance with capital requirements. Capital requirements have strong connections with risks that impact Bank/Group's activity, to which capital requirements are set by FCMC in the Minimal capital adequacy calculation regulations (1<sup>st</sup> Pillar) and in the internal capital adequacy assessment process (2<sup>nd</sup> Pillar).

Capital structure mainly consists of Tier 1, and additionally of Tier 2 capital. At 31 December 2011 the Bank/Group's capital structure was as follows:

	LVL'000	Group	Bank
<b>Tier 1</b>			
Paid in share capital		57 390	57 390
Reserve capital		7	7
Retained earnings for previous years		5 377	3 476
Minority interest		442	-
Revaluation reserve of available-for-sale financial assets		-1 662	-
Revaluation reserve of foreign currency		-	-
Expected loss from loans*		- 1 307	- 1 307
Retained earnings /losses		- 20 949	-18 269
Goodwill		-286	-
Other intangible assets		-24	-581
Investment property revaluation (earnings)		-945	- 3 374
<b>Total tier 1</b>		<b>38 043</b>	<b>37 342</b>
<b>Tier 2</b>			
Expected loss from loans*		- 1 307	- 1 307
Subordinated capital		11 421	11 421
70% from tangible fixed assets revaluation earnings		1 494	1 494
45% from investment property revaluation earnings		-	1 139
<b>Total tier 2</b>		<b>11 608</b>	<b>12 747</b>
<b>Total capital</b>		<b>49 651</b>	<b>50 089</b>

\*When the impairment losses accrued, assessing the loans quality, the Bank recognizes them through the profit/losses, creating allowance for impairment losses or/and recognizing expected losses through the Tier 1 and Tier 2 of capital directly. As recovery rates in the shipping industry were slower in 2011 as it was expected, the Bank increased the expected losses reserve for the issued loans to the shipping significantly.

## Minimum capital adequacy requirement

In accordance with the Minimum capital adequacy calculation regulations, the capital always must be greater than or equals to the sum of the following capital requirements: credit risk capital requirements, market risk and operational risk capital requirements; or capital adequacy ratio (CAD) must cover these requirements and should be not less than 8%.

For credit risk requirement's calculation the Bank/Group use Standard approach in accordance with the Minimum capital adequacy calculation regulations, choosing rating agency MOODY'S *INVESTORS SERVICE* as an appropriate external credit assessment's institution.

The Bank uses Standard approach for market risk capital requirements calculation and term method for general risk capital requirement for bonds.

For operational risk capital requirement calculation Bank uses Basic indicator approach.

## Capital requirements as of 31 December 2011

	(LVL'000)	Group	Bank
<b>Credit risk capital requirements, incl. counterparty credit risk capital requirements**</b>			
Central governments or central banks		177	177
Regional governments and local governments		-	-
State companies		-	-
International development banks		-	-
International organizations		-	-
Financial institutions		1 579	1 477

Private companies and individuals	15 106	17 497
Pool of retail exposure (MRD)	483	483
Real estate covered exposures	-	-
Past due exposures	3 241	2 936
Collective investment undertakings (CIU)	855	6 377
Other items	9 365	2 161
<b>Total credit risk capital requirements, incl. counterparty credit risk capital requirements</b>	<b>30 806</b>	<b>31 108</b>
<b>Market risks capital requirement</b>		
Foreign currency risk capital requirement	4 008	332
Equity position risk capital requirement	9	9
Bond position risk capital requirement	778	778
<b>Total market risks capital requirement</b>	<b>4 795</b>	<b>1 119</b>
<b>Operational risk capital requirement</b>		
Operational risk capital requirement	5 074	4 534
<b>Total operational risk capital requirement</b>	<b>5 074</b>	<b>4 534</b>
<b>Total capital requirements</b>	<b>40 675</b>	<b>36 761</b>
<b>Capital adequacy ratio (CAD)</b>	<b>9.77%</b>	<b>10.90%</b>

\*\*Counterparty credit risk capital requirement has been calculated for derivative instruments, mainly forward deals, and credit risk exposure net value of derivative instruments as at the 31 December 2011 is 252 th. LVL. It consists from the sum of the positive fair value adjustment of risk exposure and potential credit equivalent that have been calculating using market value method. Counterparty credit risk capital requirement is 20 th. LVL, that consists from clients' risk exposure 14 th.LVL and financial institutions' risk exposure 6 th.LVL.

## Internal capital adequacy assessment process

Internal Capital Adequacy Assessment Process is Bank/Group's management, decision making culture, risk management system's and activity planning process integral part. Internal capital adequacy assessment's aim is to ensure the adequate capital of Bank/Group for covering appropriate significant risks and/or to ensure effective management of these risks.

Bank/Group makes the capital adequacy assessment in accordance with "Pillar I +", determine appropriate capital requirements for risk covering taking for a basis Minimum capital adequacy regulatory requirements, adding other risk capital requirements, that the Bank/Group considers significant and determines them capital requirements.

In 2010, in additional to credit risk, market risk and operational risk, there were determined capital requirements for concentration risk (connected with credit risk), interest rate risk in a non-trading book, risk of money laundering and terrorism financing, reputation, strategy and business risks.

Concentration risk capital requirements calculation process is determined by the Bank, because only in Bank's loan portfolio has been fixed large borrowers concentration. Capital requirements on interest rate risk in a non-trading book, risk of money laundering and terrorism financing, reputation, strategy and business risks were determined using the simplified methods.

Liquidity risk is significant to the Bank\ the Group and it management is integral part of the Bank's \ the Group's activity. Liquidity risk is assessed, managed, supervised and planned continuously.

The capital requirement on liquidity risk is not referred directly. But defying financial instruments liquidity, according to MRCR rules, the necessity of correction of less liquid positions value can be set and the capital size should be decreased accordingly. The necessity to correct the less liquid positions value and accordingly to decrease the capital size was not set in 2011.

Additionally to the amount of required capital for risks covering the Bank\ the Group sets capital reserve (capital buffer) in order to ensure that the Bank's\ the Group's capital is sufficient to cover losses in case of potential unfavorable conditions as well as to ensure that the amount of capital available is sufficient for the whole economic cycle.



### Consolidation group

Company name	Registration country	Registration number	Registration address	Industry	Share capital (%)	Shares carrying voting rights (%)	Justification for inclusion in the group
JSC „NORVIK BANKA”	LV	40003072918	Rīga, E.Birznieka-Upīša st., 21	Financial services			Parent company
CJSC NORVIK UNIVERSAL CREDIT ORGANISATION	AM	NR. 14	Armenia, Erevan, Khanjyan st., 41	Financial services	100	100	JSC „NORVIK BANKA” subsidiary
CJSC IKSOV	AM	NR.286	Armenia, Erevan, Tpagricneri 9-55	Real estate activities	100	100	JSC „NORVIK Universal Credit Organization” subsidiary
NORVIK LĪZINGS LLC	LV	40003903469	Rīga, E.Birznieka-Upīša st., 21	Financial services	100	100	JSC „NORVIK BANKA” subsidiary
NORVIK APDROŠINĀŠANAS BROKERIS LLC	LV	40003950355	Rīga, E.Birznieka-Upīša st., 21	Insurance services	100	100	LLC „Norvik Līzings” subsidiary
JSC NORVIK IEGULDĪJUMU PĀRVALDES SABIEDRĪBA	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Financial services	100	100	JSC „NORVIK BANKA” subsidiary
NORVIK MANAGEMENT OÜ	EE	11914594	Estonia, Tallin 11618 Serva 28	Financial services	100	100	JSC „NORVIK ieguldījumu pārvaldes sabiedrība” subsidiary
ACCOUNTING LAB LLC	LV	40103259956	Rīga, E.Birznieka-Upīša st., 21	Administrative and support service activities	100	100	JSC „NORVIK ieguldījumu pārvaldes sabiedrība” subsidiary
IPS NORVIK ALTERNATIVE INVESTMENTS JSC	LV	40103215129	Rīga, E.Birznieka-Upīša st., 21	Financial services	100	100	JSC „NORVIK BANKA” subsidiary
NORVIK TECHNOLOGY LLC	LV	40003997106	Rīga, E.Birznieka-Upīša st., 21	IT services	100	100	JSC „NORVIK BANKA” subsidiary
LEGAL CONSULTING LLC	LV	40103217168	Rīga, E.Birznieka-Upīša st., 21	Legal services	100	100	JSC „NORVIK BANKA” subsidiary
NORVIK IPS JSC CIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
VISALIA LLC	LV	40103220115	Rīga, E.Birznieka-Upīša st., 21	Administrative and support service activities	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
MADORA LLC	LV	40103214354	Rīga, E.Birznieka-Upīša st., 21	Real estate management	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
LANATA LLC	LV	40103214284	Rīga, E.Birznieka-Upīša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
DAYS LLC	LV	50103219851	Rīga, E.Birznieka-Upīša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
HOMELINK LLC	LV	40103220172	Rīga, E.Birznieka-Upīša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
ACTON LLC	LV	40103220030	Rīga, E.Birznieka-Upīša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NEKUSTAMO ĪPAŠUMU UZŅĒMUMU FOND subsidiary
NORVIK IPS JSC CIF GLOBĀLAIS PĀRVADĀJUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
INSTANTA SHIPPING COMPANY LIMITED	BZ	NR.82,642	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF GLOBĀLAIS PĀRVADĀJUMU FOND subsidiary
LINK SHIPPING LTD	AG	NR. 15545	Antigua and Barbuda, 60 Nevis Street, St. John's	Water transport	100	100	NORVIK IPS JSC SIF GLOBĀLAIS PĀRVADĀJUMU FOND subsidiary

Company name	Registration country	Registration number	Registration address	Industry	Share capital (%)	Shares carrying voting rights (%)	Justification for inclusion in the group
NIKA SHIPPING COMPANY LIMITED	BZ	NR.92779	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF GLOBĀLAIS PĀRVADĀJUMU FOND subsidiary
FREA SHIPPING COMPANY LTD	MT	NO.C46896	Malta, Valetta 18/2 South street	Water transport	100	100	NORVIK IPS JSC SIF GLOBĀLAIS PĀRVADĀJUMU FOND subsidiary
VESTI SHIPPING COMPANY LIMITED	BZ	NR.82,643	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF GLOBĀLAIS PĀRVADĀJUMU FOND subsidiary
NORVIK IPS JSC CIF JŪRAS TRANSPORTA FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
ARMIDA NAVIGATION COMPANY LIMITED	AG	NR. 15833	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
SIRIUS MARITIME LIMITED	AG	NR.15664	Antigua and Barbuda, St John's 60 Nevis street	Water transport	85	85	ARMIDA NAVIGATION COMPANY LIMITED subsidiary
CORSA NAVIGATION COMPANY LIMITED	AG	NR.15847	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
OCEAN NAVIGATION COMPANY LIMITED	AG	NR.15835	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
JUNO SHIPPING COMPANY LIMITED	BZ	NR 104668	Belize p.o.box 1777, Belize City Withfield tower, 3rd floor, 4792 Coney drive	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
MEDEA SHIPPING LIMITED	AG	Nr IBC 16004	Antigua and Barbuda, St John's 60 Nevis street	Water transport	85	85	JUNO SHIPPING COMPANY LIMITED subsidiary
PRESTO MARITIME LIMITED	BZ	NR.98,727	Belize, p.o.box 1777, Belize City Withfield tower, 4792 Coney drive	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
SATORI SHIPPING COMPANY LIMITED	MT	NR.C50182	Malta, Valetta 18/2 South street	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
SKADI SHIPPING COMPANY LTD	MT	NR.C46895	Malta, Valetta 18/2 South street	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
TARDIS SHIPPING COMPANY LIMITED	BZ	NO.104,667	Belize, p.o.box 1777, Belize City Withfield tower, 3rd floor, 4792 Coney drive	Water transport	100	100	NORVIK IPS JSC SIF JŪRJSC TRANSPORTA FOND subsidiary
NORVIK IPS JSC CIF ŪDENS TRANSPORTA FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
ASTREA SHIPPING COMPANY LIMITED	BZ	NR.84,109	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
RODA SHIPPING COMPANY LIMITED	AG	NR.15620	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary

Company name	Registration country	Registration number	Registration address	Industry	Share capital (%)	Shares carrying voting rights (%)	Justification for inclusion in the group
VILAND SHIPPING COMPANY LIMITED	BZ	NR.84,108	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
OMASTER SHIPPING COMPANY LIMITED	VC	NR.17816	Saint Vincent and the Grenadines, 112 Bonadie Street, POB 613, Kingstown	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
GRANADA SHIPPING COMPANY LIMITED	VC	NR.17815	Saint Vincent and the Grenadines, 112 Bonadie Street, POB 613, Kingstown	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
KALLISTO SHIPPING COMPANY LIMITED	AG	NR.15618	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
SAVITAR SHIPPING COMPANY LIMITED	AG	NR.15619	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF ŪDENS TRANSPORTA FOND subsidiary
NORVIK IPS JSC CIF NĀKOTNES ĪPAŠUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upiša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
MAGNUM ESTATE LLC	LV	40103295514	Rīga, E.Birznieka-Upiša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NĀKOTNES ĪPAŠUMU FOND subsidiary
SERENITY LLC	LV	40103296045	Rīga, E.Birznieka-Upiša st., 21	Real estate activities	100	100	NORVIK IPS JSC SIF NĀKOTNES ĪPAŠUMU FOND subsidiary
NORVIK IPS JSC CIF TRANSPORTA UZŅĒMUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upiša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
CASSIOPEIA SHIPPING COMPANY LIMITED	AG	NR.15502	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
VELA SKY SHIPPING COMPANY LIMITED	AG	NR.15500	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
CABRANA SHIPPING COMPANY LIMITED	BZ	NR.82,644	Belize, p.o.box 1777, Belize City 35A, Regent street	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
SAGITTA SKY SHIPPING COMPANY LIMITED	BZ	NR.82,645	Belize, p.o.box 1777, Belize City 35A, Regent street	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
VOLANS SHIPPING COMPANY LIMITED	BZ	NR.82,8684	Belize, Belize City 35A Regent street, p.o.box 1777	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
DALINA SHIPPING COMPANY LIMITED	AG	NR.15555	Antigua and Barbuda, St John's 60 Nevis street	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
NEO SHIPPING COMPANY LIMITED	BZ	NR. 92,241	Belize, Withfield Tower, Third Floor, 4792 Coney Drive, P.O.Box 1777, Belize City	Water transport	100	100	NORVIK IPS JSC SIF TRANSPORTA UZŅĒMUMU FOND subsidiary
NORVIK IPS JSC CIF DAUDZNOZĀRU UZŅĒMUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upiša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
NJORD LLC	LV	50103377831	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF DAUDZNOZĀRU UZŅĒMUMU FOND subsidiary

Company name	Registration country	Registration number	Registration address	Industry	Share capital (%)	Shares carrying voting rights (%)	Justification for inclusion in the group
VENTI LLC	LV	40103377863	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF DAUDZNOZARU UZŅĒMUMU FOND subsidiary
STRIBOG LLC	LV	40103380100	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF DAUDZNOZARU UZŅĒMUMU FOND subsidiary
NORVIK IPS JSC CIF IZAUGSMES UN ATTĪSTĪBAS FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
AURA WINDFARM LLC	LV	40103448649	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF IZAUGSMES UN ATTĪSTĪBJSC FOND subsidiary
EURUS WINDFARM LLC	LV	40103449061	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF IZAUGSMES UN ATTĪSTĪBJSC FOND subsidiary
HERMES WINDFARM LLC	LV	40103448776	Rīga, Krasta st. 86-26	Electricity, gas, steam and air conditioning supply	100	100	NORVIK IPS JSC SIF IZAUGSMES UN ATTĪSTĪBJSC FOND subsidiary
NORVIK IPS JSC CIF ENERĢĒTIKAS FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
BALTIJAS NAFTAS GRUPA LLC	LV	50103484321	Rīga, E.Birznieka-Upīša st., 21	Retail trade, except of motor vehicles and motorcycles	100	100	NORVIK IPS JSC SIF ENERĢĒTIKJSC FOND subsidiary
NORVIK IPS JSC CIF INFRASTRUKTŪRAS ĪPAŠUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
KARAVELLA PROPERTY LLC	LV	50003725061	Rīga, Krasta st. 86-9	Administrative and support service activities	100	100	NORVIK IPS JSC SIF INFRJSTRUKTŪRJSC ĪPAŠUMU FOND subsidiary
KARAVELLA LLC	LV	40003836543	Rīga, Katrīnas Dambis st., 27	Accommodation and food service activities	100	100	NORVIK IPS JSC SIF INFRJSTRUKTŪRJSC ĪPAŠUMU FOND subsidiary
NORVIK IPS JSC CIF KOMERCĪPAŠUMU FONDS	LV	40003411599	Rīga, E.Birznieka-Upīša st., 21	Investment activity	100	100	JSC „NORVIK BANKA” subsidiary
MERKURS RIGANTE PLUS LLC	LV	40103283110	Rīga, Zemaišu st., 3	Real estate activities	100	100	NORVIK IPS JSC SIF KOMERCĪPAŠUMU FOND subsidiary
EKO FORUMS PLUS LLC	LV	40003884083	Rīga, Mārupes st., 19	Real estate activities	100	100	NORVIK IPS JSC SIF KOMERCĪPAŠUMU FOND subsidiary
ALPI TRANS PLUS LLC	LV	40003765698	Rīga, Mārupes st., 19	Real estate activities	100	100	EKO FORUMS PLUS LLC subsidiary

In accordance with International Financial Reporting Standards in the consolidated financial statements Bank includes all companies shown in the table. All listed companies are consolidated by the full consolidation method.

According to the FCMC, 2007 November 30, Rules #166, „Regulations on the Consolidated Supervision” consolidation group includes credit, financial institutions and special purpose vehicles. In accordance with the FCMC, investments in the companies that are not included in the consolidation group, do not create a reduction in shareholders' equity when calculating own funds.

## **Remuneration policy of the JSC NORVIK BANK for 2011**

Information is prepared in accordance with the requirements of Section 17 of the FCTC Regulation No. 171 "Regulations on Core Principles of Remuneration Policies" and Section 28 of the FCTC Regulation No. 61 "Regulations on Information Disclosure and Transparency of the Institution" (in the wording of Regulations No.312 of 13.11.2010 taken by the Finance and Capital Market Commission), which stipulate the disclosure of the remuneration policy and implemented practice.

By making public the information regarding the Remuneration policy the Bank complies with the requirements of personal data protection.

Requirements of the Remuneration policy are considered both by the Bank as well as by the level of consolidation group of the Bank, and it does not contravene the principles of customer protection or investor interest protection as well as interests of other interested parties.

Core principles of the Remuneration policy are set and approved by the Board of the Bank at least once a year revising them in accordance with the operations of the Bank, its development strategy and change of external factors.

The Board of the Bank executes the functions of the Remuneration Committee and performs the monitoring of remuneration of positions influenced by risk profiles, determination of fixed component of remuneration (salary) and variable component (bonuses).

The Bank on a monthly basis pays the fixed salary set in accordance with the labour agreement – fixed component of remuneration □ to the employee, taking the position influenced by the Bank's risk profiles, for the work duties which are performed in good will and properly.

The variable component of remuneration (bonus) is paid only for excellent work results by the employee, taking the position influenced by the Bank's risk profiles, by individual evaluation during the meeting of the Board.

The Bank, in order not to promote the increase of the Bank's risks above the risk level set by the Bank and not to limit the ability of the Bank to provide the Bank's capital adequacy, sets the maximum part of the variable remuneration (in monetary terms) for the positions influencing the risk profile, which is paid only for excellent work results by evaluating each employee individually by the Board and not exceeding 10% from the fixed component of remuneration of the previous calendar year – salary.

The Bank, upon performing the evaluation of the work results of positions influencing risk profile, when determining the fixed component of remuneration and variable component (bonus) of remuneration, complies with the following key basic principles:

- remuneration of positions executing the internal control function is set in accordance with the functions of internal control for reaching objectives regardless of the achieved results in the areas controlled by internal control functions;
- the variable component of remuneration (bonus) is not determined and paid out in case of decrease of the financial condition of the Bank or its solvency, taking into account the considerations of the long-term capital adequacy security;
- the Bank reserves the right to claim for repayment of the variable component of remuneration (bonus) in case it is paid for the results of operations which may later appear to be misrepresented for the purpose (malicious activity).

Evaluation and documentation of the work results of positions influencing the risk profile takes place individually for each of the employees, taking into account the following criteria:

- evaluation of non-financial indicators of the Bank (compliance with internal regulations, standards and limits);
- it is possible to be guided by the financial indicators of the Bank for the positions which do not perform the functions of internal control, taking into consideration the evaluation of the existing and potential risks related to the results of operations and expenses of the capital and provision of liquidity;
- evaluation of the results of operations individually combined with the evaluation of results of operations by the level of structural units and the Bank;
- indicator of results of operations of the Bank for several years.

Remuneration of employees of the Bank, including the positions influencing the risk profile, does not include shares, share-linked options, additional severance pays which exceed the severance pays stipulated by the Labour Law, the Bank does not grant them the pension-related benefits or additional contributions to the private pension funds, does not grant the remuneration in non-monetary form and does not allow the determination of the fixed amount of variable component of remuneration.

JSC NORVIK BANK informs that in 2011 a variable component of remuneration will not be paid to the Board of the Bank and other positions influencing the Bank's risk profile.

Division of remuneration of positions influencing the risk profile of the JSC NORVIK BANK by the type of operations.

Type of operations	Amount of remuneration (LVL)
Management	374548.00
Internal audit	80240.25
Compliance monitoring	23936.05
Risk management	231518.58

Remuneration of positions influencing the risk profile of the JSC NORVIK BANK for 2011 divided by groups of positions

Group of positions	Number of recipients	Amount of variable component of remuneration (LVL)	Amount of fixed component of remuneration (LVL)	The amount of paid severance pays (LVL)
Board	5*	not specified	374548.00	6683.24
Other positions influencing the Bank's risk profile **	23	not specified	335694.88	not specified

\* Number of Board members in the time period from 01 January 2011 until 23 December 2011 was 4 persons.

\*\* including the executive positions of the Bank's internal control function.